Court File No. CV-12-9667-00-CL

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 AND ARRANGEMENT OF SINO-FOREST CORPORATION

Court File No.: CV-11-431153-00CP

ONTARIO
SUPERIOR COURT OF JUSTICE

B E T W E E N :

THE TRUSTEES OF THE LABOURERS' PENSION FUND OF CENTRAL AND EASTERN CANADA, THE TRUSTEES OF THE INTERNATIONAL UNION OF OPERATING ENGINEERS LOCAL 793 PENSION PLAN FOR OPERATING ENGINEERS IN ONTARIO, SJUNDE AP-FONDEN, DAVID GRANT and ROBERT WONG

Plaintiffs

- and -

SINO-FOREST CORPORATION, ERNST & YOUNG LLP, BDO LIMITED (formerly known as BDO MCCABE LO LIMITED), ALLEN T.Y. CHAN, W. JUDSON MARTIN, KAI KIT POON, DAVID J. HORSLEY, WILLIAM E. ARDELL, JAMES P. BOWLAND, JAMES M.E. HYDE, EDMUND MAK, SIMON MURRAY, PETER WANG, GARRY J. WEST, CREDIT SUISSE SECURITIES (CANADA), INC., TD SECURITIES INC., DUNDEE SECURITIES CORPORATION, RBC DOMINION SECURITIES INC., SCOTIA CAPITAL INC., CIBC WORLD MARKETS INC., MERRILL LYNCH CANADA INC., CANACCORD FINANCIAL LTD., MAISON PLACEMENTS CANADA INC., CREDIT SUISSE SECURITIES (USA) LLC and MERRILL LYNCH, PIERCE, FENNER & SMITH INCORPORATED (successor by merger to Banc of America Securities LLC)

Defendants

Proceeding under the *Class Proceedings Act, 1992*

BOOK OF AUTHORITIES OF THE PLAINTIFFS DEALER SETTLEMENT APPROVAL (Returnable May 11, 2015)

VOLUME I OF II

April 24, 2015

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Court File No. CV-12-9667-00-CL

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

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TABLE OF CONTENTS

1. *Labourers' Pension Fund of Central and Eastern Canada v. Sino-Forest Corp.*, 2013 ONSC 1078

2. *Dabbs v. Sun Life Assurance Co. of Canada*, [1998] O.J. No. 1598 (Gen. Div.)

3. *Nunes v. Air Transat AT Inc.,* [2005] O.J. No. 2527 (S.C.J.)

4. *Osmun v. Cadbury Adams Canada Inc.*, [2010] O.J. No. 1877 (S.C.J)

5. *Parsons v. Canadian Red Cross Society*, [1999] O.J. No. 3572 (S.C.J)

6. *Robertson v. ProQuest Information and Learning Company*, 2011 ONSC 1647

7. *Marcantonio v. TVI Pacific Inc.*,[2009] O.J. No. 3409 (S.C.J.)

8. *Metzler Investment GmbH v Gildan Activewear Inc.*, 2011 ONSC 1146

9. *Robinson v Rochester Financial Ltd.*, 2012 ONSC 911

10. *Semple v Canada (Attorney General)*, 2006 MBQB 285 (Man. Q.B.)

11. *ATB Financial v Metcalfe & Mansfield Alternative Investments II Corp,* 2008 ONCA 587

12. *Healy v. Gregory*, [2009] O.J. No. 2562 (S.C.J.)

13. *Canadian Red Cross Society (Re)*, [1998] O.J. No. 3306 (Gen. Div.)

14. *Century Services Inc. v. Canada (Attorney General)*, [2010] S.C.J. No. 60 (S.C.J.)

15. *Playdium Entertainment Corp. (Re)*, [2001] O.J. No. 4252 (S.C.J.)

16. *Hayes Forest Services Ltd. (Re)*, [2009] B.C.J. No. 1725 (S.C.)

17. *Ontario v. Canadian Airlines Corp.*, [2001] A.J. No. 1457 (Alta. Q.B.)

18. *Canadian Red Cross Society (Re)*, [2002] O.J. No. 2567 (S.C.J.)

19. *Bhasin v. Hrynew*, 2014 SCC 71

20. *1578838 Ontario Inc. v. Bank of Nova Scotia*, 2011 ONSC 3482

21. *Olympia & York Developments Ltd. (Re),* [1993] O.J. No. 545 (Gen. Div.)

22. *IFP Technologies (Canada) Inc. v. Encanada Midstream and Marketing*, [2014] A.J. No. 883 (Alta. Q.B.)

VOLUME II

23. *Sun Indalex Finance, LLC v. United Steelworkers*, [2013] 1 S.C.R. 271 (S.C.C.)

24. *In re IMAX Sec. Litig.*, 283 F.R.D. 178 (S.D.N.Y. 2012)

25. *Federal Housing Fin. Agency v. Nomura Holding Amer. Inc.*, F. Supp. 3d, 2014 WL 7232443

26. *Feyko v. Yuhe Intern., Inc.*, No. CV 11–05511, 2013 WL 816409 (C.D. Cal. Mar. 5, 2013)

27. *Ontario New Home Warranty Program v Chevron Chemical Co.*, [1999] O.J. No. 2245 (S.C.J.)

28. *Eidoo v Infineon Technologies AG,* 2012 ONSC 3801

29. *Sino-Forest Corporation (Re),* 2012 ONSC 7050

30. *Zaniewicz v. Zungui Haixi Corp.*, 2013 ONSC 5490

31. *In re WorldCom, Inc. Sec. Litig.*, 388 F. Supp. 2d 319 (S.D.N.Y. 2005)

32. *Gould v BMO Nesbitt Burns Inc.*, [2007] O.J. No. 1095 (S.C.J.)

33. *Cosimo Borrelli in his capacity as trustee of the SFC Litigation Trust v. David J. Horsley et al.*, Notice of Acton issued May 31, 2013

34. Sino-Forest Litigation Trust Agreement, Art. 1.5(a)-(b)

35. International Accounting Standard 2 — Inventories, IFRS

36. *Dobbie v. Arctic Glacier*, Order dated December 4, 2012 (File No. 08-59725)

37. *McKenna v Gammon Gold*, Order dated December 4, 2012 (File No. 08-36143600CP)

38. *Zaniewicz v. Zungui Haixi Corp.*, Order dated August 26, 2013 (File 36143600CP)

39. *Metzler Investment GmbH v. Gildan Activewear Inc.,* Order dated February 18, 2011 (File No. 58574CP)

40. *Labourers' Pension Fund of Central and Eastern Canada v. Sino-Forest Corp.*, Order dated December 27, 2013 (File 12-9667-00CL/11-431153-00CP)

Case Name:

Labourers' Pension Fund of Central and Eastern Canada (Trustees of) v. Sino-Forest Corp.

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 Sino-Forest Corporation, Applicant
Between
The Trustees of the Labourers' Pension Fund of Central and Eastern Canada, The Trustees of the International Union of Operating Engineers Local 793 Pension Plan for Operating Engineers in Ontario, Sjunde Ap-Fonden, David Grant and Robert Wong, Plaintiffs, and
Sino-Forest Corporation, Ernst & Young LLP, BDO Limited (formerly known as BDO McCabe Lo Limited), Allen T.Y. Chan, W. Judson Martin, Kai Kit Poon, David J. Horsley, William E. Ardell, James P. Bowland, James M.E. Hyde, Edmund Mak, Simon Murray, Peter Wang, Garry J. West, P'Yry (Beijing) Consulting Company Limited, Credit Suisse Securities (Canada) In., TD Securities Inc., Dundee Securities Corporation, RBC Dominion Securities Inc., Scotia Capital Inc., CIBC World Markets Inc., Merrill Lynch Canada Inc., Canaccord Financial Ltd., Maison Placements Canada Inc., Credit Suisse Securities (USA) LLC and Merrill Lynch, Pierce, Fenner & Smith Incorporated (successor by Merger to Banc of America Securities LLC), Defendants

[2013] O.J. No. 1339

2013 ONSC 1078

227 A.C.W.S. (3d) 930

37 C.P.C. (7th) 135

100 C.B.R. (5th) 30

2013 CarswellOnt 3361

Court File Nos. CV-12-9667-00CL and CV-11-431153-00CP

Ontario Superior Court of Justice
Commercial List

G.B. Morawetz J.

Heard: February 4, 2013.
Judgment: March 20, 2013.

(82 paras.)

Bankruptcy and insolvency law -- Companies' Creditors Arrangement Act (CCAA) matters -- Compromises and arrangements -- Sanction by court -- Motion by Securities Purchasers' Committee for approval of Ernst & Young Settlement and Release allowed -- Ernst & Young were former auditors of SFC and named as defendant in class proceeding commenced on behalf of SFC debt and equity investors alleging complex financial fraud -- Stay issued pursuant to CCAA -- Settlement and Release included in Plan of Compromise and Reorganization contemplated payment of $117 million and was approved by majority of creditors -- Settlement and Release was fair and reasonable -- Objectors' opposition based on lack of opt-out rights was not sustainable in CCAA or class proceeding context.

Civil litigation -- Civil procedure -- Parties -- Class or representative actions -- Settlements -- Approval -- Motion by Securities Purchasers' Committee for approval of Ernst & Young Settlement and Release allowed -- Ernst & Young were former auditors of SFC and named as defendant in class proceeding commenced on behalf of SFC debt and equity investors alleging complex financial fraud -- Stay issued pursuant to CCAA -- Settlement and Release included in Plan of Compromise and Reorganization contemplated payment of $117 million and was approved by majority of creditors -- Settlement and Release was fair and reasonable -- Objectors' opposition based on lack of opt-out rights was not sustainable in CCAA or class proceeding context.

Motion by the Ad Hoc Securities Purchasers' Committee for approval of the Ernst & Young Settlement and Release. SFC was a publicly-traded forestry company with a registered office in Toronto and the majority of its operations located in China. SFC issued various debt and equity offerings to investors between 2007 and 2011. After the SFC share price collapsed, it was subsequently alleged that it had engaged in a complex fraudulent scheme misrepresenting its timber rights, misstating financial results, overstating the value of its assets, and concealing material information. The underwriters of the SFC debt and equity offerings were named as defendants in class action proceedings commenced on behalf of investors in both types of offerings. Ernst & Young and BDO acted as auditors for SFC during the relevant times and were named as defendants. Certification and leave motions had yet to be heard due to a stay granted to SFC under the

Companies' Creditors Arrangement Act. The Committee filed a proof of claim on behalf of the putative class of debt and equity investors exceeding $9 billion. Ernst & Young filed a proof of claim for damages and indemnification. The ensuing $117 million settlement was approved by a majority of creditors and included in the Plan of Compromise and Reorganization in respect of SFC. The Committee moved for approval of the settlement. The Objectors were SFC shareholders who opposed the no opt-out and full-third party release features of the Settlement. They moved for appointment of the Objectors to represent the interests of all those opposed to the Settlement.

HELD: Approval motion allowed and Objection motion dismissed. The Ernst & Young Release was justifiable as part of the Ernst & Young Settlement in order to effect any distribution of settlement proceeds. The claims to be released were necessarily and rationally related to the purpose of the Plan given the inextricability and circularity of Ernst & Young's claims against SFC, and those of the Objectors as against Ernst & Young. The Plan benefited claimants in the form of a significant and tangible distribution. The Release was fair and reasonable and not overly broad or offensive to public policy. It provided substantial benefits to relevant stakeholders and was consistent with the purpose and spirit of the CCAA. The Objectors' claim against Ernst & Young was not capable of consideration in isolation from the CCAA proceedings. Their opt-out argument could not be sustained, as the jurisprudence did not permit a dissenting stakeholder to opt out of a restructuring. By virtue of deciding, on their own volition, not to participate in the CCAA process, the Objectors relinquished their right to file a claim and take steps, in a timely way, to assert their rights to vote in the CCAA proceeding. No right to conditionally opt out of a settlement existed under the Class Proceedings Act or the CCAA.

Statutes, Regulations and Rules Cited:

Class Proceedings Act, 1992, S.O. 1992, c. 6, s. 9

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36,

Counsel:

Kenneth Rosenberg, Max Starnino, A. Dimitri Lascaris, Daniel Bach, Charles M. Wright, and Jonathan Ptak, for the Ad Hoc Committee of Purchasers including the Class Action Plaintiffs.

Peter Griffin, Peter Osborne, and Shara Roy, for Ernst & Young LLP.

John Pirie and David Gadsden, for Pöyry (Beijing) Consulting Company Ltd.

Robert W. Staley, for Sino-Forest Corporation.

Won J. Kim, Michael C. Spencer, and Megan B. McPhee, for the Objectors, Invesco Canada Ltd., Northwest & Ethical Investments LP and Comité Syndical National de Retraite Bâtirente Inc.

John Fabello and Rebecca Wise for the Underwriters.

Ken Dekker and Peter Greene, for BDO Limited.

Emily Cole and Joseph Marin, for Allen Chan.

James Doris, for the U.S. Class Action.

Brandon Barnes, for Kai Kit Poon.

Robert Chadwick and Brendan O'Neill, for the Ad Hoc Committee of Noteholders.

Derrick Tay and Cliff Prophet for the Monitor, FTI Consulting Canada Inc.

Simon Bieber, for David Horsley.

James Grout, for the Ontario Securities Commission.

Miles D. O'Reilly, Q.C., for the Junior Objectors, Daniel Lam and Senthilvel Kanagaratnam.

ENDORSEMENT

G.B. MORAWETZ J.:--

INTRODUCTION

1 The Ad Hoc Committee of Purchasers of the Applicant's Securities (the "Ad Hoc Securities Purchasers' Committee" or the "Applicant"), including the representative plaintiffs in the Ontario class action (collectively, the "Ontario Plaintiffs"), bring this motion for approval of a settlement and release of claims against Ernst & Young LLP [the "Ernst & Young Settlement", the "Ernst & Young Release", the "Ernst & Young Claims" and "Ernst & Young", as further defined in the Plan of Compromise and Reorganization of Sino-Forest Corporation ("SFC") dated December 3, 2012 (the "Plan")].

2 Approval of the Ernst & Young Settlement is opposed by Invesco Canada Limited ("Invesco"), Northwest and Ethical Investments L.P. ("Northwest"), Comité Syndical National de Retraite Bâtirente Inc. ("Bâtirente"), Matrix Asset Management Inc. ("Matrix"), Gestion Férique and Montrusco Bolton Investments Inc. ("Montrusco") (collectively, the "Objectors"). The Objectors particularly oppose the no-opt-out and full third-party release features of the Ernst & Young Settlement. The Objectors also oppose the motion for a representation order sought by the Ontario Plaintiffs, and move instead for appointment of the Objectors to represent the interests of all objectors to the Ernst & Young Settlement.

3 For the following reasons, I have determined that the Ernst & Young Settlement, together with the Ernst & Young Release, should be approved.

FACTS

Class Action Proceedings

4 SFC is an integrated forest plantation operator and forest productions company, with most of its assets and the majority of its business operations located in the southern and eastern regions of the People's Republic of China. SFC's registered office is in Toronto, and its principal business office is in Hong Kong.

5 SFC's shares were publicly traded over the Toronto Stock Exchange. During the period from March 19, 2007 through June 2, 2011, SFC made three prospectus offerings of common shares. SFC also issued and had various notes (debt instruments) outstanding, which were offered to investors, by way of offering memoranda, between March 19, 2007 and June 2, 2011.

6 All of SFC's debt or equity public offerings have been underwritten. A total of 11 firms (the "Underwriters") acted as SFC's underwriters, and are named as defendants in the Ontario class action.

7 Since 2000, SFC has had two auditors: Ernst & Young, who acted as auditor from 2000 to 2004 and 2007 to 2012, and BDO Limited ("BDO"), who acted as auditor from 2005 to 2006. Ernst & Young and BDO are named as defendants in the Ontario class action.

8 Following a June 2, 2011 report issued by short-seller Muddy Waters LLC ("Muddy Waters"), SFC, and others, became embroiled in investigations and regulatory proceedings (with the Ontario Securities Commission (the "OSC"), the Hong Kong Securities and Futures Commission and the Royal Canadian Mounted Police) for allegedly engaging in a "complex fraudulent scheme". SFC concurrently became embroiled in multiple class action proceedings across Canada, including Ontario, Quebec and Saskatchewan (collectively, the "Canadian Actions"), and in New York (collectively with the Canadian Actions, the "Class Action Proceedings"), facing allegations that SFC, and others, misstated its financial results, misrepresented its timber rights, overstated the value of its assets and concealed material information about its business operations from investors, causing the collapse of an artificially inflated share price.

9 The Canadian Actions are comprised of two components: first, there is a shareholder claim, brought on behalf of SFC's current and former shareholders, seeking damages in the amount of $6.5 billion for general damages, $174.8 million in connection with a prospectus issued in June 2007, $330 million in relation to a prospectus issued in June 2009, and $319.2 million in relation to a prospectus issued in December 2009; and second, there is a noteholder claim, brought on behalf of former holders of SFC's notes (the "Noteholders"), in the amount of approximately $1.8 billion. The noteholder claim asserts, among other things, damages for loss of value in the notes.

10 Two other class proceedings relating to SFC were subsequently commenced in Ontario: *Smith et al. v. Sino-Forest Corporation et al.*, which commenced on June 8, 2011; and *Northwest and Ethical Investments L.P. et al. v. Sino-Forest Corporation et al.*, which commenced on September 26, 2011.

11 In December 2011, there was a motion to determine which of the three actions in Ontario should be permitted to proceed and which should be stayed (the "Carriage Motion"). On January 6, 2012, Perell J. granted carriage to the Ontario Plaintiffs, appointed Siskinds LLP and Koskie Minsky LLP to prosecute the Ontario class action, and stayed the other class proceedings.

CCAA Proceedings

12 SFC obtained an initial order under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("CCAA") on March 30, 2012 (the "Initial Order"), pursuant to which a stay of proceedings was granted in respect of SFC and certain of its subsidiaries. Pursuant to an order on May 8, 2012, the stay was extended to all defendants in the class actions, including Ernst & Young. Due to the stay, the certification and leave motions have yet to be heard.

13 Throughout the CCAA proceedings, SFC asserted that there could be no effective restructuring of SFC's business, and separation from the Canadian parent, if the claims asserted against SFC's subsidiaries arising out of, or connected to, claims against SFC remained outstanding.

14 In addition, SFC and FTI Consulting Canada Inc. (the "Monitor") continually advised that timing and delay were critical elements that would impact on maximization of the value of SFC's assets and stakeholder recovery.

15 On May 14, 2012, an order (the "Claims Procedure Order") was issued that approved a claims process developed by SFC, in consultation with the Monitor. In order to identify the nature and extent of the claims asserted against SFC's subsidiaries, the Claims Procedure Order required any claimant that had or intended to assert a right or claim against one or more of the subsidiaries, relating to a purported claim made against SFC, to so indicate on their proof of claim.

16 The Ad Hoc Securities Purchasers' Committee filed a proof of claim (encapsulating the approximately $7.3 billion shareholder claim and $1.8 billion noteholder claim) in the CCAA proceedings on behalf of all putative class members in the Ontario class action. The plaintiffs in the New York class action filed a proof of claim, but did not specify quantum of damages. Ernst & Young filed a proof of claim for damages and indemnification. The plaintiffs in the Saskatchewan class action did not file a proof of claim. A few shareholders filed proofs of claim separately. No proof of claim was filed by Kim Orr Barristers P.C. ("Kim Orr"), who represent the Objectors.

17 Prior to the commencement of the CCAA proceedings, the plaintiffs in the Canadian Actions settled with Pöyry (Beijing) Consulting Company Limited ("Pöyry") (the "Pöyry Settlement"), a forestry valuator that provided services to SFC. The class was defined as all persons and entities

who acquired SFC's securities in Canada between March 19, 2007 to June 2, 2011, and all Canadian residents who acquired SFC securities outside of Canada during that same period (the "Pöyry Settlement Class").

18 The notice of hearing to approve the Pöyry Settlement advised the Pöyry Settlement Class that they may object to the proposed settlement. No objections were filed.

19 Perell J. and Émond J. approved the settlement and certified the Pöyry Settlement Class for settlement purposes. January 15, 2013 was fixed as the date by which members of the Pöyry Settlement Class, who wished to opt-out of either of the Canadian Actions, would have to file an opt-out form for the claims administrator, and they approved the form by which the right to opt-out was required to be exercised.

20 Notice of the certification and settlement was given in accordance with the certification orders of Perell J. and Émond J. The notice of certification states, in part, that:

> IF YOU CHOOSE TO OPT OUT OF THE CLASS, YOU WILL BE OPTING OUT OF THE **ENTIRE** PROCEEDING. THIS MEANS THAT YOU WILL BE UNABLE TO PARTICIPATE IN ANY FUTURE SETTLEMENT OR JUDGMENT REACHED WITH OR AGAINST THE REMAINING DEFENDANTS.

21 The opt-out made no provision for an opt-out on a conditional basis.

22 On June 26, 2012, SFC brought a motion for an order directing that claims against SFC that arose in connection with the ownership, purchase or sale of an equity interest in SFC, and related indemnity claims, were "equity claims" as defined in section 2 of the CCAA, including the claims by or on behalf of shareholders asserted in the Class Action Proceedings. The equity claims motion did not purport to deal with the component of the Class Action Proceedings relating to SFC's notes.

23 In reasons released July 27, 2012 [*Re Sino-Forest Corp*., 2012 ONSC 4377], I granted the relief sought by SFC (the "Equity Claims Decision"), finding that "the claims advanced in the shareholder claims are clearly equity claims". The Ad Hoc Securities Purchasers' Committee did not oppose the motion, and no issue was taken by any party with the court's determination that the shareholder claims against SFC were "equity claims". The Equity Claims Decision was subsequently affirmed by the Court of Appeal for Ontario on November 23, 2012 [*Re Sino-Forest Corp.*, 2012 ONCA 816].

Ernst & Young Settlement

24 The Ernst & Young Settlement, and third party releases, was not mentioned in the early versions of the Plan. The initial creditors' meeting and vote on the Plan was scheduled to occur on November 29, 2012; when the Plan was amended on November 28, 2012, the creditors' meeting

was adjourned to November 30, 2012.

25 On November 29, 2012, Ernst & Young's counsel and class counsel concluded the proposed Ernst & Young Settlement. The creditors' meeting was again adjourned, to December 3, 2012; on that date, a new Plan revision was released and the Ernst & Young Settlement was publicly announced. The Plan revision featured a new Article 11, reflecting the "framework" for the proposed Ernst & Young Settlement and for third-party releases for named third-party defendants as identified at that time as the Underwriters or in the future.

26 On December 3, 2012, a large majority of creditors approved the Plan. The Objectors note, however, that proxy materials were distributed weeks earlier and proxies were required to be submitted three days prior to the meeting and it is evident that creditors submitting proxies only had a pre-Article 11 version of the Plan. Further, no equity claimants, such as the Objectors, were entitled to vote on the Plan. On December 6, 2012, the Plan was further amended, adding Ernst & Young and BDO to Schedule A, thereby defining them as named third-party defendants.

27 Ultimately, the Ernst & Young Settlement provided for the payment by Ernst & Young of $117 million as a settlement fund, being the full monetary contribution by Ernst & Young to settle the Ernst & Young Claims; however, it remains subject to court approval in Ontario, and recognition in Quebec and the United States, and conditional, pursuant to Article 11.1 of the Plan, upon the following steps:

(a) the granting of the sanction order sanctioning the Plan including the terms of the Ernst & Young Settlement and the Ernst & Young Release (which preclude any right to contribution or indemnity against Ernst & Young);
(b) the issuance of the Settlement Trust Order;
(c) the issuance of any other orders necessary to give effect to the Ernst & Young Settlement and the Ernst & Young Release, including the Chapter 15 Recognition Order;
(d) the fulfillment of all conditions precedent in the Ernst & Young Settlement; and
(e) all orders being final orders not subject to further appeal or challenge.

28 On December 6, 2012, Kim Orr filed a notice of appearance in the CCAA proceedings on behalf of three Objectors: Invesco, Northwest and Bâtirente. These Objectors opposed the sanctioning of the Plan, insofar as it included Article 11, during the Plan sanction hearing on December 7, 2012.

29 At the Plan sanction hearing, SFC's counsel made it clear that the Plan itself did not embody the Ernst & Young Settlement, and that the parties' request that the Plan be sanctioned did not also cover approval of the Ernst & Young Settlement. Moreover, according to the Plan and minutes of settlement, the Ernst & Young Settlement would not be consummated (*i.e.* money paid and releases effective) unless and until several conditions had been satisfied in the future.

30 The Plan was sanctioned on December 10, 2012 with Article 11. The Objectors take the position that the Funds' opposition was dismissed as premature and on the basis that nothing in the sanction order affected their rights.

31 On December 13, 2012, the court directed that its hearing on the Ernst & Young Settlement would take place on January 4, 2013, under both the CCAA and the *Class Proceedings Act, 1992*, S.O. 1992, c. 6 ("CPA"). Subsequently, the hearing was adjourned to February 4, 2013.

32 On January 15, 2013, the last day of the opt-out period established by orders of Perell J. and Émond J., six institutional investors represented by Kim Orr filed opt-out forms. These institutional investors are Northwest and Bâtirente, who were two of the three institutions represented by Kim Orr in the Carriage Motion, as well as Invesco, Matrix, Montrusco and Gestion Ferique (all of which are members of the Pöyry Settlement Class).

33 According to the opt-out forms, the Objectors held approximately 1.6% of SFC shares outstanding on June 30, 2011 (the day the Muddy Waters report was released). By way of contrast, Davis Selected Advisors and Paulson and Co., two of many institutional investors who support the Ernst & Young Settlement, controlled more than 25% of SFC's shares at this time. In addition, the total number of outstanding objectors constitutes approximately 0.24% of the 34,177 SFC beneficial shareholders as of April 29, 2011.

LAW AND ANALYSIS

Court's Jurisdiction to Grant Requested Approval

34 The Claims Procedure Order of May 14, 2012, at paragraph 17, provides that any person that does not file a proof of claim in accordance with the order is barred from making or enforcing such claim as against any other person who could claim contribution or indemnity from the Applicant. This includes claims by the Objectors against Ernst & Young for which Ernst & Young could claim indemnity from SFC.

35 The Claims Procedure Order also provides that the Ontario Plaintiffs are authorized to file one proof of claim in respect of the substance of the matters set out in the Ontario class action, and that the Quebec Plaintiffs are similarly authorized to file one proof of claim in respect of the substance of the matters set out in the Quebec class action. The Objectors did not object to, or oppose, the Claims Procedure Order, either when it was sought or at any time thereafter. The Objectors did not file an independent proof of claim and, accordingly, the Canadian Claimants were authorized to and did file a proof of claim in the representative capacity in respect of the Objectors' claims.

36 The Ernst & Young Settlement is part of a CCAA plan process. Claims, including contingent claims, are regularly compromised and settled within CCAA proceedings. This includes outstanding litigation claims against the debtor and third parties. Such compromises fully and finally dispose of such claims, and it follows that there are no continuing procedural or other rights in such

proceedings. Simply put, there are no "opt-outs" in the CCAA.

37 It is well established that class proceedings can be settled in a CCAA proceeding. See *Robertson v. ProQuest Information and Learning Co.*, 2011 ONSC 1647 [*Robertson*].

38 As noted by Pepall J. (as she then was) in *Robertson*, para. 8:

> When dealing with the consensual resolution of a CCAA claim filed in a claims process that arises out of ongoing litigation, typically no court approval is required. In contrast, class proceedings settlements must be approved by the court. The notice and process for dissemination of the settlement agreement must also be approved by the court.

39 In this case, the notice and process for dissemination have been approved.

40 The Objectors take the position that approval of the Ernst & Young Settlement would render their opt-out rights illusory; the inherent flaw with this argument is that it is not possible to ignore the CCAA proceedings.

41 In this case, claims arising out of the class proceedings are claims in the CCAA process. CCAA claims can be, by definition, subject to compromise. The Claims Procedure Order establishes that claims as against Ernst & Young fall within the CCAA proceedings. Thus, these claims can also be the subject of settlement and, if settled, the claims of all creditors in the class can also be settled.

42 In my view, these proceedings are the appropriate time and place to consider approval of the Ernst & Young Settlement. This court has the jurisdiction in respect of both the CCAA and the CPA.

Should the Court Exercise Its Discretion to Approve the Settlement

43 Having established the jurisdictional basis to consider the motion, the central inquiry is whether the court should exercise its discretion to approve the Ernst & Young Settlement.

CCAA Interpretation

44 The CCAA is a "flexible statute", and the court has "jurisdiction to approve major transactions, including settlement agreements, during the stay period defined in the Initial Order". The CCAA affords courts broad jurisdiction to make orders and "fill in the gaps in legislation so as to give effect to the objects of the CCAA." [*Re Nortel Networks Corp.*, 2010 ONSC 1708, paras. 66-70 ("*Re Nortel*")); *Re Canadian Red Cross Society* (1998), 5 C.B.R. (4th) 299, 72 O.T.C. 99, para. 43 (Ont. C.J.)]

45 Further, as the Supreme Court of Canada explained in *Re Ted Leroy Trucking Ltd. [Century*

Services], 2010 SCC 60, para. 58:

> CCAA decisions are often based on discretionary grants of jurisdiction. The incremental exercise of judicial discretion in commercial courts under conditions one practitioner aptly described as "the hothouse of real time litigation" has been the primary method by which the CCAA has been adapted and has evolved to meet contemporary business and social needs (internal citations omitted). ... When large companies encounter difficulty, reorganizations become increasingly complex. CCAA courts have been called upon to innovate accordingly in exercising their jurisdiction beyond merely staying proceedings against the Debtor to allow breathing room for reorganization. They have been asked to sanction measures for which there is no explicit authority in the CCAA.

46 It is also established that third-party releases are not an uncommon feature of complex restructurings under the CCAA [*ATB Financial v. Metcalf and Mansfield Alternative Investments II Corp.*, 2008 ONCA 587 ("*ATB Financial*"); *Re Nortel, supra*; *Robertson, supra*; *Re Muscle Tech Research and Development Inc.* (2007), 30 C.B.R. (5th) 59, 156 A.C.W.S. (3d) 22 (Ontario S.C.J.) ("*Muscle Tech*"); *Re Grace Canada Inc.* (2008), 50 C.B.R. (5th) 25 (Ont. S.C.J.); *Re Allen-Vanguard Corporation*, 2011 ONSC 5017].

47 The Court of Appeal for Ontario has specifically confirmed that a third-party release is justified where the release forms part of a comprehensive compromise. As Blair J. A. stated in *ATB Financial, supra*:

> 69. In keeping with this scheme and purpose, I do not suggest that any and all releases between creditors of the debtor company seeking to restructure and third parties may be made the subject of a compromise or arrangement between the debtor and its creditors. Nor do I think the fact that the releases may be "necessary" in the sense that the third parties or the debtor may refuse to proceed without them, of itself, advances the argument in favour of finding jurisdiction (although it may well be relevant in terms of the fairness and reasonableness analysis).
>
> 70. The release of the claim in question must be justified as part of the compromise or arrangement between the debtor and its creditors. In short, there must be a reasonable connection between the third party claim being compromised in the plan and the restructuring achieved by the plan to warrant inclusion of the third party release in the plan ...
>
> 71. In the course of his reasons, the application judge made the following findings, all of which are amply supported on the record:
>
> a) The parties to be released are necessary and essential to the restructuring of the debtor;
>
> b) The claims to be released are rationally related to the purpose of the Plan and

necessary for it;

c) The Plan cannot succeed without the releases;

d) The parties who are to have claims against them released are contributing in a tangible and realistic way to the Plan; and

e) The Plan will benefit not only the debtor companies but creditor Noteholders generally.

72. Here, then - as was the case in T&N - there is a close connection between the claims being released and the restructuring proposal. The tort claims arise out of the sale and distribution of the ABCP Notes and their collapse in value, just as do the contractual claims of the creditors against the debtor companies. The purpose of the restructuring is to stabilize and shore up the value of those notes in the long run. The third parties being released are making separate contributions to enable those results to materialize. Those contributions are identified earlier, at para. 31 of these reasons. The application judge found that the claims being released are not independent of or unrelated to the claims that the Noteholders have against the debtor companies; they are closely connected to the value of the ABCP Notes and are required for the Plan to succeed ...

73. I am satisfied that the wording of the CCAA - construed in light of the purpose, objects and scheme of the Act and in accordance with the modern principles of statutory interpretation - supports the court's jurisdiction and authority to sanction the Plan proposed here, including the contested third-party releases contained in it.

...

78. ... I believe the open-ended CCAA permits third-party releases that are reasonably related to the restructuring at issue because they are encompassed in the comprehensive terms "compromise" and "arrangement" and because of the double-voting majority and court sanctioning statutory mechanism that makes them binding on unwilling creditors.

...

113. At para. 71 above I recited a number of factual findings the application judge made in concluding that approval of the Plan was within his jurisdiction under the CCAA and that it was fair and reasonable. For convenience, I reiterate them here - with two additional findings - because they provide an important foundation for his analysis concerning the fairness and reasonableness of the

Plan. The application judge found that:

a) The parties to be released are necessary and essential to the restructuring of the debtor;
b) The claims to be released are rationally related to the purpose of the Plan and necessary for it;
c) The Plan cannot succeed without the releases;
d) The parties who are to have claims against them released are contributing in a tangible and realistic way to the Plan;
e) The Plan will benefit not only the debtor companies but creditor Noteholders generally;
f) The voting creditors who have approved the Plan did so with knowledge of the nature and effect of the releases; and that,
g) The releases are fair and reasonable and not overly broad or offensive to public policy.

48 Furthermore, in *ATB Financial*, *supra*, para. 111, the Court of Appeal confirmed that parties are entitled to settle allegations of fraud and to include releases of such claims as part of the settlement. It was noted that "there is no legal impediment to granting the release of an antecedent claim in fraud, provided the claim is in the contemplation of the parties to the release at the time it is given".

Relevant CCAA Factors

49 In assessing a settlement within the CCAA context, the court looks at the following three factors, as articulated in *Robertson*, *supra*:

(a) whether the settlement is fair and reasonable;
(b) whether it provides substantial benefits to other stakeholders; and
(c) whether it is consistent with the purpose and spirit of the CCAA.

50 Where a settlement also provides for a release, such as here, courts assess whether there is "a reasonable connection between the third party claim being compromised in the plan and the restructuring achieved by the plan to warrant inclusion of the third party release in the plan". Applying this "nexus test" requires consideration of the following factors: [*ATB Financial*, *supra*, para. 70]

(a) Are the claims to be released rationally related to the purpose of the plan?
(b) Are the claims to be released necessary for the plan of arrangement?
(c) Are the parties who have claims released against them contributing in a tangible and realistic way? and
(d) Will the plan benefit the debtor and the creditors generally?

Counsel Submissions

51 The Objectors argue that the proposed Ernst & Young Release is not integral or necessary to the success of Sino-Forest's restructuring plan, and, therefore, the standards for granting third-party releases in the CCAA are not satisfied. No one has asserted that the parties require the Ernst & Young Settlement or Ernst & Young Release to allow the Plan to go forward; in fact, the Plan has been implemented prior to consideration of this issue. Further, the Objectors contend that the $117 million settlement payment is not essential, or even related, to the restructuring, and that it is concerning, and telling, that varying the end of the Ernst & Young Settlement and Ernst & Young Release to accommodate opt-outs would extinguish the settlement.

52 The Objectors also argue that the Ernst & Young Settlement should not be approved because it would vitiate opt-out rights of class members, as conferred as follows in section 9 of the CPA: "Any member of a class involved in a class proceeding may opt-out of the proceeding in the manner and within the time specified in the certification order." This right is a fundamental element of procedural fairness in the Ontario class action regime [*Fischer v. IG Investment Management Ltd.*, 2012 ONCA 47, para. 69], and is not a mere technicality or illusory. It has been described as absolute [*Durling v. Sunrise Propane Energy Group Inc.*, 2011 ONSC 266]. The opt-out period allows persons to pursue their self-interest and to preserve their rights to pursue individual actions [*Mangan v. Inco Ltd.*, (1998), 16 C.P.C. (4th) 165, 38 O.R. (3d) 703 (Ont. C.J.)].

53 Based on the foregoing, the Objectors submit that a proposed class action settlement with Ernst & Young should be approved solely under the CPA, as the Pöyry Settlement was, and not through misuse of a third-party release procedure under the CCAA. Further, since the minutes of settlement make it clear that Ernst & Young retains discretion not to accept or recognize normal opt-outs if the CPA procedures are invoked, the Ernst & Young Settlement should not be approved in this respect either.

54 Multiple parties made submissions favouring the Ernst & Young Settlement (with the accompanying Ernst & Young Release), arguing that it is fair and reasonable in the circumstances, benefits the CCAA stakeholders (as evidenced by the broad-based support for the Plan and this motion) and rationally connected to the Plan.

55 Ontario Plaintiffs' counsel submits that the form of the bar order is fair and properly balances the competing interests of class members, Ernst & Young and the non-settling defendants as:

(a) class members are not releasing their claims to a greater extent than necessary;

(b) Ernst & Young is ensured that its obligations in connection to the Settlement will conclude its liability in the class proceedings;

(c) the non-settling defendants will not have to pay more following a judgment than they would be required to pay if Ernst & Young remained as a defendant in the action; and

(d) the non-settling defendants are granted broad rights of discovery and an

appropriate credit in the ongoing litigation, if it is ultimately determined by the court that there is a right of contribution and indemnity between the co-defendants.

56 SFC argues that Ernst & Young's support has simplified and accelerated the Plan process, including reducing the expense and management time otherwise to be incurred in litigating claims, and was a catalyst to encouraging many parties, including the Underwriters and BDO, to withdraw their objections to the Plan. Further, the result is precisely the type of compromise that the CCAA is designed to promote; namely, Ernst & Young has provided a tangible and significant contribution to the Plan (notwithstanding any pitfalls in the litigation claims against Ernst & Young) that has enabled SFC to emerge as Newco/NewcoII in a timely way and with potential viability.

57 Ernst & Young's counsel submits that the Ernst & Young Settlement, as a whole, including the Ernst & Young Release, must be approved or rejected; the court cannot modify the terms of a proposed settlement. Further, in deciding whether to reject a settlement, the court should consider whether doing so would put the settlement in "jeopardy of being unravelled". In this case, counsel submits there is no obligation on the parties to resume discussions and it could be that the parties have reached their limits in negotiations and will backtrack from their positions or abandon the effort.

Analysis and Conclusions

58 The Ernst & Young Release forms part of the Ernst & Young Settlement. In considering whether the Ernst & Young Settlement is fair and reasonable and ought to be approved, it is necessary to consider whether the Ernst & Young Release can be justified as part of the Ernst & Young Settlement. See *ATB Financial, supra*, para. 70, as quoted above.

59 In considering the appropriateness of including the Ernst & Young Release, I have taken into account the following.

60 Firstly, although the Plan has been sanctioned and implemented, a significant aspect of the Plan is a distribution to SFC's creditors. The significant and, in fact, only monetary contribution that can be directly identified, at this time, is the $117 million from the Ernst & Young Settlement. Simply put, until such time as the Ernst & Young Settlement has been concluded and the settlement proceeds paid, there can be no distribution of the settlement proceeds to parties entitled to receive them. It seems to me that in order to effect any distribution, the Ernst & Young Release has to be approved as part of the Ernst & Young Settlement.

61 Secondly, it is apparent that the claims to be released against Ernst & Young are rationally related to the purpose of the Plan and necessary for it. SFC put forward the Plan. As I outlined in the Equity Claims Decision, the claims of Ernst & Young as against SFC are intertwined to the extent that they cannot be separated. Similarly, the claims of the Objectors as against Ernst & Young are, in my view, intertwined and related to the claims against SFC and to the purpose of the

Plan.

62 Thirdly, although the Plan can, on its face, succeed, as evidenced by its implementation, the reality is that without the approval of the Ernst & Young Settlement, the objectives of the Plan remain unfulfilled due to the practical inability to distribute the settlement proceeds. Further, in the event that the Ernst & Young Release is not approved and the litigation continues, it becomes circular in nature as the position of Ernst & Young, as detailed in the Equity Claims Decision, involves Ernst & Young bringing an equity claim for contribution and indemnity as against SFC.

63 Fourthly, it is clear that Ernst & Young is contributing in a tangible way to the Plan, by its significant contribution of $117 million.

64 Fifthly, the Plan benefits the claimants in the form of a tangible distribution. Blair J.A., at paragraph 113 of *ATB Financial*, *supra*, referenced two further facts as found by the application judge in that case; namely, the voting creditors who approved the Plan did so with the knowledge of the nature and effect of the releases. That situation is also present in this case.

65 Finally, the application judge in *ATB Financial*, *supra*, held that the releases were fair and reasonable and not overly broad or offensive to public policy. In this case, having considered the alternatives of lengthy and uncertain litigation, and the full knowledge of the Canadian plaintiffs, I conclude that the Ernst & Young Release is fair and reasonable and not overly broad or offensive to public policy.

66 In my view, the Ernst & Young Settlement is fair and reasonable, provides substantial benefits to relevant stakeholders, and is consistent with the purpose and spirit of the CCAA. In addition, in my view, the factors associated with the *ATB Financial* nexus test favour approving the Ernst & Young Release.

67 In *Re Nortel*, *supra*, para. 81, I noted that the releases benefited creditors generally because they "reduced the risk of litigation, protected Nortel against potential contribution claims and indemnity claims and reduced the risk of delay caused by potentially complex litigation and associated depletion of assets to fund potentially significant litigation costs". In this case, there is a connection between the release of claims against Ernst & Young and a distribution to creditors. The plaintiffs in the litigation are shareholders and Noteholders of SFC. These plaintiffs have claims to assert against SFC that are being directly satisfied, in part, with the payment of $117 million by Ernst & Young.

68 In my view, it is clear that the claims Ernst & Young asserted against SFC, and SFC's subsidiaries, had to be addressed as part of the restructuring. The interrelationship between the various entities is further demonstrated by Ernst & Young's submission that the release of claims by Ernst & Young has allowed SFC and the SFC subsidiaries to contribute their assets to the restructuring, unencumbered by claims totalling billions of dollars. As SFC is a holding company with no material assets of its own, the unencumbered participation of the SFC subsidiaries is crucial

to the restructuring.

69 At the outset and during the CCAA proceedings, the Applicant and Monitor specifically and consistently identified timing and delay as critical elements that would impact on maximization of the value and preservation of SFC's assets.

70 Counsel submits that the claims against Ernst & Young and the indemnity claims asserted by Ernst & Young would, absent the Ernst & Young Settlement, have to be finally determined before the CCAA claims could be quantified. As such, these steps had the potential to significantly delay the CCAA proceedings. Where the claims being released may take years to resolve, are risky, expensive or otherwise uncertain of success, the benefit that accrues to creditors in having them settled must be considered. See *Re Nortel, supra*, paras. 73 and 81; and *Muscle Tech, supra*, paras. 19-21.

71 Implicit in my findings is rejection of the Objectors' arguments questioning the validity of the Ernst & Young Settlement and Ernst & Young Release. The relevant consideration is whether a proposed settlement and third-party release sufficiently benefits all stakeholders to justify court approval. I reject the position that the $117 million settlement payment is not essential, or even related, to the restructuring; it represents, at this point in time, the only real monetary consideration available to stakeholders. The potential to vary the Ernst & Young Settlement and Ernst & Young Release to accommodate opt-outs is futile, as the court is being asked to approve the Ernst & Young Settlement and Ernst & Young Release as proposed.

72 I do not accept that the class action settlement should be approved solely under the CPA. The reality facing the parties is that SFC is insolvent; it is under CCAA protection, and stakeholder claims are to be considered in the context of the CCAA regime. The Objectors' claim against Ernst & Young cannot be considered in isolation from the CCAA proceedings. The claims against Ernst & Young are interrelated with claims as against SFC, as is made clear in the Equity Claims Decision and Claims Procedure Order.

73 Even if one assumes that the opt-out argument of the Objectors can be sustained, and opt-out rights fully provided, to what does that lead? The Objectors are left with a claim against Ernst & Young, which it then has to put forward in the CCAA proceedings. Without taking into account any argument that the claim against Ernst & Young may be affected by the claims bar date, the claim is still capable of being addressed under the Claims Procedure Order. In this way, it is again subject to the CCAA fairness and reasonable test as set out in *ATB Financial, supra.*

74 Moreover, CCAA proceedings take into account a class of creditors or stakeholders who possess the same legal interests. In this respect, the Objectors have the same legal interests as the Ontario Plaintiffs. Ultimately, this requires consideration of the totality of the class. In this case, it is clear that the parties supporting the Ernst & Young Settlement are vastly superior to the Objectors, both in number and dollar value.

75 Although the right to opt-out of a class action is a fundamental element of procedural fairness in the Ontario class action regime, this argument cannot be taken in isolation. It must be considered in the context of the CCAA.

76 The Objectors are, in fact, part of the group that will benefit from the Ernst & Young Settlement as they specifically seek to reserve their rights to "opt-in" and share in the spoils.

77 It is also clear that the jurisprudence does not permit a dissenting stakeholder to opt-out of a restructuring. [*Re Sammi Atlas Inc.,* (1998), 3 C.B.R. (4th) 171 (Ont. Gen. Div. (Commercial List)).] If that were possible, no creditor would take part in any CCAA compromise where they were to receive less than the debt owed to them. There is no right to opt-out of any CCAA process, and the statute contemplates that a minority of creditors are bound by the plan which a majority have approved and the court has determined to be fair and reasonable.

78 SFC is insolvent and all stakeholders, including the Objectors, will receive less than what they are owed. By virtue of deciding, on their own volition, not to participate in the CCAA process, the Objectors relinquished their right to file a claim and take steps, in a timely way, to assert their rights to vote in the CCAA proceeding.

79 Further, even if the Objectors had filed a claim and voted, their minimal 1.6% stake in SFC's outstanding shares when the Muddy Waters report was released makes it highly unlikely that they could have altered the outcome.

80 Finally, although the Objectors demand a right to conditionally opt-out of a settlement, that right does not exist under the CPA or CCAA. By virtue of the certification order, class members had the ability to opt-out of the class action. The Objectors did not opt-out in the true sense; they purported to create a conditional opt-out. Under the CPA, the right to opt-out is "in the manner and within the time specified in the certification order". There is no provision for a conditional opt-out in the CPA, and Ontario's single opt-out regime causes "no prejudice ... to putative class members". [CPA, section 9; *Osmun v. Cadbury Adams Canada Inc.* (2009), 85 C.P.C. (6th) 148, paras. 43-46 (Ont. S.C.J.); and *Eidoo v. Infineon Technologies AG*, 2012 ONSC 7299.] *Miscellaneous*

81 For greater certainty, it is my understanding that the issues raised by Mr. O'Reilly have been clarified such that the effect of this endorsement is that the Junior Objectors will be included with the same status as the Ontario Plaintiffs.

DISPOSITION

82 In the result, for the foregoing reasons, the motion is granted. A declaration shall issue to the effect that the Ernst & Young Settlement is fair and reasonable in all the circumstances. The Ernst & Young Settlement, together with the Ernst & Young Release, is approved and an order shall issue substantially in the form requested. The motion of the Objectors is dismissed.

G.B. MORAWETZ J.

Indexed as:

Dabbs v. Sun Life Assurance Co. of Canada

Between
Paul Dabbs, plaintiff, and
Sun Life Assurance Company of Canada, defendant

[1998] O.J. No. 1598

Court File No. 96-CT-022862

Ontario Court of Justice (General Division)

Sharpe J.

Heard: February 5, 1998.
Judgment: February 24, 1998.

(14 pp.)

Practice -- Persons who can sue and be sued -- Individuals and corporations, status or standing -- Class or representative actions, for damages -- Settlements -- Court approval.

Ruling as to procedural issues with respect to a motion for settlement approval of a class action suit involving a claim for damages against an insurer for breach of contract. The claim was settled by an agreement. Fourteen members of the proposed class filed objections to the settlement. The issues were the onus for approval of the agreement, the role of the court and factors to be considered in the approval of the agreement, procedures for and scope of the objection to the agreement and costs.

HELD: The parties proposing the settlement had the onus of showing that it should be approved. The role of the court was to find that the settlement was fair, reasonable and in the best interests of all those affected by it. The factors to be considered were the likelihood of recovery, the amount and nature of discovery evidence, the settlement terms, counsel's recommendations, the future expense of litigation, the number of objectors, the nature of objections and the presence of good faith. The objectors had the right to adduce evidence by way of affidavit but had no right to oral discovery or production of documents. They were subject to the discretion of the court to impose appropriate terms as to costs.

Statutes, Regulations and Rules Cited:

Canada Business Corporations Act, R.S.C. 1985, c. C-44, s. 242(2).

Class Proceedings Act, 1992, ss. 12, 14, 29, 32(1).

Ontario Rules of Civil Procedure, Rule 7.08(1).

Counsel:

Michael A. Elzenga and Charles M. Wright, for the plaintiff.
H. Lorne Morphy and Patricia D.S. Jackson, for the defendant.
Michael Deverett, for 3 objectors.
Gary R. Will and J. Douglas Barnett, for 11 objectors.

SHARPE J.:--

1. NATURE OF PROCEEDINGS

1 In this action, commenced pursuant to the Class Proceedings Act 1992, the plaintiff asserts claims for alleged breach of contract and negligent misrepresentation arising out of the manner in which whole life participating insurance policies with a premium offset option were sold. Similar actions were commenced in Quebec and in British Columbia. Before the defendant filed a statement of defence and before certification as a class proceeding, this action, together with the Quebec and British Columbia actions, was settled by written agreement, dated June 16, 1997, setting out detailed and complex terms. The settlement is subject to and conditional upon court approval in all three provinces.

2 Winkler J. approved a form of notice of motion for a certification/authorization and agreement approval to be sent to members of the proposed Ontario class. Similar orders were made in Quebec and British Columbia. The notice stated that members of the class who wished to participate in the hearing for approval of the settlement were required to file a written statement of objection and notice of appearance by a specified date. Fourteen members of the proposed Ontario class filed objections. Three are represented by Mr. Deverett and eleven by Messrs. Will and Barnett. At the opening of this hearing, Mr. Deverett indicated that one of the objectors he represents wished to withdraw from further participation.

3 On August 28, 1997 Winkler J. directed that there be a hearing to determine certain procedural

issues, namely:

(a) Standing to object;
(b) Procedures for and scope of objection;
(c) The role of the court in approval of the agreement;
(d) Onus for approval of the agreement;
(e) Factors to be considered by the court for approval of the agreement;
(f) Cost consequences.

4 The issue of standing was determined by Winkler J. and it was contemplated that the motion to determine the remaining procedural issues would be heard on September 4, 1997. It did not proceed on that date as the Deverett objectors requested an adjournment. The Deverett objectors then brought a motion to set aside Winkler J.'s earlier order regarding the notice of motion for certification/authorization, to declare the plaintiff's counsel to be in a conflict of interest, and for other relief, including an order that those objectors be given immunity from costs and be awarded interim costs. While the costs issue remains outstanding, other aspects of the motion were dismissed by Winkler J. An application for leave to appeal from that order was dismissed by O'Driscoll J. on January 22, 1998.

5 I have now heard full argument on the outstanding procedural issues specified by Winkler J.'s August 29, 1997 direction. For convenience of analysis, I propose to deal with them in the following order:

(a) Onus for approval of the agreement;
(b) The role of the court in approval of the agreement;
(c) Factors to be considered by the court for approval of the agreement;
(d) Procedures for and scope of objection;
(e) Cost consequences

6 I wish to emphasize at the outset that what follows is intended only to provide a procedural framework for the hearing of this motion. It would be entirely inappropriate to attempt to determine in the context of one case a process appropriate for all cases. My ruling has been determined on the basis of the submissions I have heard and is intended to do no more than provide guidance to the parties and objectors in the present case.

2. ANALYSIS

(a) Onus for approval of the agreement

7 It is common ground that the parties proposing the settlement bear the onus of satisfying the court that it ought to be approved.

(b) The role of the court in approval of the agreement

8 There are two matters to be determined by the court: (1) should the action be certified as a class proceeding and, if the answer is yes, (2) should the settlement be approved. While the role of the court with respect to certification is well defined by the Class Proceedings Act, 1992, the same cannot be said of the approval of settlements. Section 29 provides that "[a] settlement of a class proceeding is not binding unless approved by the court" but the Act provides no statutory guidelines that are to be followed.

9 Experience from other situations in which the court is required to approve settlements does, however, provide guidance. Court approval is required in situations where there are parties under disability (see Rule 7.08(1)). Court approval is also required in other circumstances where there are affected parties not before the court (see Canada Business Corporations Act, R.S.C. 1985, c. C-44, s. 242(2) dealing with derivative actions). The standard in these situations is essentially the same and is equally applicable here: the court must find that in all the circumstances the settlement is fair, reasonable and in the best interests of those affected by it.

10 It has often been observed that the court is asked to approve or reject a settlement and that it is not open to the court to rewrite or modify its terms; Poulin v. Nadon, [1950] O.R. 219 (C.A.) at 222-3. As a practical matter, it is within the power of the court to indicate areas of concern and afford the parties the opportunity to answer and address those concerns with changes to the settlement; see eg Bowling v. Pfizer Inc. 143 F.R.D. 141 (1992), I would observe, however, that the fact that the settlement has already been approved in Quebec and British Columbia would have to be considered as a factor making changes unlikely in this case.

11 With respect to specific objections raised by the objectors, there is an additional factor to be kept in mind. The role of the court is to determine whether the settlement is fair, reasonable and in the best interests of the class as a whole, not whether it meets the demands of a particular class member. As approval is sought at the same time as certification, even if the settlement is approved, class members will be afforded the right to opt out. There is, accordingly an element control that may be exercised to alleviate matters of particular concern to individual class members.

12 Various definitions of "reasonableness" were offered in argument. The word suggests that there is a range within which the settlement must fall that makes some allowance for differences of view, as an American court put it "a range which recognizes the uncertainties of law and fact in any particular case and the concomitant risks and costs necessarily inherent in taking any litigation to completion". (Newman v. Stein 464 F. (2d) 689 (1972) at 693).

(c) Factors to be considered by the court for approval of the agreement

13 A leading American text, Newberg on Class Actions, (3rd ed), para. 11.43 offers the following useful list of criteria:

1. Likelihood of recovery, or likelihood of success
2. Amount and nature of discovery evidence

3. Settlement terms and conditions
4. Recommendation and experience of counsel
5. Future expense and likely duration of litigation
6. Recommendation of neutral parties if any
7. Number of objectors and nature of objections
8. The presence of good faith and the absence of collusion

14 I also find the following passage from the judgment of Callaghan A.C.J.H.C. in Sparling v. Southam Inc. (1988), 66 O.R. (2d) 225 at 230-1 to be most helpful. Callaghan A.C.J.H.C. was considering approval of a settlement in a derivative action, but his comments are equally applicable to the approval of settlements of class action:

> In approaching this matter, I believe it should be observed at the outset that the courts consistently favour the settlement of lawsuits in general. To put it another way, t here is an overriding public interest in favour of settlement. This policy promotes the interests of litigants generally by saving them the expense of trial of disputed issues, and it reduces the strain upon an already overburdened provincial court system.
>
> In deciding whether or not to approve a proposed settlement under s. 235(2) of the Act, the court must be satisfied that the proposal is fair and reasonable to all shareholders. In considering these matters, the court must recognize that settlements are by their very nature compromises, which need not and usually do not satisfy every single concern of all parties affected. Acceptable settlements may fall within a broad range of upper and lower limits.
>
> In cases such as this, it is not the court's function to substitute its judgment for that of the parties who negotiate the settlement. Nor is it the court's function to litigate the merits of the action. I would also state that it is not the function of the court as simply rubber-stamp the proposal.
>
> The court must consider the nature of the claims that were advanced in the action, the nature of the defences to those claims that were advanced in the pleadings, and the benefits accruing and lost to the parties as a result of the settlement.
>
> ...

The matter was aptly put in two American cases that were cited to me in the course of argument. In a decision of the Federal Third Circuit Court in Yonge v. Katz, 447 F. (2d) 431 (1971), it is stated:

> It is not necessary in order to determine whether an agreement of settlement and compromise shall be approved that the court try the case which is before it for settlement. Such procedures would emasculate the very purpose for which settlements are made. The court is only called upon to consider and weigh the nature of the claim, the possible defences, the situation of the parties, and the exercise of business judgment in determining whether the proposed settlement is reasonable.

In another case cited by all parties in these proceedings, Greenspun v. Bogan, 492 F. (2d) 375 at p. 381 (1974), it is stated:

> ... any settlement is the result of a compromise - each party surrendering something in order to prevent unprofitable litigation, and the risks and costs inherent in taking litigation to completion. A district court, in reviewing a settlement proposal, need not engage in a trial of the merits, for the purpose of settlement is precisely to avoid such a trial. See United Founders Life Ins. Co. v. Consumer's National Life Inc. Co., 447 F. (2d) 647 (7th Cir. 1971); Florida Trailer & Equipment Co. v. Deal, 284 F. (2d) 567, 571 (5th Cir. 1960). It is only when one side is so obviously correct in its assertions of law and fact that it would be clearly unreasonable to require it to compromise in the extent of the settlement, that to approve the settlement would be an abuse of discretion. (Emphasis added)

15 It is apparent that the court cannot exercise its function without evidence. The court is entitled to insist on sufficient evidence to permit the judge to exercise an objective, impartial and independent assessment of the fairness of the settlement in all the circumstances.

16 In the arguments presented by the proponents of the settlement, considerable emphasis is placed on the opinion of senior counsel that the settlement is fair and reasonable as an important factor. While I agree that the opinion of counsel is evidence worthy of consideration, it is only one factor to be considered. It does not relieve the parties proposing the settlement of the obligation to provide sufficient information to permit the court to exercise its function of independent approval. On the other hand, the court must be mindful of the fact that as the consequence of not approving the settlement is that the litigation may well continue, there are inherent constraints on the extent to which the parties can be expected to make complete disclosure of the strengths and weaknesses of

their case.

(d) Procedures for and scope of objection

17 The Class Proceedings Act, 1992, s. 12 confers a general discretion on the court with respect to the conduct of class proceedings:

> 12. The court, on the motion or a party or class member, may make an order it considers appropriate respecting the conduct of a class proceeding to ensure its fair and expeditious determination and, for the purpose, may impose such terms on the parties as it considers appropriate.

18 Section 14 provides for the participation of class members in the following terms:

> 14(1) In order to ensure the fair and adequate representation of the interests of the claims or any subclass or for any other appropriate reason, the court may, at any time in a class proceeding, permit one or more class members to participate in the proceeding.
>
> (2) Participation under subsection (1) shall be in whatever manner and on whatever terms, including terms as to costs, the court considers appropriate.

19 As already noted, the order of Winkler J. required class members who wished to object to the settlement to file written objections. It remains to determine the procedural and other rights objectors have in relation to the approval process.

20 In general, the procedural rights of all participate in the approval process must reflect the nature of the process itself and the special role of the court. The matter cannot be viewed in strictly adversarial terms. The plaintiff and the defendant find themselves in common cause, seeking approval of the settlement. The objectors have their own specific concerns which, upon examination, may or may not be reflective of the interests of the class as a whole.

21 In view of the fact that the purpose of the exercise is to ensure that the interests of the unrepresented class members are protected, the court is called upon to play a more active role than is called for in strictly adversarial proceedings. It is important that the court itself remain firmly in control of the process and that the matter not be treated as if it were a dispute to be resolved between the proponents of the settlement on the one side and the objectors on the other.

(i) Objectors' right to adduce evidence

22 I can see no reason why the objectors should not have the right to adduce evidence. However, given the interests of the objectors and the nature of the process, the right to adduce evidence is not at large. Any evidence adduced by the objectors must be relevant to the points they have raised by

way of objection. It must also be adduced in a timely fashion. I direct that any evidence be adduced by way of affidavit filed at least 30 days prior to the date set for the hearing of this motion.

(ii) Objectors' right to discovery

23 Under the Rules of Court, the right to oral discovery and production of documents is restricted to parties to an action. The objectors are not parties to the action, and accordingly have no right to oral discovery or production of documents.

24 On the other hand, s. 14(2) of the Act does provide that participation "shall be in whatever manner and on whatever terms ... the court considers appropriate." On behalf of the objectors he represents, Mr. Deverett sought the right to conduct essentially a "no holds barred" discovery of the parties to the action. He submitted that as no discovery had been conducted, it was impossible to assess the merits of the case and the settlement without one. In my view, this submission misses the whole point of the settlement approval exercise. The very purpose of the settlement at an early stage of the proceedings is to avoid the cost and delay involved in discovery and other pre-trial procedures. If Mr. Deverett is right, then a class action could almost never be settled without discovery, for if the parties did not conduct one, an objector could insist upon doing so as a precondition of settlement. This would create a powerful disincentive to early settlements by the parties and would run counter to the general policy of the law which strongly favours early resolution of disputes. On the other hand, the lack of discovery is a factor the court may take into account in assessing the fairness of the settlement. However, the remedy in a case where the court concludes that the settlement cannot be approved without a discovery is to refuse to approve the settlement and not to have one conducted by an objector. Given the very different in approach to discovery in the United States, I do not find the American authorities cited by the objectors on this point to be persuasive.

25 The objectors represented by Mr. Will seek production of certain specific documents relevant to their claims. This request has to be assessed in the light of the settlement agreement itself. An important element of the settlement agreement is a process to resolve individual claims. One aspect of that process will entitled these objectors to production of documents. The process will also permit them to opt out of the settlement after they receive production. In my view, in light of the process contemplated by the settlement agreement, these objectors are not entitled to insist upon production of documents at this stage. The point of the approval process is to determine whether the settlement is fair, reasonable and in the best interests of those affected by it. The issue for the court, then, is to assess whether the process contemplated by the settlement agreement is a fair one. I fail to see what relevance documents pertaining to the claims of these objections have at this stage or how they would assist the court in determining whether the settlement and the process it specifies is a fair one.

26 Accordingly, in the circumstances of this case, I find that it is not appropriate to grant the objectors the right to oral or documentary discovery.

(iii) Right to cross-examine

27 The objectors also seek a general right to cross-examine on the affidavits filed in support of approval of the settlement. There is not inherent right to cross-examine: see eg. Kevork v. The Queen, [1984] 2 F.C. 753. On the other hand, it is important that there be some way for the court to ensure that evidence on contentious points can be probed and tested. As I have already stated, I view the approval process as one which the court must control and in which the court must take an active role. In keeping with that principle, and in view of the extremely open-ended request made by the Deverett objectors, I direct as follows:

(1) that any cross-examination of deponents shall take place viva voce before the court on the dates set for the hearing of the certification/approval motion;
(2) that any party or objector who wishes to cross-examine a deponent serve and file at least 10 days prior to the motion a written outline of the matters upon which cross-examination is requested;
(3) that the nature and extent of cross-examination shall, subject to the discretion of the court, only be in an area indicated by the written outline and shall be subject to the discretion of the court to exclude such cross-examination which may be exercised either before or during the hearing of the motion;
(4) that any deponent for which cross-examination is requested shall be available to attend court on the days the motion is to be heard as if under summons;
(5) that in any event, Mr. Ritchie be in attendance for the motion;
(6) that the right of the court to question witnesses shall remain within the sole discretion of the court and shall not be in any way affected by para (2).

(e) Costs consequences

28 The Deverett objectors seek an order that they not be subject to any order as to costs and that they be awarded interim costs. It was suggested, in the alternative, by Mr. Will that I specify in advance the circumstances which would or would not lead to an adverse costs order.

29 In my view, no such orders or directives should be made. Nothing has been shown that would bring this case within the category of "very exceptional cases" contemplated by Organ v. Barnett (1992), 11 O.R. (3d) 210 as justifying an award of interim costs to ensure that the objectors are able to continue their participation. Section 32(1) of the Act, which provides that class members are not liable for costs except with respect to the determination of their own claims, does not apply. That provision contemplates the usual situation where a class member takes no active step in the proceedings. The objectors are subject to the discretion conferred by s. 14(2), which expressly

preserves the right of the court to impose appropriate terms as to costs.

30 It is important that, as one means of controlling the process, the court retain its discretion with respect to the costs of this process. I hardly need add that my discretion is to be exercised in accordance with an established body of law dealing with cost orders. That body of law recognizes the right of the court to award costs to compensate for or sanction inappropriate behaviour by a litigant. It also recognizes that in certain cases, departure from the ordinary rule that an unsuccessful pay the costs of the winner may be appropriate: see eg. Mahar v. Rogers Cablesystems Ltd. (1995), 25 O.R. (3d) 690.

CONCLUSION

31 If there are further procedural issues which arise prior to the hearing of the motion, I may be spoken to.

SHARPE J.

Case Name:
Nunes v. Air Transat A.T. Inc.

PROCEEDING UNDER the Class Proceedings Act, 1992
Between
Josephine Nunes and Jorge Nunes, plaintiffs, and
Air Transat A.T. Inc., Airbus S.A.S., Airbus of North America Inc., Rolls-Royce PLC and Rolls-Royce Canada Limited and Airbus GIE, defendants

[2005] O.J. No. 2527

20 C.P.C. (6th) 93

140 A.C.W.S. (3d) 25

2005 CarswellOnt 2503

Court File No. 01-CV-217295 CP

Ontario Superior Court of Justice

M.C. Cullity J.

Heard: May 30, 2005.
Judgment: June 20, 2005.

(30 paras.)

Civil procedure -- Parties -- Class or representative actions -- Settlements -- Approval.

Motion by the plaintiffs, Nunes and Nunes, for approval of a settlement of the class action against Air Transat, Airbus and Rolls-Royce. The action was for damages suffered by passengers when an Air Transat flight ran out of fuel, lost power and made an emergency landing. The time for opting out had expired and 176 class members would share the settlement. The settlement provided for a $7,650,000 fund plus accrued interest to be distributed to class members after payment of counsel fees, disbursement and expenses. Class members would receive a maximum of $80,000 non-pecuniary damages for post-traumatic stress disorder or $100,000 if accompanied by a

significant personal injury. Monetary limits also included $50,000 for loss of income, $5,000 for out-of-pocket expenses and $5,000 for future care expenses. Family Law Act claims would be limited to $5,000. Class members would make claims to class counsel who would give an assessment. Class members could accept the assessment or request review by an arbitrator. The settlement agreement did not allow class members to opt out. In negotiating the settlement, class counsel had obtained questionnaires from all but a few class members to enable their claims to be reviewed with the assistance of a clinical psychologist and physician. Two class members informed the court that they objected to the settlement.

HELD: Motion allowed in part. Provisional approval was given to the settlement pending the decision on the fees of class counsel. The settlement was fair and reasonable. Class counsel's meticulous investigation concluded that almost all class members would claim to suffer post-traumatic stress disorder or other psychological harm. Given that the Warsaw Convention limited Air Transat's liability to damages for bodily injury, there was a significant risk that claims for post-traumatic stress disorder would not be successful at trial. Class counsel concluded that the case against Rolls-Royce was weak and that Airbus had tenable defences. The monetary limits on damages were carefully considered and determined principally for the purpose of achieving fairness for the class as a whole. The most problematic limit was for loss of income, but there would likely be few claims for loss of income relative to claims for psychological harm. Only one member provided documentation in favour an income loss in excess of the limit. The fairness and reasonableness of the settlement had to be judged in relation to the class as a whole. In choosing to impose monetary limits, class counsel properly considered the nature of damages likely to be claimed, the likely value of the claims, the possibility that one or a few very large claims for income losses would substantially deplete the amount available for other class members and the need to simplify the claims process to avoid delays.

Statutes, Regulations and Rules Cited:

Class Proceedings Act, 1992, S.O. 1992, c. 6, s. 29(2)

Family Law Act,

Negligence Act, R.S.O. 1990, c. 1,

Warsaw Convention,

Counsel:

J.J. Camp Q.C., Glenn Grenier and Allan Dick -- for the Plaintiffs

B. Timothy Trembley -- for the Defendant, Air Transat A.T.
Inc.

D. Bruce Garrow -- for the Defendants, Rolls-Royce PLC and Rolls-Royce Canada Limited

John Callaghan and Keith Geurts -- for the Defendants, Airbus of North America Inc., and Airbus GIE

REASONS FOR DECISION

1 M.C. CULLITY J.:-- The plaintiffs moved for the court's approval of a settlement of this action pursuant to section 29(2) of the Class Proceedings Act 1992 S.O. 1992, c. 6 ("CPA"). There was also a motion for approval of the fees and disbursements of class counsel.

2 The proceedings involve claims against the defendants for damages suffered by passengers on Air Transat Flight 236 ("Flight 236") when, in August 2001, the aircraft, an Airbus A330, ran out of fuel, lost power in each of its engines and made an emergency landing in the Azores Islands. The defendant, Air Transat A.T. Inc., ("Air Transat") was the operator of the aircraft. Airbus S.A.S. and Airbus North America Inc., (together "Airbus") and Rolls-Royce PLC and Rolls-Royce Canada Limited (together "Rolls-Royce") were sued as responsible for the manufacture of the aircraft, and that of its engines, respectively. Claims were also made on behalf of family members of the passengers.

The Settlement

3 The proceedings were certified by order of this court on July 4, 2003. The time for opting out has expired and it has now been determined that, of the 291 passengers on board Flight 236, 115 have either opted out or entered into individual settlements with Air Transat - leaving 176 class members who would share in the benefits to be provided under the terms of the proposed settlement. These benefits can be summarised as follows:

1. A fund of $7,650,000, plus accrued interest, is to be paid to an administrator in exchange for a release of all claims of class members arising from the events of Flight 236.
2. The administrator is to invest the fund in income-earning accounts and, after payment of class counsel fees and disbursements and expenses of administration, the fund is to be distributed among class members subject to monetary limits for particular kinds of damages and, otherwise, in accordance with a claims procedure contained in the settlement agreement.
3. The monetary limits on different heads of damages claimed by any member are:

(a) damages for non-pecuniary loss arising from post-traumatic stress disorder or similar psychological injury would not exceed $80,000 unless accompanied by evidence of other significant permanent personal injury - in which case the maximum amount of non-pecuniary damages would not exceed $100,000;
(b) damages for past and future loss of income would not exceed $50,000;
(c) damages for out-of-pocket expenses would not exceed $5000; and
(d) damages in respect of future-care expenses would not exceed $5000.

4. Family member claimants would be limited to their rights of recovery under the Family Law Act (Ontario) and the claims asserted by all such members that are derivative of the claims of a particular passenger would not exceed $5000.

4 The settlement provides for class members to make claims, initially, to class counsel who are to provide the claimants with what counsel consider to be a fair and reasonable assessment of the value. Members then would have the option of accepting the assessment or of requesting a review by an arbitrator to be appointed by the court. In the latter event, the arbitrator would determine the value of the claim. Distributions would be made accordingly.

5 The claims process and the powers and procedures to be followed by class counsel, the administrator, a management committee of counsel - that is to work with the administrator and to make the initial assessment of claims for loss of income - and the arbitrator are set out in some detail in the settlement agreement and in a schedule to it. Caps would be placed on the fees payable to the administrator and to members of the management committee, and on an hourly rate to be charged by the arbitrator. Class counsel would not charge fees for their services in assessing the value of claims in addition to the lump-sum amount that the court is asked to approve in connection with their services to date, and the capped amounts that may be charged by members of the management committee.

The Law

6 The role of the court, and the standards to be applied, in determining whether a settlement should be approved has been discussed in several decisions of this court including Dabbs v. Sun Life Assurance Co of Canada (1998), 40 O.R. (3d) 429 (G.D.), at page 444, affirmed (1998), 41 O.R. (3d) 97 (C.A.); Parsons v. Canadian Red Cross Society, [1999] O.J. No. 3572 (S.C.J.), at paras. 77-80; Fraser v. Falconbridge Ltd, [2002] O.J. No. 2383 (S.C.J.), at paras. 13-14; and Vitapharm v. F. Hoffman - La Roche Ltd, [2005] O.J. No. 1118 (S.C.J.), at paras. 110-118.

7 In Vitapharm, Cumming J. distilled the following principles from the earlier authorities:

(a) to approve a settlement, the court must find that it is fair, reasonable, and in the best interests of the class;
(b) the resolution of complex litigation through the compromise of claims is encouraged by the courts and favoured by public policy;
(c) there is a strong initial presumption of fairness when a proposed class settlement, which was negotiated at arm's-length by counsel for the class, is presented for court approval;
(d) to reject the terms of the settlement and require the litigation to continue, a court must conclude that the settlement does not fall within a zone of reasonableness;
(e) a court must be assured that the settlement secures appropriate consideration for the class in return for the surrender of litigation rights against the defendants. However, the court must balance the need to scrutinise the settlement against the recognition that there may be a number of possible outcomes within a zone or range of reasonableness. All settlements are the product of compromise and a process of give and take and settlements rarely give all parties exactly what they want. Fairness is not a standard of perfection. Reasonableness allows for a range of possible resolutions. A less than perfect settlement may be in the best interests of those affected by it when compared to the alternative of the risks and costs obligation.
(f) it is not the court's function to substitute its judgment for that of the parties or to attempt to renegotiate a proposed settlement. Nor is it the court's function to litigate the merits of the action or, on the other hand, to simply rubber-stamp a proposal;
(g) the burden of satisfying the court that a settlement should be approved is on the party seeking approval;
(h) in determining whether to approve a settlement, the court takes into account factors such as:

  (i) the likelihood of recovery or likelihood of success;
  (ii) the amount and nature of discovery, evidence or investigation;
  (iii) the proposed settlement terms and conditions;
  (iv) the recommendations and experience of counsel;
  (v) the future expense and likely duration of litigation;
  (vi) the recommendation of neutral parties, if any;
  (vii) the number of objectors and nature of objections;
  (viii) the presence of arm's-length bargaining and the absence of collusion;
  (ix) information conveying to the court the dynamics of, and the positions taken by the parties during, the negotiations; and
  (x) the degree and nature of communications by counsel and the representative plaintiff with class members during the litigation.

8 I believe the following statements of Winkler J. in Parsons and in Fraser are particularly apposite to the settlement under consideration in this case:

> It is well established that settlements need not achieve a standard of perfection. Indeed, in this litigation, crafting a perfect settlement would require an omniscience and wisdom to which neither this court nor the parties have ready recourse. The fact that a settlement is less than ideal for any particular class member is not a bar to approval for the class as a whole. (Parsons, at paragraph 79)

> Lengthy litigation would not be in the interests of the plaintiffs with its inherent risk and delay. The court must approve or reject the settlement in its entirety. It cannot substitute or alter it. ... The court does not, and cannot, seek perfection in every aspect, nor can it insist that every person be treated equally." (Fraser, at para. 13)

9 I note, however, that, unlike the position in the above cases, other than Fraser, class members who do not approve of the settlement have no right to opt out of the proceedings as the time in which this could be done has expired and, unlike what I think I was the position in Parsons, such a right is not conferred, or contemplated, by the settlement agreement. As notice of the terms of the settlement and of the approval hearing, and the right to object, that I considered to be reasonable and adequate was given to class members, and only two of them have informed the court that they have objections to the settlement, the potential significance of the inability to opt out at this stage might be considered to be limited to these objectors.

Discussion

10 Subject to the specific points made by, or on behalf of, the two objectors, I am satisfied that the factors set out above militate heavily in favour of the settlement. The proceedings were contentiously adversarial from the outset and the litigation risks for the plaintiffs were significant. Article 17 of the Warsaw Convention limits the liability of Air Transat to damages for bodily injury. Class counsel conducted a meticulous investigation and review of the likely claims of class members and concluded that virtually all of them will claim to have suffered post-traumatic stress disorder or other forms of mental or emotional harm. Although I found that, for the purposes of certification, the question whether such harm is to be considered to be bodily injury should be included in the common issues to be tried, counsel's research into the interpretation of Article 17 in this jurisdiction, and internationally, convinced them that there was a highly significant risk that the plaintiffs would not be successful on this issue at trial. After a lengthy examination of the evidence relating to the causes of the events on Flight 236, they concluded also that the case against Rolls-Royce was very weak and that Airbus had tenable defences that not only cast doubts on the prospects for establishing liability against it but made it inevitable that the litigation would be

protracted and expensive. I see no reason to question the competence, diligence or judgment of class counsel on the assessment of litigation risks or, indeed, in the manner in which the proceedings were conducted and the settlement negotiated at arm's-length between the parties.

11 When negotiating the terms of the settlement, class counsel had obtained completed questionnaires from all but a few class members to enable their claims to be reviewed with the assistance of a clinical psychologist in Vancouver and a physician in Portugal. This information, and medical reports that were provided by class members, were independently reviewed by each of the firms acting as co-counsel for the purpose of arriving at an estimate of the total value of the claims of class members. All the information was then provided to counsel for Air Transat to enable them to make their own assessment and, after the negotiations that ensued, the settlement amount of $7,650,000 was arrived at. In class counsel's submission, this amount, less counsels' fees, expenses and administration costs should be considered to be fair and reasonable - as well as substantial - compensation for the claims of class members. In their estimate - made on the basis of their assessment of the claims of class members that have already been completed - it should provide each class member with a recovery of at least 70 per cent of the amount likely to be assessed as the value of such member's claim. This is, of course, only an estimate and, to some extent, it is based on assumptions - about, for example, the amounts that will be claimed for loss of income and the number of claims that will be referred to the arbitrator - that might, or might not, turn out to be unduly optimistic.

12 I am satisfied that the caps proposed to be placed on the recovery of particular heads of damages have been carefully considered and determined principally for the purpose of achieving fairness for the class as a whole. It appears likely that the claims for mental and emotional harm will be made by virtually all of the class members and will be far more common than claims for significant physical injuries or loss of income. The cap of $80,000 for psychological harm ($100,000 if accompanied by significant permanent other injury) was chosen after a review of recent awards in this jurisdiction and elsewhere for post-traumatic stress disorder and similar illnesses.

13 I should note at this point that, although the terms of the proposed settlement might be construed as limiting claims for physical injuries to those that are accompanied by claims for psychological harm, I understand the intention to be that claims for physical injuries alone - if there are any - are to be compensated subject to a cap of $100,000.

14 The most problematic of the monetary limits placed on the recovery of particular types of damages is that relating to loss of income. In conducting their preliminary assessment of the value of the claims of class members, class counsel had less information about the potential loss of income than they had relating to the other heads of damages. However, to the extent that they were able to judge, there would be few claims for loss of income relative to those for psychological harm and only one passenger had provided documentation in support of an income loss in excess of the cap of $50,000. That member, I presume was Mr. Manuel Ribeiro, one of the two members of the

class who objected to the settlement. At the hearing, counsel indicated that their attention had been drawn to one other such potential claim that, on the basis of the information available to them, they considered to be of doubtful weight.

15 Through his counsel, Mr. Ribeiro successfully requested an adjournment of the original hearing date appointed for the motion for approval. At the continuation of the hearing, he was represented by Mr. Brian Brock Q.C. who, while disclaiming an intention to object to the settlement agreement in principle, requested that class counsel should be required to revisit it to address a number of issues that he raised in his written and oral submissions. In general terms, these issues relate to (a) whether class counsel gave sufficient significance to the fact that neither Airbus nor Rolls-Royce could claim the protection of Article 17 of the Warsaw Convention and the possibility that, as joint tortfeasors with Air Transat, damages that could not be recovered from it might be recoverable in full from either of them under section 1 of the Negligence Act R.S.O. 1990, c. 1 (as amended) even if only a very small degree of relative fault was apportioned to them; (b) whether the caps placed on non-pecuniary and pecuniary damages are fair and reasonable; and (c) whether the amount of legal fees requested by class counsel, and the manner in which they would be borne by class members, are fair and reasonable.

16 In an affidavit sworn for the purpose of the motion by Mr. Joe Fiorante - a partner of one of the firms acting as class counsel - he indicated that the arguments mentioned by Mr. Brock in connection with the first of the above issues had been considered by them and advanced in the negotiations for the settlement. I see no reason to reject this evidence or to conclude that the considerations to which Mr. Brock referred are sufficient to remove the terms of the settlement from the "zone of reasonableness".

17 Mr. Brock's submission that the caps were unfair was made in the context of his opinion that the value of Mr. Ribeiro's claims for non-pecuniary damages for post-traumatic stress disorder and loss of income will exceed the limits of $80,000 and $50,000 that would be imposed under the settlement.

18 Class counsel's response to the submission with respect to non-pecuniary damages was that already mentioned - namely, that, from their review of damages awarded in recent cases, other than those involving sexual assaults, the $80,000 cap was at the high end of the range and, notwithstanding the evidence that, since the events of Flight 236, Mr. Ribeiro has suffered, and will continue to suffer, psychological difficulties that will require psychiatric support and, probably, adjunct medication, they are not convinced that his claim would fall outside the likely range of damages. Based on their review of damages awards, I do not believe this conclusion is unreasonable although, as an experienced counsel in personal injury cases, Mr. Brock's opinion that a higher award could be obtained merits respect. The fairness and reasonableness of the settlement - including the cap of $80,000 for non-pecuniary damages - must, however, be judged in relation to the class as a whole and is not to be determined in respect of the claims of each member considered separately. The comments of Winkler J. that I have quoted from Parsons and Fraser are in point. On

the basis of the record before me, I believe I am justified in deferring to the opinion of class counsel that the cap of $80,000 on non-pecuniary damages would not operate unfairly in respect of Mr. Ribeiro, let alone in respect of the class as a whole.

19 Mr. Brock's criticism of the existence of the cap on the recovery for different heads of damages was not based exclusively on his opinion that his client's non-pecuniary damages would exceed $80,000. He made a similar objection with respect to the application of a $50,000 limit to Mr. Ribeiro's claim for loss of income. In his submission, such a limit would operate with obvious unfairness to Mr. Ribeiro in that his potential claim - calculated on the basis of a reduction in his income of $54,000 a year - would be approximately $670,000. Mr. Brock informed me that his client was prepared to testify that, since Flight 236, he has lost his motivation to conduct his landscaping business of 25 years, the number of his employees and his customers has diminished and the business is now confined to grass cutting. In support of his estimate of Mr. Ribeiro's loss of income, Mr. Brock provided unaudited income statements of the corporation that operates the business for 1998, 2000, 2002 and 2004. These show that, between April 2001 and April 2004, the gross income of the corporation declined by approximately $48,600. During that period, operating expenses fell by approximately $49,156. Of this amount, approximately $32,000 represented a reduction in wages paid to employees. Two employees were laid off in the period after Flight 236. No personal income tax returns, or other information, were provided that would indicate the wages, or other amounts, received by Mr. Ribeiro from the business in those years.

20 The income statements hardly support Mr. Brock's estimate that his client had suffered an income loss of approximately $54,000 a year and, on the basis of the limited information provided, class counsel concluded that they were unable to determine whether Mr. Ribeiro's total past and future income loss would exceed $50,000. I am in no better position. At the most, I can infer that Mr. Ribeiro claims to have suffered a loss of income that will exceed the cap by a significant amount. The question is whether the existence of this claim is, in itself, sufficient to justify a decision to withhold approval of the settlement. In Mr. Brock's submission it is, because it illustrates not merely that the cap is too low but, as well, the unfairness of placing any caps on heads of damages. As he stated in his brief or memorandum filed in the motion:

> If an individual plaintiff's claim falls within the cap it would appear that such person would make a full recovery. Those whose claims exceed the cap would recover only a proportionate share. No explanation is provided as to why those with serious claims should have their claims compromised in this way at the expense of those whose claims are not as serious.
>
> At a minimum one would expect that the recovery for each plaintiff would be on a pro-rata basis so that the percentage of recovery or loss of recovery would be equal.

21 Although I cannot amend the settlement, I do not think there is any doubt that I would have authority to refer this aspect of it back to the parties for their further consideration. After giving this matter careful thought, I am not disposed to do this.

22 As I have indicated, I do not intend to find that the total amount to be paid by Air Transat is less than that which would fall within a zone, or range, of reasonableness. The question that arises is how the net amount is to be distributed among class members if it is less than the total amount of their claims. The provision of caps is one method. Each of the possibilities suggested by Mr. Brock is another. In preferring the first method as being in the best interests of the class as a whole, counsel considered:

(a) the nature of the damages likely be claimed by the great majority of class members;
(b) the likely value of such claims;
(c) the possibility that the existence of one, or a few, very large claims for income losses would substantially deplete the amount available for distribution to the other class members; and
(d) the need to simplify the claims process to avoid delays and to reduce expenses.

23 In my judgment each of these considerations was relevant, and properly considered by class counsel. The last of them underlines the necessity to consider the provisions of the settlement as a whole and not to place the focus on particular aspects of it in isolation. The objective of simplifying the claims process is relected in the caps placed on certain types of administrative expenses, the involvement of class counsel without further remuneration and the attempt to devise a process that members will find satisfactory without having recourse to arbitration. Each of these factors presupposes the existence of - and is designed to assist in effecting - an expeditious and economic method of allocating and distributing the net settlement funds among class members.

24 In my judgment, I would not be justified in finding that the existence, or the amounts, of the caps is so evidently unfair and unreasonable that approval of the settlement should be withheld. Nor do I believe that anything of value is likely to be gained by referring the matter back for further consideration by the parties. I am satisfied that the questions have been carefully considered by them. The qualifications and experience of class counsel were reviewed at some length in the carriage motion early in the proceedings. Nothing has occurred since then to dilute my confidence in the competence and diligence with which they would perform their responsibilities under the CPA. Their ability to identify each of the members of the class has enabled them to conduct an unusually thorough investigation and preliminary assessment of the claims of virtually all of them. Their decision that the imposition of the caps would be in the interests of the class as a whole is one which is entitled to be given considerable weight. I do not believe there is sufficient reason for impeding, or delaying, the implementation of the settlement by asking them to reconsider that decision.

25 The third of Mr. Brock's objections concerns the amount of the fees of class counsel and the manner in which they would be borne by class members. The appropriate amount of the fees will be considered in an endorsement that will follow the release of these reasons after Mr. Brock has had an opportunity to review the time dockets of class counsel. The extent to which approval is given to the payment of class counsel's fees before the final distribution - and any consequential changes to the terms of the claims process - will also be considered in the endorsement to follow.

26 The proposal that the fees, as then approved, should come off the top - rather than to be apportioned among class members in accordance with the value of the amounts ultimately distributed to each of them - is, I believe, appropriate in the circumstances of this case where a gross settlement amount would be paid up front by Air Transat and the further services of class counsel - other than those of the management committee - are to be provided for no further charge. Counsel have acted for the class as a whole and have negotiated a settlement on that basis. I see nothing unfair, or unreasonable, in awarding approved fees out of the settlement proceeds without regard to the proportions in which the proceeds will be shared by class members.

27 The other objection I received was made by Mr. Giancarlo Cristiano in an attachment to an email message to class counsel. In the message Mr. Cristiano thanked counsel for their diligence in dealing with the file and, subject to certain questions, concerns and objections to the terms of the settlement, he expressed his pleasure that it had been reached. In the attached letter he objected that the settlement contained no finding of liability for negligence on the part of Air Transat and no award of punitive damages. He also complained of the level of fees payable to class counsel and the administrator.

28 The first two of these objections misapprehend both the nature of the settlement as a compromise between the parties and the powers of the court. The settlement contains no admission of liability, negligence, on the part of Air Transat because it has not agreed to make any such admission. This, of course, is very common in a settlement of litigation and I have no jurisdiction to insert such a provision in the settlement. All I could do would be to refuse approval of the settlement unless it contained an admission of liability. Mr. Cristiano did not ask me to do this and I would not consider such a decision to be in the best interests of class members. Similarly, and contrary to Mr. Cristiano's impression, I have no power to amend the settlement so as to insert a claim for punitive damages.

29 I will consider Mr. Cristiano's objection with respect to legal fees and expenses of administration in the endorsement that is to follow.

Disposition

30 Accordingly, pending the decision on the fees of class counsel, I will give provisional approval to the settlement as fair, reasonable and in the best interests of class members. This approval is subject to the terms of the endorsement that is to follow, any necessary adjustments to the times within which claims are to be made, any other acts to be performed and any other

amendments counsel may consider to be required as a result of the delay in the release of these reasons. These changes, counsel's submissions with respect to the fees of independent counsel, a few drafting issues and the terms of any formal order can be considered following the release of the endorsement.

M.C. CULLITY J.

Case Name:
Osmun v. Cadbury Adams Canada Inc.

Between
David Osmun and Metro (Windsor) Enterprises Inc.,
Plaintiffs, and
Cadbury Adams Canada Inc., The Hershey Company, Hershey Canada Inc., Nestlé Canada, Inc., Mars, Incorporated, Mars Canada Inc. and ITWAL Limited, Defendants
PROCEEDINGS UNDER the Class Proceedings Act, 1992.

[2010] O.J. No. 1877

2010 ONSC 2643

5 C.P.C. (7th) 341

188 A.C.W.S. (3d) 1001

2010 CarswellOnt 2813

Court File No. 08-CV-347263PD2

Ontario Superior Court of Justice

G.R. Strathy J.

Heard: April 21, 2010
Judgment: May 5, 2010.

(70 paras.)

Civil litigation -- Civil procedure -- Parties -- Class or representative actions -- Settlements -- Approval -- Motion by plaintiffs for approval of partial settlement allowed, subject to resolution of issues -- Plaintiffs in class alleged defendants conspired and fixed chocolate confectionary prices -- Proposed settlement had one chocolate manufacturer pay $5,700,000 and co-operate with plaintiffs; distributer assigned its claims to plaintiffs and co-operated -- Settlement fair and reasonable -- Settlement included Pierringer order barring non-settling defendants from seeking contribution from settling defendants -- While order not symmetrical, not prejudicial as it exposed

non-settling defendants to liability for all damages only if no right of contribution found -- However, wording unclear, so counsel to resolve precise form of order.

Motion by the plaintiffs for approval of a partial settlement with two defendants. The action had been certified for the purposes of settlement and notice had been delivered to the class members and no one had objected to the settlement or opted out. The plaintiffs alleged that the defendants, three chocolate manufacturers and a major distributor, had conspired to, and did, fix chocolate confectionary prices in Canada. Companion proceedings had been commenced across Canada. The plaintiffs had entered into separate settlements with one manufacturer and the distributor. The plaintiffs in additional proceedings had agreed to resolve their claims through the settlement and have their actions dismissed without costs. The chocolate manufacturer had agreed to pay $5,700,000 plus interest, co-operate with plaintiffs in their claims against the non-settling defendants and pay costs of notice in excess of $25,000. The distributor had agreed to assign any claims it had against non-settling defendants to the plaintiffs, to co-operate and to pay notice costs up to $25,000. In return, the settling defendants were to receive full releases. The proposed settlement also contained a Pierringer order preventing the non-settling defendants from seeking contribution from the settling defendants. The non-settling defendants objected to the proposed settlement on the basis of the Pierringer order, which they argued was not symmetrical.

HELD: Motion allowed, subject to resolution of issues. The settlement provided a direct financial benefit to the plaintiffs and a non-pecuniary benefit in the defendants' co-operation. The settlement was rational, given that the manufacturer was a major player, representing 50 per cent of profits and the distributor was essentially a co-operative with no substantial assets. The settlement was fair, reasonable and in the class members' best interests. The lack of symmetry complained of by the non-settling defendants was only problematic if it was prejudicial. The bar order provided that, if it was found that there was a right of contribution from the settling defendants, the plaintiffs would be limited to only damages that the non-settling defendants were proportionately liable for. However, if no right of contribution was found, the non-settling defendants could be exposed liability for all the damages. This was not prejudicial, since the non-settling defendants would have no right of indemnification in light of such a finding, regardless. The order did not immediately make the non-settling defendants liable; it simply left the determination of liability for another day. The order was not oppressive, as the non-settling defendants were also major players in the chocolate confection industry, and the settling defendants had receiving a substantial financial penalty in settling. However, the wording of the bar order was confusing and contained unclear phrases, such as "allocable to the conduct of". It would likely be more appropriate to use a standard bar order. Counsel was directed to resolve the precise form of the order and the settlement would be approved subject to this resolution.

Statutes, Regulations and Rules Cited:

Class Proceedings Act, S.O. 1992, c. 6, s. 8.1(1)(b), s. 12

Negligence Act, R.S.O. 1990, c. N.1, s. 1

Counsel:

Harvey T. Strosberg Q.C. and *Charles M. Wright*, for the plaintiffs.

Scott Maidment and *Adrienne Boudreau*, for the defendants The Hershey Company and Hershey Canada Inc.

Christopher P. Naudie and *Jean-Marc LeClerc,* for the defendant Cadbury Adams Canada Inc.

Catherine Beagan Flood and *Iris Antonios*, for the defendant Nestle Canada Inc.

Don Houston and *Randy Hughes*, for the defendant ITWAL Limited.

Sandra Forbes and *Davit D. Akman*, for the defendants Mars Incorporated and Mars Canada Inc.

REASONS FOR DECISION - SETTLEMENT APPROVAL

1 G.R. STRATHY J.:-- This is a motion by the plaintiffs for approval of a partial settlement with two of the defendants, Cadbury Adams Canada Inc. ("Cadbury") and ITWAL Limited ("ITWAL"). For the reasons that follow, I approve the settlement.

2 On December 30, 2009, I certified this action against Cadbury and ITWAL, on consent, for the purposes of settlement: *Osmun v. Cadbury Adams Canada Inc.*, [2009] O.J. No. 5566.

3 Notice of the certification and of this approval hearing has been given to the class. The deadline for written objections to the settlement agreement was April 11, 2010. There have been no objections delivered. The deadline to submit written requests to opt out of the action was April 13, 2010. No class members have opted out. The settlement is opposed by the defendants The Hershey Company and Hershey Canada Inc. (together, "Hershey"), primarily on the basis of the terms of the bar order. Other concerns, detailed below, have been expressed by counsel for Mars Incorporated and Mars Canada Inc. (together, "Mars").

Background

4 The plaintiffs allege that the defendants conspired to fix, and did fix, maintain or stabilize prices of chocolate confectionary products in Canada, and that ITWAL engaged in price maintenance. The defendants, other than ITWAL, are manufacturers of chocolate confectionary products. ITWAL operates a retail and wholesale foodservice distribution network, and was a major

purchaser and distributor of chocolate confectionary products during the relevant period.

5 Companion proceedings have been commenced across Canada. This action, together with the British Columbia action titled *Jacob Stuart Main v. Cadbury Schweppes plc, Cadbury Adams Canada Inc., Mars, Incorporated, Mars Canada Inc. formerly known as Effem Inc., The Hershey Company, Hershey Canada Inc., Nestlé S.A., Nestlé Canada Inc. and ITWAL Limited* (Vancouver Registry) (Court File No. S078807) and the Quebec action titled *Gaetan Roy v. Cadbury Adams Canada Inc., Hershey Canada Inc., Mars Canada Inc., Nestlé Canada Inc.* (File No. 200-06-000094-071), will be referred to as the "Main Proceedings."

The Settlement Agreements

6 The plaintiffs in the Main Proceedings have entered into separate settlements with Cadbury, dated October 14, 2009 and with ITWAL, dated October 6, 2009 (the "Settlement Agreements"). Cadbury and ITWAL will be referred to as the "Settling Defendants" or "SDs." The Settlement Agreements are subject to court approval in Ontario, British Columbia and Quebec. Cadbury retained the right to terminate its settlement agreement if a pre-defined "opt out threshold" was exceeded. If the settlement is not approved, or is terminated by one of the SDs, the action will proceed as a contested proceeding and the SDs will be entitled to contest certification. If the Settlement Agreements are approved, the Main Proceedings will continue against the remaining defendants (referred to as the "Non-Settling Defendants" or "NSDs").

7 Other proceedings have been commenced in Canada regarding alleged price-fixing in the chocolate confectionary industry (the "Additional Proceedings"). The plaintiffs in the Additional Proceedings have agreed to resolve their claims as part of the Settlement Agreements. The plaintiffs in the Additional Proceedings have agreed that, upon the Settlement Agreements becoming effective, the Additional Proceedings will be dismissed without costs and with prejudice against the SDs and other Releasees.

8 The Settlement Agreements are detailed and complex. Among other things, under the Cadbury settlement agreement:

a. Cadbury agreed to pay CDN $5,700,000 to the class. On November 5, 2009, Cadbury paid $5,795,695.60, being the settlement amount, plus pre-deposit interest at a rate of 2.5% per annum from February 5, 2009. Class counsel deposited these monies in an interest-bearing trust account. As of April 12, 2010, after payment of the costs of distributing the notice, the balance in the trust account was $5,655,431.33.

b. Cadbury is required to cooperate with the plaintiffs to aid them in pursuing their claims against the non-settling defendants. Cadbury is required to:

i. provide an evidentiary proffer;

ii. produce relevant documents, including transactional data and price announcements; and
iii. make available current and (if reasonably necessary) former directors, officers or employees of Cadbury for interviews with counsel in the Main Proceedings and/or experts retained by them, to provide testimony at trial, and/or affidavit evidence.

c. Cadbury will pay for the cost of the notice program in excess of $250,000. Counsel estimate that Cadbury will be required to pay at least $16,000 towards the cost of notice.
d. Cadbury has the right to terminate the Cadbury Settlement Agreement should opt outs exceed a certain threshold. As noted, there have been no opt outs.

9 The ITWAL settlement agreement provides:

a. ITWAL will assign to or for the benefit of the settlement class any claim it has against the NSDs in relation to the purchase, sale, pricing, discounting, marketing, or distribution of chocolate products (as defined). On the basis of this assignment, the plaintiffs will claim damages against the NSDs based on the sale of all chocolate products in Canada including those sold to and through ITWAL.
b. ITWAL will cooperate with the plaintiffs in pursuing the claims against the NSDs; and,

i. ITWAL will produce copies of relevant "Take Action Now" notices, transactional data, and other relevant documents that are reasonably necessary for the prosecution of the Main Proceedings;
ii. Glenn Stevens, the President and Chief Executive Officer of ITWAL will make himself available for an interview with counsel in the Main Proceedings and/or experts retained by them; and
iii. If reasonably necessary, ITWAL will make current directors, officers or employees of ITWAL available for testimony at trial and/or to provide affidavit evidence.

c. ITWAL will pay the costs of notice up to $25,000.

10 Upon the Settlement Agreements becoming effective, the Main Proceedings will be dismissed against Cadbury and ITWAL, without costs and with prejudice. Cadbury and ITWAL will receive full and final releases from the settlement class. If approved, these releases will form part of the

final settlement approval orders.

The bar order - *Pierringer* orders

11 The Settlement Agreements also contain a "bar order," an ingredient that is common in partial settlements of tort actions in both class actions and ordinary actions. A settling defendant in such an action would not want to settle with the plaintiff, while leaving itself exposed to claims for contribution and indemnity from its co-defendants. A defendant opposing the partial settlement could effectively act as a spoiler of the settlement by maintaining a claim for contribution and indemnity from the settling defendant. In order to promote the settlement of complex multi-party litigation, a device was necessary to permit the plaintiff to settle with one or more defendants who want to settle, while maintaining the action against one or more defendants who do not want to settle. The device that has been crafted, and approved by the courts, is referred to as a "*Pierringer* agreement."[1] Under such an agreement, the settling defendants agree to pay the plaintiff to pay a sum that is a compromise of their proportionate share of the plaintiff's claim. The court grants an order barring the non-settling defendants from seeking contribution and indemnity from the settling defendants. In return for this, the plaintiff is permitted to continue the action against the non-settling defendants, but only for the proportion of the damage for which they are directly responsible.

12 The authority to make an order giving effect to a *Pierringer* agreement, referred to as a "bar order," arises from s. 12 of the *C.P.A.*, which provides that "[T]he court, on the motion of a party or class member, may make any order it considers appropriate respecting the conduct of a class proceeding to ensure its fair and expeditious determination and, for the purpose, may impose such terms on the parties as it considers appropriate." As well, s. 13 provides that "[T]he court, on its own initiative or on the motion of a party or class member, may stay any proceeding related to the class proceeding before it, on such terms as it considers appropriate": see *Ontario New Home Warranty Program v. Chevron Chemical Co.* (1999), 46 O.R. (3d) 130, [1999] O.J. No. 2245 (S.C.J.) at paras. 40, 41, 75, 76. It is well-settled that the bar order cannot interfere with the substantive rights of the non-settling defendants: *Amoco Canada Petroleum Co. v. Propak Systems Ltd.*, above.

13 *Pierringer* agreements have been frequently approved by Canadian courts in class proceedings and individual actions: *Manitoba (Securities Commission) v. Crocus Investment Fund*, 2006 MBQB 276, 28 B.L.R. (4th) 228 (Q.B.) at paras. 29-30; *Amoco Canada Petroleum Co. v. Propak Systems Ltd.*, 2001 ABCA 110, 200 D.L.R. (4th) 667 at 673-675; *M.(J.) v. B.(W.)* (2004), 71 O.R. (3d) 171, [2004] O.J. No. 2312 (C.A.) at para. 31; *Hudson Bay Mining and Smelting Co.* v. *Fluor Daniel Wright* (1997), 12 C.P.C. (4th) 94, 120 Man. R. (2d) 214 (Q.B.) at para. 26.

14 There are a number of cases, including price-fixing cases, in which bar orders have been approved by this court: *Gariepy v. Shell Oil Co.* (2002), 26 C.P.C. (5th) 358, [2002] O.J. No. 4022 (S.C.J.); *Furlan v. Shell Oil Co.*, 2002 BCSC 1577, 25 C.P.C. (5th) 363; *Toronto Transit Commission v. Morganite Canada Co. (c.o.b. National Electrical Carbon Canada)* (2007), 47

C.P.C. (6th) 179, [2007] O.J. No. 448 (S.C.J.) at paras. 26, 36; *Randall Klein Inc. v. Nan Ya Plastics Corp. et al* (14 June 2005), London 41309CP, (Ont. S.C.J.)

15 In the partial settlement of a typical class action involving the negligence of several defendants, the following form of bar order has been used, to limit the plaintiff's claim against the non-settling defendants to their several liability:

> The Plaintiffs shall not make joint and several claims against the Non-Settling Defendants but shall restrict their claims to several claims against each of the Non-Settling Defendants such that the Plaintiffs shall be entitled to receive only those damages proven to have been caused by each of the Non-Settling Defendants.

See: *Gariepy v. Shell Oil Co.*, above, at para. 19; *Ontario New Home Warranty Program v. Chevron Chemical Co.*, above, at para. 36.

16 In this case, the proposed form of bar order in Ontario and British Columbia, as set out in the Cadbury settlement agreement, is in the following terms:

> (1) The Main Plaintiffs in the Ontario Proceeding and the BC Proceeding shall seek a bar order from the Ontario and BC Courts providing for the following:
>
> (a) all claims for contribution, indemnity or other claims over, whether asserted or unasserted or asserted in a representative capacity, inclusive of interest, taxes and costs, relating to the Released Claims (including, without limitation, the ITWAL Claims held and released by the Settlement Class as Released Claims), which were or could have been brought in the Main Proceedings or otherwise, by any Non-Settling Defendant or any other Person or party, against a Releasee, or by a Releasee against a Non-Settling Defendant, are barred, prohibited and enjoined in accordance with the terms of this section (unless such claim is made in respect of a claim by an Opt Out);
>
> (b) a Non-Settling Defendant may, upon motion on at least ten (10) days notice to counsel for the Settling Defendants, and not to be brought unless and until the action against the Non-Settling Defendants has been certified and all appeals or times to appeal have been exhausted, seek an order from one or more of the Ontario and BC Courts for the following:
>
> > (A) documentary discovery and an affidavit of documents in accordance with the relevant rules of civil procedure from Cadbury Adams Canada;
> >
> > (B) oral discovery of a representative of Cadbury Adams Canada, the transcript of which may be read in at trial;
> >
> > (C) leave to serve a request to admit on Cadbury Adams Canada in respect of factual matters; and/or

(D) the production of a representative of Cadbury Adams Canada to testify at trial, with such witness to be subject to cross-examination by counsel for the Non-Settling Defendants.

Cadbury Adams Canada retains all rights to oppose such motion(s).

(c) To the extent that that an order is granted pursuant to section 8.1(1)(b) and discovery is provided to a Non-Settling Defendant, a copy of all discovery provided, whether oral or documentary in nature, shall timely be provided by Cadbury Adams Canada to the Main Plaintiffs and Class Counsel; and

(d) a Non-Settling Defendant may effect service of the motion(s) referred to in section 8.1(1)(b) on Cadbury Adams Canada by service on counsel of record for Cadbury Adams Canada in the Main Proceedings.

(2) If the Courts ultimately determine there is a right of contribution and indemnity between co-conspirators, the Main Plaintiffs in the Ontario Proceeding and the BC Proceeding and the Settlement Class Members in the Ontario Proceeding and the BC Proceeding shall restrict their joint and several claims against the Non-Settling Defendants such that the Main Plaintiffs in the Ontario Proceeding and the BC Proceeding and the Settlement Class Members in the Ontario Proceeding and the BC Proceeding shall be entitled to claim and recover from the Non-Settling Defendants on a joint and several basis, only those damages, if any, arising from and allocable to the conduct of and/or sales by the Non-Settling Defendants. [emphasis added]

17 The terms of the proposed ITWAL bar order are substantially the same.

18 The reason for the underlined language, which is contentious, is that the law in Canada is uncertain about whether there is a right to contribution and indemnity between intentional tortfeasors, particularly where their conduct is alleged to be a criminal conspiracy: see *Blackwater v. Plint,* 2005 SCC 58, [2005] 3 S.C.R. 3 at para. 67.

19 For this reason, the plaintiffs in this case, like plaintiffs in other price-fixing cases, want to preserve their right to pursue the NSDs based on their joint liability for the plaintiffs damages, should it be determined that there is no right to contribution and indemnity between criminal co-conspirators. This is why para. 2 of the proposed bar order provides that "If the Courts ultimately determine there is a right of contribution and indemnity between co-conspirators ..." the plaintiffs will only be able to claim damages "arising from and allocable to the conduct of and/or sales" of the NSDs.

20 I will return to the subject of the proposed bar order later in these reasons.

The Position of the Defendants

Hershey's Position

21 Hershey objects to the settlement because it says that the terms of the bar order permit the plaintiffs to sue the NSDs for the profits wrongfully earned by the SDs while at the same time depriving the NSDs of their substantive right to seek apportionment, contribution and indemnity from those parties. It says that, unlike the typical "symmetrical" bar order in a *Pierringer* settlement, which releases the SDs but limits the plaintiff's claim against the NSDs to their own proportionate share of liability, the proposed settlement in this case is "asymmetrical". Hershey says that the settlement should not be approved because it deprives the NSDs of their substantive rights, allows Cadbury to retain unlawful profits while transferring liability for them to the NSDs, and it is generally unfair to them because it treats them differently from the SDs. I will discuss this objection in more detail below.

Mars' Position

22 Mars raises several issues with respect to the settlement. I will identify them here and will also set out the disposition of these issues, which is largely the result of agreement between counsel.

(1) The ITWAL Assignment

23 Mars raises questions about the validity of the assignment of ITWAL's claims to the plaintiffs. These questions include whether the assignment is champertous and whether there is any right to assign a claim that is associated with the assignor's own illegal behaviour: *Frederickson v. Insurance Corporation of British Columbia* (1985), 64 B.C.L.R. 301, 1986 CarswellBC 131, at paras. 26 and 36-37 (C.A.), aff'd [1988] 1 S.C.R. 1089, 1988 CarswellBC 697; *Canada Cement LaFarge Ltd. v. British Columbia Lightweight Aggregate Ltd.*, [1983] 1 S.C.R. 452, [1983] S.C.J. No. 33 at pp. 473, 475-479. Plaintiffs' counsel acknowledges that there may be some defences to the assignment and to ITWAL's underlying claims. The parties agree that these issues do not have to be resolved at this time. The NSDs are at liberty to raise these and other issues relating to the ITWAL assignment at any time in the future. I leave it to counsel to agree on and propose the terms of the order to give effect to this acknowledgment.

(2) The fate of the Additional Proceedings and other actions

24 Ms. Forbes on behalf of Mars expressed the concern that the proposed settlement approval orders contemplate that the Additional Proceedings will be dismissed against the SDs but will continue against the NSDs, without the benefit of a bar order, causing potential unfairness to the NSDs. She also notes that the Settlement Agreements provide that any person who falls within the settlement class, and has commenced another action, but has not opted out of the Main Proceedings, is deemed to have agreed to the dismissal of that other action as against the SDs. Mars submits that by not opting out, the class members are required to pursue any claims they have against the NSDs

in the Main Proceedings and not through other actions and there should be an order to this effect.

25 I was advised that counsel are continuing to discuss the resolution of these issues. I will therefore defer consideration pending counsel either proposing a solution or reaching an impasse.

(3) Cadbury Holdings Limited

26 Cadbury Holdings Limited ("Cadbury Holdings") is not a defendant in this action or in the Quebec action, but it is a defendant in the British Columbia action. For this reason, it is a signatory to the Cadbury settlement agreement. Mars submits that both Cadbury and Cadbury Holdings should be identified as an SD in the settlement approval order and the NSDs should have the right to bring a motion for discovery of both Cadbury entities. Counsel for Cadbury acknowledges that such an order is appropriate. I agree.

(4) The Bar Order

27 Ms. Forbes made other submissions with respect to the bar order, the details of which I will discuss below.

The Plaintiffs' Response

28 Mr. Strosberg on behalf of the plaintiffs points to the enormous value of obtaining the cooperation of a "whistleblower" in conspiracy class actions. Leniency is part of the Competition Bureau's official policy (see Canadian Competition Bureau's Immunity Program under the *Competition Act* found online at http://competitionbureau.gc.ca/eic/site/cb-bc.nsf /eng/ 02480. html). There is nothing wrong in the civil context, he submits, with giving the party who breaks the "icejam" a better deal on settlement than the other defendants who want to defend the case to the hilt. This is particularly the case when the "icebreaker" cooperates with the plaintiff as Cadbury and ITWAL have promised to do here. I accept this general proposition.

29 Mr. Strosberg also submits that the simple answer to Hershey's objections concerning the bar order is that its claim for contribution and indemnity is statute barred because it has not been asserted and the limitation period has expired. I do not accept this submission. First, in order to come to this determination it would be necessary to make factual inquiries and there is no record before me that would permit me to do so. Second, there are limitation periods in other jurisdictions that appear to be unexpired.

30 The balance of Mr. Strosberg's submissions have to do with the approval of the settlement and the bar order.

The Test for settlement approval

31 The plaintiffs refer to *Nunes v. Air Transat A.T. Inc.,* [2005] O.J. No. 2527, 20 C.P.C. (6th) 93 (S.C.J.) at para. 7, in which Cullity J. set out a useful summary of the principles to be applied on a

motion for settlement approval:

(a) to approve a settlement, the court must find that it is fair, reasonable, and in the best interests of the class;
(b) the resolution of complex litigation through the compromise of claims is encouraged by the courts and favoured by public policy;
(c) there is a strong initial presumption of fairness when a proposed settlement, which was negotiated at arm's-length by counsel for the class, is presented for court approval;
(d) to reject the terms of a settlement and require the litigation to continue, a court must conclude that the settlement does not fall within a zone of reasonableness;
(e) a court must be assured that the settlement secures appropriate consideration for the class in return for the surrender of litigation rights against the defendants. However, the court must balance the need to scrutinize the settlement against the recognition that there may be a number of possible outcomes within a zone or range of reasonableness. All settlements are the product of compromise and a process of give and take. Settlements rarely give all parties exactly what they want. Fairness is not a standard of perfection. Reasonableness allows for a range of possible resolutions. A less than perfect settlement may be in the best interests of those affected by it when considered in light of the risks and obligations associated with continued litigation;
(f) it is not the court's function to substitute its judgment for that of the parties or to attempt to renegotiate a proposed settlement. Nor is it the court's function to litigate the merits of the action or simply rubber-stamp a proposed settlement; and
(g) the burden of satisfying the court that a settlement should be approved is on the party seeking approval.

32 In addition, the plaintiffs refer to the often-cited decisions of Sharpe J., as he then was, in *Dabbs* v. *Sun Life, Assurance Company of Canada*, [1998] O.J. No. 1598 (Gen. Div.) at para. 13; and (1998), 40 O.R. (3d) 429, [1998] O.J. No. 2811 (Gen. Div.) at pp. 439-444; aff'd (1998), 41 O.R. (3d) 97, 165 D.L.R. (4th) 482 (C.A.); leave to appeal to denied [1998] S.C.C.A. No. 372. In the first of the above judgments, Sharpe J. set out a list of factors that are useful in assessing the reasonableness of a proposed settlement. The factors are as follows:

(a) the presence of arm's-length bargaining and the absence of collusion;
(b) the proposed settlement terms and conditions;
(c) the number of objectors and nature of objections;
(d) the amount and nature of discovery, evidence or investigation;
(e) the likelihood of recovery or likelihood of success;
(f) the recommendations and experience of counsel;
(g) the future expense and likely duration of litigation;

(h) information conveying to the court the dynamics of, and the positions taken by the parties during, the negotiations;
(i) the recommendation of neutral parties, if any; and
(j) the degree and nature of communications by counsel and the representative plaintiff with class members during the litigation.

33 It is worth noting, as Sharpe J. himself did, that these factors must not be applied in a mechanical way. They are no more than a guide to the process. It is not necessary for all factors to be present, nor is it necessary that the factors be given equal weight. Some factors may be given greater significance, while others might be disregarded, depending on the circumstances of the case.

34 The court cannot modify the terms of a proposed settlement. The court can only approve or reject the settlement. In deciding whether to reject a settlement, the court should consider whether doing so could de-rail the settlement negotiations. There is no obligation on parties to resume discussions and it may be that the parties have reached their limits in negotiations and will backtrack from their positions or abandon the effort. This result would be contrary to the widely-held view that the resolution of complex litigation through settlement is encouraged by the courts and favoured by public policy: *Semple* v. *Canada (Attorney General)*, 2006 MBQB 285, 40 C.P.C. (6th) 314 at para. 26; *Ontario New Home Warranty Program v. Chevron Chemical Co.,* at paras. 69, 70.

35 I will examine below what I regard as the most important factors supporting approval of the settlement in this case.

The settlement terms and conditions are favourable to the class

36 I have set out above the key terms of the settlement. In this case, the court is dealing with a partial settlement that resolves the plaintiffs' claims against two of the defendants but leaves three remaining defendants in the action. There are direct financial benefits from the settlement, in that there will be a significant monetary recovery for the class. In addition, securing the cooperation of Cadbury and ITWAL is an important and immeasurable non-pecuniary benefit. This would be significant in any case, but in a conspiracy action, where the allegation is that the defendants share a dark secret, obtaining the cooperation of two of the alleged conspirators to assist the plaintiff in pursuing the alleged co-conspirators is of inestimable value. Cooperation of non-settling defendants has been considered to be an important factor in other cases: *Crosslink Technology, Inc. v. BASF Canada et al,* (November 30, 2007), London, 50305CP (Ont. S.C.J.) at p. 8, paras. 22, 23 (unreported); *Nutech Brands Inc. et al. v. Air Canada et al.*, [2009] O.J. No. 709 (19 February 2009), London, 50389CP (S.C.J.) at paras. 29-30, 36-37.

37 Tactically, the settlement is beneficial to the Class, because it reduces the size of the opposition, simplifies the litigation, and drives a potential wedge between the alleged conspirators.

38 There is a rational and justifiable basis for the *quantum* of the plaintiffs' settlement with

Cadbury. It represents approximately 50% of the profits flowing to Cadbury as a result of an average 5.2% increase in its prices on October 31, 2005 and continuing until September, 2007. It represents a reasonable compromise of the plaintiffs' financial claim to reflect litigation risks, other factors contributing to the price increase and the benefit of Cadbury's cooperation in the ongoing action.

39 ITWAL is a corporation, but it is essentially a cooperative. Its members hold shares in the corporation and any profits are paid out annually. Counsel agree that ITWAL does not have significant assets. It is unlikely that a large judgment against it could be satisfied.

40 The assignment of ITWAL's claims represents a significant potential value to the settlement class. It is an integral part of the ITWAL settlement agreement. Moreover, the Cadbury settlement agreement is subject to express conditions that require the completion of this assignment under the ITWAL settlement agreement prior to the effective date of the Cadbury settlement. Since ITWAL was a major purchaser of chocolate products during the relevant period, Cadbury required a release of ITWAL's claims as a part of the settlement.

41 While ITWAL's financial contribution to the settlement is very modest, the benefit of its cooperation is important.

The settlement is the result of a real negotiating process

42 I am satisfied that the settlement in this case was the process of a real and extensive bargaining process between parties represented by experienced counsel and that the settlement achieved is a real one.

The partial settlement reduces risk of loss and increases prospects of success

43 Litigation is all about risks. Every party wants to reduce its downside and increase its upside. This partial settlement gives the plaintiffs the best of both worlds. It compromises a difficult, and by no means certain, claim against the SDs in exchange for real money and increased prospects of success against the NSDs. It may well act as an incentive to some of the NSDs to settle the claim, either individually or as a group.

There has been no objection to the settlement

44 It is significant that there has not been a single objection or opt-out. No class member opposes the settlement. There has been extensive advertising of the settlement and members of the class include large and sophisticated corporations.

The settlement comes with the recommendations of experienced class counsel

45 When class counsel presents a negotiated settlement to the court for approval, it is almost invariable that it will bear counsel's seal of approval. One might ask, therefore, why the

recommendation of class counsel should be a factor. The answer is threefold. First, counsel has a duty to the class as a whole and not just to the representative plaintiffs. Counsel has to keep this responsibility in mind in recommending a settlement. Second, having been appointed by the court, counsel owes a duty to the court, including a duty to identify any limitations of the settlement. That duty has been fulfilled in this case. Third, counsel is uniquely situated to assess the risks and benefits of the litigation and the advantages of any settlement. In the case of a partial settlement, counsel is best situated to make the kind of judgment call involved in assessing the benefits obtained in exchange for releasing a party from the litigation. Class counsel in this case have extensive experience in class proceedings, including considerable experience in price-fixing cases. Their recommendation carries considerable weight.

46 I am entirely satisfied that from the perspective of the settlement class, the settlement is fair, reasonable and in their best interests. The remaining question, however, is whether the proposed bar order is fair to the NSDs. It will not be fair if it affects their substantive rights.

Is the bar order unfair to the NSDs?

47 There is precedent for a bar order of the kind proposed here in a price-fixing conspiracy case. A similar order was granted by Rady J. in *Irving Paper Limited et al v. Autofina Chemicals Inc. et al*, (September 24, 2008), London, 47026 (S.C.J.). The order was the result of a partial settlement. It appears that in that case the NSDs took no position with respect to the form of order.

48 Rady J. also made a similar form of order in *Crosslink Technology, Inc.* v. *BASF Canada,* (November 30, 2007), File 50305CP (S.C.J.). In that case, the NSDs opposed the proposed order, arguing that it was unfair that the plaintiff did not agree absolutely to limit its claims against the NSDs to their proportionate liability, and instead put the onus on the NSDs to obtain a court ruling that there was a right to contribution and indemnity. The NSDs also objected to the use of the term "allocable to the sales or conduct" of the NSDs, which is similar to the language used in the proposed bar order in this case. They contended that this language was an attempt to transfer to the NSDs responsibility for profits made from sales by the SDs, because the conduct of the NSDs in the alleged conspiracy contributed to those profits. The plaintiffs argued that there may well be no right of contribution between criminal co-conspirators engaged in anti-competitive behaviour. They said that in view of the uncertain state of Canadian law on the subject, the bar order should not compromise the plaintiff's claims against the NSDs any more than was necessary to fairly protect them. The proposed bar order left open the possibility that a court could ultimately determine that a right to contribution and indemnity existed, in which case the plaintiffs' claim would be limited to the NSDs' proportionate share. On the other hand, if there was no such right, the plaintiffs would be free to pursue the NSDs for the full extent of the damages caused by the conspiracy.

49 Rady J. concluded, at paras. 47 - 50, that the proposed bar order was appropriate:

> I begin by observing that the litigants agree that it is not settled in Canada whether a right to contribution and indemnity exists between co-conspirators in a

> price fixing case. It is not necessary for the court to make that determination at this junction.
>
> It seems to me that the proposed wording ... is appropriate in the circumstances of this case for several reasons. First, this is a case involving allegations of what may be criminal or quasi-criminal conduct as well as allegations of tortuous behaviour, including conspiracy and intentional interference with economic relations. The law respecting the rights of co-defendants to claim contribution and indemnity in a case such as this is not clear. As a result, it strikes me as inappropriate to craft a bar order based on an assumption that the right exists. The Non Settling Defendants are not prejudiced because their potential rights are not being limited or abrogated. They are simply held in abeyance pending further determination of the court.
>
> With respect to the inclusion of the reference to the conduct of the Non Settling Defendants, it seems to me that the frailty of that argument is that it presumes that the basis of allocating liability is based on share of sales. However, there are other methods for allocating liability, one based on profits, for example. The basis for allocating liability is an open question, and as with the entitlement to contribution and indemnity, remains to be determined by the court.
>
> As a result, I cannot give effect to the objections of the Non Settling Defendants. I am unable to conclude that their ability to fully and fairly defend their position is impaired by the proposed order.

50 I was also referred to an order made by Leitch R.S.J. in a partial settlement in *Nutech Brands Inc. v. Air Canada et al.* (Court File No. 50389CP) February 18, 2009. The order defined "Proportionate Liability" as follows:

> 'Proportionate Liability' means that proportion of any judgment that, had they not settled, a court or other arbiter would have apportioned to the Settling Defendants and Released Parties, whether pursuant to the *pro rata,* proportionate fault, *pro tanto,* or another method.

51 The order then provided, in paragraph 13:

> (a) Subject to paragraph (b) of this paragraph [which deals with claims in other jurisdictions and is not relevant] all claims for contribution and indemnity or other claims over, whether asserted or unasserted or asserted in a representative capacity, inclusive of interest, taxes and costs, relating to the Released Claims,

which were or could have been brought in the Action by any Non-Settling Defendant or any other Person or Party against a Released Party, or by a Released Party against a Non-Settling defendant or any other Person or Party, are barred, prohibited and enjoined in accordance with the terms of this paragraph (unless such claim is made in respect of a claim by an Opt Out);

52 Paragraphs 14 and 15 of the order then provided:

14. THIS COURT ORDERS that if, in the absence of paragraph 13 hereof, the Non-Settling Defendants would have the right to make claims for contribution and indemnity or other claims over, whether in equity or in law, by statute or otherwise, from or against the Released Parties:

(a) the Plaintiffs and the Settlement Class Members shall not claim or be entitled to recover from the Non-Settling Defendants that portion of any damages, costs or interest awarded in respect of any claim(s) on which judgment is entered that corresponds to the Proportionate Liability of the Released Parties proven at trial or otherwise;

(b) for greater certainty, the Plaintiffs and the Settlement Class Members shall limit their claims against the Non-Settling Defendants to, and shall be entitled to recover from the Non-Settling Defendants, only those claims for damages, costs and interest attributable to the Non-Settling Defendants' several liability to the Plaintiffs and the Settlement Class Members, if any;

(c) this Court shall have full authority to determine the Proportionate Liability at the trial or other disposition of this Action, whether or not the Released Parties remain in this action or appear at the trial or other disposition, and the Proportionate Liability shall be determined as if the Released Parties are parties to this Action for that purpose and any such finding by this Court in respect of the Proportionate Liability shall only apply in this Action and shall not be binding upon the Released Parties in any other proceedings.

15. THIS COURT ORDERS that if, in the absence of paragraph 13 hereof, the Non-Settling Defendants would not have the right to make claims for contribution and indemnity or other claims over, whether in equity or in law, by statute or otherwise, from or against the Released Parties, then nothing in this Order is intended to or shall limit, restrict or affect any arguments which the Non-Settling Defendants may make regarding the reduction of any judgment against them in the Action.

53 I have reproduced the terms of this order in detail because it appears to have been the product of negotiation between sophisticated parties, represented by very experienced counsel in class proceedings, some of whom are involved in this action. There is much to commend these terms and I shall return to them later in these reasons.

54 I have set out above the substance of Hershey's opposition to the bar order in this case. Hershey says that the order is unfair because there is no symmetry between what each party gives up. The NSDs lose the right to claim contribution and indemnity from the SDs, but in return the plaintiffs do not give up the right to claim from the NSDs the profits wrongfully earned by the SDs. Mr. Maidment submits that, under a proper *Pierringer* order, when the SDs are released from the action they take their liability with them and it cannot be transferred to the shoulders of the NSDs.

55 Mr. Maidment submits that, even if this form of order is permitted by the *C.P.A.*, it should not be granted because it does not promote behaviour modification. He argues that it permits the SDs to keep the fruits of their unlawful activity by entering into a speedy settlement with the plaintiffs and passing the burden of their conduct onto the shoulders of their competitors. He submits that, faced with the potential of massive joint and several liability, with no right of recourse against the SDs, there is enormous and unfair pressure on the NSDs to settle. A bit player, who has small market share, made small profits and whose participation in the acts in question was borderline, will be under enormous pressure to settle in the face of a potentially devastating award of 100% of the damages.

56 Mr. Maidment's submission is that the *C.P.A.* does not permit the form of bar order proposed in this case because it interferes with the substantive rights of the NSDs. He relies on *Lau v. Bayview Landmark Inc.* (2006), 34 C.P.C. (6th) 138, [2006] O.J. No. 600 (S.C.J.). That proposed class action arose from a failed real estate investment scheme. It was alleged that a real estate firm (the settling defendants) was jointly and severally liable with a law firm (the non-settling defendants) for breach of trust, breach of fiduciary duty and negligence for releasing investment funds to some of the co-defendants. The terms of the proposed settlement did not contain a bar order, barring claims against the non-settling defendants for their joint and several liability. The plaintiffs, who were propounding the settlement, took the position that a bar order was not required because the non-settling defendants had not made cross-claims against the settling defendants and, in the absence of such claims, there was no reason to limit the claims of the plaintiffs to the several liability of the non-settling defendants.

57 C.L. Campbell J. refused to approve the settlement in the form sought by the plaintiffs - i.e., without a bar order. He noted that the defendants might be liable as concurrent tortfeasors rather than joint tortfeasors, but in any event he concluded that the failure to include a bar order would prejudice the non-settling defendants' rights. With the settling defendants out of the action, the non-settling defendants would be deprived of the right to shift responsibility for the plaintiffs' loss to the settling defendants and to distinguish their conduct from the conduct of the settling defendants. They would be deprived of the ability to assert crossclaims in the future, which they might have deferred doing for tactical reasons. He concluded that the absence of a bar order would cause unfairness at paras. 18-21:

> I have concluded that the non-settling Defendants cannot procedurally or substantively be put back in the position that they would have been if there were

> no settlement, for the purposes of fully advancing their defence without any opportunities to amend pleadings and cross-claim, neither of which are before me or permitted in the agreement between the settling parties.
>
> I accept the general premise of settlement of actions in part where settlement in whole may not be possible. Partial settlement can well result in shortened, less expensive trials and may well be the precursor to a full settlement. In this situation, the settlement sought by the Plaintiffs would deprive the non-settling Defendants of substantive rights.
>
> The Court of Appeal for Ontario has recognized the principle of encouraging settlement in *M. (J.) v. B. (W.),* [2004] O.J. No. 2312. But in approving what has come to be known as a "Pierringer" agreement, the Court adopted the proposition that such partial settlements must achieve "the goal of the proportionate share agreement [being] to limit the liability of the non-settling party to its several liability." ..
>
> The Court of Appeal in *M. (J.)* confirmed that while apportionment of liability may be made at trial even thought there is an absent defendant through settlement, that process must not create an unfairness. In my view, the settlement here as proposed without a bar order would create an unfairness.

58 I respectfully agree with the conclusion of Campbell J. on the issues before him. I do not, however, consider that this case is authority for the proposition that it was lack of "symmetry" that made the settlement objectionable - it was the fact that the settlement prejudiced the NSDs' substantive rights. It left them jointly liable for all the plaintiffs' damages without the corresponding right of contribution from the SDs. In this case, if it is ultimately found that there is a right of contribution from the SDs, the plaintiffs' damages will be confined to the NSDs' proportionate share. If it is found that, because of the nature of their conduct, there is no right of contribution, the NSDs may be exposed to the plaintiffs' entire damages. In the latter instance, there is no prejudice to their substantive rights because it will have been determined that the NSDs have no right to contribution and indemnity and the plaintiffs have the right to sue whomsoever they choose.

59 Mr. Maidment submits that the decision of Rady J. in *Crosslink Technology, Inc.* v. *BASF Canada*, above, is wrong because the uncertainty in the state of the law should not be a reason for depriving the NSDs of their substantive rights. He refers to *Hunt. v. Carey*, [1990] 2 S.C.R. 959, [1990] S.C.J. No. 93 at para. 33 in support of the proposition that a party should not be "driven from the judgment seat" because of the uncertain state of the law or the novelty of the issue before the court. He says that the language of s. 1 of the *Negligence Act*, R.S.O. 1990, c. N.1, permitting

apportionment, contribution and indemnity between defendants "in the degree in which they are respectively found to be at fault or negligent" means that there is a right to contribution in the case of intentional faults: *Bell Canada v. COPE (Sarnia)* (1980), 31 O.R. (2d) 571, [1980] O.J. No. 3882 (C.A.), affg. (1980), 11 C.C.L.T. 170, [1980] O.J. No. 69 (H.C.J.); *Bains* v. *Hofs* (1992), 76 B.C.L.R. (2d) 98, [1992] B.C.J. No. 2709, at para. 26 (S.C.); *Brown v. Cole* (1995), 43 C.P.C. (3d) 111, 14 B.C.L.R. (3d) 53 at para. 20 (C.A.); see also, *Rabideau v. Maddocks* (1992), 12 O.R. (3d) 83, [1992] O.J. No. 2850 (Gen. Div.).

60 It of some interest that the United States Supreme Court has held that there is no right to contribution between co-conspirators under U.S. antitrust legislation: *Texas Industries v. Radcliff Materials,* 451 U.S. 630, 646 (1981). I also note a decision of Senior Master Rodgers in *Standard International Corporation et. al. v. Morgan et al.,* [1967] 1 O.R. 328, [1967] O.J. No. 932 (H.C.J.) at para. 12, in which it was held, relying on *Hollebone v. Barnard*, [1954] O.R. 236, [1954] 2 D.L.R. 278, that the words "fault or negligence" in the *Negligence Act* were synonymous and simply mean "negligence" and that there is no right of contribution between co-conspirators.

61 The decision in *Hollebone v. Barnard,* was not followed by Linden J. in *Bell Canada v. Cope (Sarnia),* a decision that was affirmed by the Court of Appeal. That case was one of both trespass and negligence. The Court of Appeal adopted the conclusion of Linden J. that:

> Fault and negligence, as these words are used in the statute, are not the same thing. Fault certainly includes negligence, but it is much broader than that. Fault incorporates all intentional wrongdoing, as well as other types of substandard conduct. In this case, both intentional and negligent wrongdoing were satisfactorily proved.

62 In *Blackwater v. Plint,* above, the Supreme Court of Canada expressly left the issue open for another day, at para. 67:

> It remains an open question whether the term "fault" in the *Negligence Act* includes vicarious liability. Fault has been held not to include intentional torts and torts other than negligence: e.g., *Chernesky v. Armadale Publishers Ltd.*, [1974] 6 W.W.R. 162 (Sask C.A.); *Funnell v. C.P.R.*, [1964] 2 O.R. 325 (H.C.). Other cases hold the contrary: *Bell Canada v. Cope (Sarnia) Ltd.* (1980), 11 C.C.L.T. 170 (Ont. H.C.); *Gerling Global General Insurance Co. v. Siskind, Cromarty, Ivey & Dowler* (2004), 12 C.C.L.I. (4th) 278 (Ont. Sup. Ct. J.). However, it is not necessary to resolve this dispute. If vicarious liability amounts to "fault" under the *Negligence Act*, the trial judge's conclusion that Canada was 75% at fault would amount to a finding that fault could be apportioned, with the result that s. 1(2) would not apply to impose an equal allocation. On the other hand, if vicarious liability is not "fault" under the Act, then the Act does not apply. In this case, liability may be assigned at common law, with the same

result.

63 Mr. Maidment has pointed to some interesting commentaries on the social and economic desirability of the fair apportionment of responsibility for conspiracies in restraint of trade and allowing contribution between co-conspirators: Robert P. Taylor, *"Contribution: Searching for Fairness in a Procedural Thicket"* (1980) 49 Antitrust L. J. 1029 at 1031; Council of the Section of Antitrust Law, *"Report of the Section on Proposed Amendment of the Clayton Act to Permit Contribution in Damage Actions"* (1980) 49 Antitrust L. J. 291 at 293. As fascinating as these issues are, the parties agree that I cannot and need not resolve them at this time.

64 Mr. Maidment submits, however, that the effect of postponing the determination of this issue is to make his clients "immediately and presumptively liable" for the overcharges of ITWAL and Cadbury. As he puts it in his factum:

> As a practical matter, the complete release of the SDs means that the SDs' liability is *immediately* and presumptively transferred to the NSDs. Moreover, the NSDs' substantive right to apportionment and contribution is *immediately* and presumptively abrogated and replaced by a vague proviso that has been specially formulated by the plaintiffs and has never been the subject of any proper judicial interpretation or application in any trial.

65 In my view, this overstates the effect of the proposed order. The order does not transfer liability, presumptively or otherwise. It simply leaves that determination for another day. While it may leave the NSDs in some uncertainty concerning their rights of indemnity, that uncertainty existed from the commencement of this litigation in view of the unsettled state of the law.

66 Finally, as I have noted, Mr. Maidment submits that if there is jurisdiction to make the order, it should not be granted because it does not promote behaviour modification and it is unfair to his clients because it puts them under extreme pressure to settle the case. On the former point, he says that permitting this type of settlement will give an incentive to the most culpable conspirator to settle the case and to shift its share of the responsibility to the less culpable. The court's approval of the settlement would create an environment in which the parties whose behaviour is most in need of modification are rewarded for their wrongdoing. On the latter point, he says that the settlement is not fair and reasonable when viewed from the perspective of the NSDs because it will place pressure on innocent defendants to settle the case to avoid a crushing liability - see Robert P. Taylor, *"Contribution: Searching for Fairness in a Procedural Thicket"*, above at 1033; Joseph Angland, *"Joint and Several Liability, Contribution, and Claim Reduction"* (2008) New Directions in Antitrust Law and Policy at 2372, 2380-2382.

67 Whatever the force that Mr. Maidment's submissions might have in another case, on the facts of this case they are not persuasive. First, I am satisfied that the settlement with Cadbury results in a substantial financial penalty that is rationally related to the benefits Cadbury received from the price increases at issue. That, coupled with the promise of cooperation and the publicity attached to the

settlement, accomplishes the behaviour modification goals of class proceedings. This is not a case in which the defendant has paid a pittance for the release it has obtained. Second, the NSDs are very substantial manufacturers of chocolate products, nationally and internationally, with large shares in a market they obviously dominate. They are not "bit players" who are likely to be intimidated into an oppressive settlement.

68 I do have a concern with respect to the language of the proposed bar order that provides that if the courts determine that there is a right of contribution and indemnity the plaintiffs will be entitled to recover from the NSDs "on a joint and several basis, only those damages, if any, arising from and allocable to the conduct of and/or sales by the Non-Settling Defendants." My concern arises for two reasons. First, I am not sure what "allocable to the conduct" means. Does it mean the same as "the degree in which they are respectively found to be at fault" as used in s. 1 of the *Negligence Act* and, if so, why not simply say so? Second, by referring to "allocable to the ... sales" of the NSDs, it appears to confuse measure of damages with degree of responsibility for damages. I think the problem arises, in part, because there is no clear agreement on the measure of the individual liability of a co-conspirator. It might be more appropriate, for example, to simply use the language of the standard bar order, such as "the damage proven to have been caused by the NSDs."

69 I mentioned earlier the terms of the bar order in *Nutech Brands Inc. v. Air Canada,* proposed by Ms. Forbes. It seems to me that an order in that form would remove some of the concerns I have expressed about the bar order currently proposed. As the issue was not fully canvassed on the hearing, I would suggest that counsel discuss the precise form of the order and attempt to resolve the question. I have set aside dates for a continuation of the hearing, and will hear further submissions on the issue at that time, if necessary. The parties may make written submissions prior to the hearing, if they wish to do so.

Conclusion

70 Subject to the resolution of the issues identified in these reasons, I am prepared to approve the Cadbury settlement and the ITWAL settlement. A case conference should be arranged, as soon as possible, to discuss the procedure for the resolution of any outstanding issues and to settle the terms of the order.

G.R. STRATHY J.

cp/e/qllxr/qljxr/qlcas/qlhcs

1 After *Pierringer v. Hoger,* 124 N.W. 2d 106 (Wis. S.C. 1963).

Indexed as:

Parsons v. Canadian Red Cross Society

PROCEEDING UNDER the Class Proceedings Act, 1992
Between
Dianna Louise Parsons, Michael Herbert Cruickshanks, David Tull, Martin Henry Griffen, Anna Kardish, Elsie Kotyk, Executrix of the Estate of Harry Kotyk, deceased and Elsie Kotyk, personally, plaintiffs, and
The Canadian Red Cross Society, Her Majesty the Queen in Right of Ontario and the Attorney General of Canada, defendants
And between
James Kreppner, Barry Isaac, Norman Landry, as Executor of the Estate of the late Serge Landry, Peter Felsing, Donald Milligan, Allan Gruhlke, Jim Love and Pauline Fournier, as Executrix of the Estate of the late Pierre Fournier, plaintiffs, and
The Canadian Red Cross Society, the Attorney General of Canada and Her Majesty the Queen in Right of Ontario, defendants

[1999] O.J. No. 3572

103 O.T.C. 161

40 C.P.C. (4th) 151

91 A.C.W.S. (3d) 351

1999 CarswellOnt 2932

Court File Nos. 98-CV-141369 and 98-CV-146405

Ontario Superior Court of Justice

Winkler J.

Heard: August 19-21, 1999.
Judgment: September 22, 1999.

(133 paras.)

Practice -- Class proceedings -- Settlements -- Court approval.

Motion by various parties for approval of a settlement in two companion class proceedings commenced under the Class Proceedings Act. One plaintiff class was persons who were infected with hepatitis C from blood transfusions between January 1, 1986 and July 1, 1990. The other plaintiff class was persons infected with hepatitis C from the taking of blood or blood products during the same time period. In both proceedings, there was also a family class consisting of family members of persons in the other main classes. The defendants in the two actions were the Canadian Red Cross Society, the Queen in Right of Ontario, and the Attorney General of Canada. The plaintiff classes were national in scope. As such, the other provincial and territorial governments except Quebec and British Columbia also moved to be included in the two actions as defendants, but only if the settlement was approved. The claims in these actions were founded on the decision by the CRCS and its government's overseers not to conduct testing of blood donations to the Canadian blood supply after a test for the hepatitis C virus became available and had been put into widespread use in the U.S. On this motion, the parties presented a comprehensive settlement package to the court. It consisted of a settlement agreement, a funding agreement, and plans for distribution of the settlement funds in the two actions. However, there were over 80 written objections to the settlement proposal from individuals afflicted with hepatitis C. The objections related to a number of issues, specifically, the adequacy of the total value of the settlement amount, the extent of compensation provided through the settlement, the sufficiency of the settlement fund to provide the proposed compensation, the reversion of any surplus, and the costs of administering the plans.

HELD: Motion dismissed. The settlement proposal was within the range of reasonableness having regard to the risks inherent in carrying the matter through to trial. The level of benefits ascribed within the settlement were acceptable having regard for the accessibility of the plan to successive claims in the event of a worsening of a class member's condition. This progressive approach outweighed any deficiencies which might have existed in the levels of benefits. However, there were two areas which required modification in order for the settlement to receive court approval. The first area related to access to the fund by opt-out claimants, specifically, the benefits provided from the fund for an opt-out claimant could not exceed those available to a similarly injured class member who remained in the class. The second area related to the surplus provisions of the settlement proposal.

Statutes, Regulations and Rules Cited:

Class Proceedings Act 1992, S.O. 1992, c. 6, ss. 5(2), 8(3), 29(2).

Companies Creditors Arrangement Act, R.S.C. 1985, c. C-36.

Counsel:

Harvey Strosberg, Q.C., Heather Rumble Peterson and Patricia Speight, for the plaintiffs.
Wendy Matheson and Jane Bailey, for the Canadian Red Cross Society.
Michèle Smith and R.F. Horak, for Her Majesty the Queen in Right of Ontario.
Ivan G. Whitehall, Q.C., Catherine Moore and J.C. Spencer, for the Attorney General of Canada.
Wilson McTavish, Q.C., Linda Waxman and Marian Jacko, for the Office of the Children's Lawyer.
Laurie Redden, for the Office of the Public Guardian and Trustee.
Beth Symes, for the Thalassemia Foundation of Canada, Friend of the Court.
William P. Dermody, for the Intervenors, Hubert Fullarton and Tracey Goegan.
L. Craig Brown, for the Hepatitis C Society of Canada, Friend of the Court.
Pierre R. Lavigne, for Dominique Honhon, Friend of the Court.
Bruce Lemer, for Anita Endean, Friend of the Court.
Elizabeth M. Stewart, for the Provinces and Territories other than British Columbia and Quebec.
Bonnie A. Tough and David Robins, for the plaintiffs.
Janice E. Blackburn and James P. Thomson, for the Canadian Hemophilia Society, Friend of the Court.

WINKLER J.:--

Nature of the Motion

1 This is a motion for approval of a settlement in two companion class proceedings commenced under the Class Proceedings Act 1992, S.O. 1992, c. 6, the "Transfused Action" and the "Hemophiliac Action", brought on behalf of persons infected by Hepatitis-C from the Canadian blood supply. The Transfused Action was certified as a class proceeding by order of this court on June 25, 1998, as later amended on May 11, 1999. On the latter date, an order was also issued certifying the Hemophiliac Action. There are concurrent class proceedings in respect of the same issues before the courts in Quebec and British Columbia. The Ontario proceedings apply to all persons in Canada who are within the class definition with the exception of any person who is included in the proceedings in Quebec and British Columbia. The motion before this court concerns a Pan-Canadian agreement intended to effect a national settlement, thus bringing to an end this aspect to the blood tragedy. Settlement approval motions similar to the instant proceeding have been contemporaneously heard by courts in Quebec and British Columbia with a view to bringing finality to the court proceedings across the country.

The Parties

2 The plaintiff class in the Transfused Action are persons who were infected with Hepatitis C from blood transfusions between January 1, 1986 to July 1, 1990. The plaintiff class in the Hemophiliac Action are persons infected with Hepatitis C from the taking of blood or blood products during the same time period.

3 The defendants in the Ontario actions are the Canadian Red Cross Society ("CRCS"), Her Majesty the Queen in Right of Ontario, and the Attorney General of Canada. The Ontario classes are national in scope. Therefore, the other Provincial and Territorial Governments of Canada, with the exception of Quebec and British Columbia, have moved to be included in the Ontario actions as defendants but only if the settlement is approved.

4 The court has granted intervenor status to a number of individuals, organizations and public bodies, namely, Hubert Fullarton and Tracy Goegan, the Canadian Hemophilia Society, the Thalassemia Foundation of Canada, the Hepatitis C Society of Canada, the Office of the Children's Lawyer and the Office of the Public Guardian and Trustee of Ontario.

5 Pursuant to an order of this court, Pricewaterhouse Coopers received and presented to the court over 80 written objections to the settlement from individuals afflicted with Hepatitis-C. In addition, 11 of the objectors appeared at the hearing of the motion to proffer evidence as to their reasons for objecting to the settlement.

6 The approval of the settlement before the court is supported by class counsel and the Ontario and Federal Crown defendants. In addition to these parties, the Provincial and Territorial governments who seek to be included if the settlement is approved, and the intervenors, the Canadian Hemophilia Society, the Office of the Children's Lawyer and the Office of the Public Guardian and Trustee made submissions in support of approval of the settlement. The Canadian Red Cross Society ("CRCS") appeared, but did not participate, all actions against it having been stayed by order of Mr. Justice Blair dated July 28, 1999, pursuant to a proceeding under the Companies Creditors Arrangement Act, R.S.C. 1985, c. C-36. The other intervenors and individual objectors voiced concerns about the settlement and variously requested that the court either reject the settlement or vary some of its terms in the interest of fairness.

Background

7 Both actions were commenced as a result of the contamination of the Canadian blood supply with infectious viruses during the 1980s. The background facts are set out in the pleadings and the numerous affidavits forming the record on this motion. The following is a brief summary.

8 The national blood supply system in Canada was developed during World War II by the CRCS. Following WWII, the CRCS was asked to carry on with the operation of this national system, and did so as part of its voluntary activities without significant financial support from any government. As a result of its experience and stewardship of system, the CRCS had a virtual monopoly on the collection and distribution of blood and blood products in Canada.

9 Over time the demand for blood grew and Canada turned to a universal health care system. Because of these developments, the CRCS requested financial assistance from the provincial and territorial governments. The governments, in turn, demanded greater oversight over expenditures. This led to the formation of the Canadian Blood Committee which was composed of representatives of the federal, provincial and territorial governments. The CBC became operational in the summer of 1982. Other than this overseer committee, there was no direct governmental regulation of the blood supply in Canada.

10 The 1970s and 80s were characterized medically by a number of viral infection related problems stemming from contaminated blood supplies. These included hepatitis and AIDS. The defined classes in these two class actions, however, are circumscribed by the time period beginning January 1, 1986 and ending July 1, 1990. During the class periods, the CRCS was the sole supplier and distributor of whole blood and blood products in Canada. The viral infection at the center of these proceedings is now known as Hepatitis C.

11 Hepatitis is an inflammation of the liver that can be caused by various infectious agents, including contaminated blood and blood products. The inflammation consists of certain types of cells that infiltrate the tissue and produce by-products called cytokines or, alternatively, produce antibodies which damage liver cells and ultimately cause them to die.

12 One method of transmission of hepatitis is through blood transfusions. Indeed, it was common to contract hepatitis through blood transfusions. However, due to the limited knowledge of the effects of contracting hepatitis, the risk was considered acceptable in view of the alternative of no transfusion which would be, in many cases, death.

13 As knowledge of the disease evolved, it was discovered that there were different strains of hepatitis. The strains identified as Hepatitis A ("HAV") and Hepatitis B ("HBV") were known to the medical community for some time. HAV is spread through the oral-fecal route and is rarely fatal. HBV is blood-borne and may also be sexually transmitted. It can produce violent illness for a prolonged period in its acute phase and may result in death. However, most people infected with HBV eliminate the virus from their system, although they continue to produce antibodies for the rest of their lives.

14 During the late 1960s, an antigen associated with HBV was identified. This discovery led to the development of a test to identify donated blood contaminated with HBV. In 1972, the CRCS implemented this test to screen blood donations. It soon became apparent that post-transfusion hepatitis continued to occur, although much less frequently. In 1974, the existence of a third form of viral hepatitis, later referred to as Non-A Non-B Hepatitis ("NANBH") was postulated.

15 This third viral form of hepatitis became identified as Hepatitis C ("HCV") in 1988. Its particular features are as follows:

(a) transmission through the blood supply if HCV infected donors are unaware of

their infected condition and if there is no, or no effective, donor screening;
(b) an incubation period of 15 to 150 days;
(c) a long latency period during which a person infected may transmit the virus to others through blood and blood products, or sexually, or from mother to fetus; and
(d) no known cure.

16 The claims in these actions are founded on the decision by the CRCS, and its overseers the CBC, not to conduct testing of blood donations to the Canadian blood supply after a "surrogate" test for HCV became available and had been put into widespread use in the United States.

17 In a surrogate test a donor blood sample is tested for the presence of substances which are associated with the disease. The surrogate test is an indirect method of identifying in a blood sample the likelihood of an infection that cannot be identified directly because no specific test exists. During the class period, there were two surrogate tests capable of being used to identify the blood donors suspected of being infected with HCV, namely, a test to measure the ALT enzyme in a donor's blood and a test to detect the anti-HBc, a marker of HBV, in the blood.

18 The ALT enzyme test was useful because it highlights inflammation of the liver. There is an increased level of ALT enzymes in the blood when a liver is inflamed. The test is not specific for any one liver disease but rather indicates inflammation from any cause. Elevated ALT enzymes are a marker of liver dysfunction which is often associated with HCV.

19 The anti-HBc test detects exposure to HBV and is relevant to the detection of HCV because of the assumption that a person exposed to HBV is more likely than normal to have been exposed to HCV, since both viruses are blood-borne and because the populations with higher rates of seroprevalence were believed to be similar.

20 The surrogate tests were subjected to various studies in the United States. Among other aspects, the studies analyzed the efficacy of each test in preventing NANBH post-transfusion infection and the extent to which the rejection of blood donations would be increased. The early results of the studies did not persuade the agencies responsible for blood banks in the U.S. to implement surrogate testing as a matter of course. However, certain individuals, including Dr. Harvey Alter, a leading U.S. expert on HCV, began a campaign to have the U.S. blood agencies change their policies. In consequence, in April 1986 the largest U.S. blood agency decided that both surrogate tests should be implemented, and further, that the use of the tests would become a requirement of the agency's standard accreditation program in the future. This effectively made surrogate testing the national standard in the U.S. and by August 1, 1986, all or virtually all volunteer blood banks in the U.S. screened blood donors by using the ALT and anti-HBc tests.

21 This course was not followed in Canada. Although there was some debate amongst the doctors involved with the CRCS, surrogate testing was not adopted. Rather, in 1984 a meeting was held at the CRCS during which a multi-centre study was proposed. The purpose of the study was to

determine the incidence of NANBH in Canada. The CRCS blood centres proposed to take part in the study were those in Toronto, Montreal, Ottawa, Edmonton and Vancouver.

22 Prior to the 1984 meeting however, Dr. Victor Feinman of Mount Sinai Hospital had already begun a study to determine the incidence of NANBH in those who had received blood transfusions. This study had a significant limitation in that it did not measure the effectiveness of surrogate testing. Although the limitation was known to the CRCS, the medical directors agreed at their meeting on March 29-30, 1984 to review Dr. Feinman's research to determine whether the proposed CRCS multi-centre study was still required. Ultimately, the CRCS did not conduct the multi-centre study.

23 The CRCS was aware of the American decision to implement surrogate testing in 1986 but opted instead to await a full assessment of the results of the Dr. Feinman study and the impact of testing for the Human-Immunodeficiency Virus ("HIV") and "self-designation" as possible surrogates to screen for NANBH.

24 This decision was criticized by Dr. Alter. In an article published in the Medical Post in February 1988, Dr. Alter was quoted as stating that:

> "while the use of surrogate markers is far from ideal, the lack of any specific test to identify [NANBH], coupled with the serious chronic consequences of the disease, makes the need for these surrogate tests essential."

25 The CRCS never implemented surrogate testing. In late 1988, HCV was isolated. The Chiron Corporation developed a test for anti-HCV for use by blood banks. In March 1990, the CRCS blood centres began implementing the anti-HCV test, and by June 30, 1990, all centres had implemented the test. Hence the class definitions stipulated in the two certification orders before this court, covers the period between January 1, 1986 and July 1, 1990, which corresponds to the interval between the widespread use of surrogate testing in the U.S. and the universal adoption of the Chiron HCV test in Canada. The classes are described fully below.

The Claims

26 It is alleged by the plaintiffs in both actions that had the defendants taken steps to implement the surrogate testing, the incidence of HCV infection from contaminated blood would have been reduced by as much as 75% during the class period. Consequently, they bring the actions on behalf of classes described as the Ontario Transfused Class and the Ontario Hemophiliac Class. The plaintiffs assert claims based in negligence, breach of fiduciary duty and strict liability in tort as against all of the defendants.

The Classes

27 The Ontario Transfused Class is described as:

(a) all persons who received blood collected by the CRCS contaminated with HCV during the Class Period and who are or were infected for the first time with HCV and who are:

(i) presently or formerly resident in Ontario and receive blood in Ontario and who are or were infected with post-transfusion HCV;
(ii) resident in Ontario and received blood in any other Province or Territory of Canada other than Quebec and who are or were infected with post-transfusion HCV;
(iii) resident elsewhere in Canada and received blood in Canada, other than in the Provinces of British Columbia and Quebec, and who are or were infected with post-transfusion HCV;
(iv) resident outside Canada and received blood in any Province or Territory of Canada, other than in the Province of Quebec, and who are or were infected with post-transfusion HCV; and
(v) resident anywhere and received blood in Canada and who are or were infected with post-transfusion HCV and who are not included as class members in the British Columbia Transfused Class Action or the Quebec Transfused Class Action;

(b) the Spouse of a person referred to in subparagraph (a) who is or was infected with HCV by such person; and

(c) the child of a person referred to in subparagraph (a) or (b) who is or was infected with HCV by such person.

28 The Ontario Hemophiliac Class is described as:

(a) all persons who have or, had a congenital clotting factor defect or deficiency, including a defect or deficiency in Factors V, VII, VIII, IX, XI, XII, XIII or von Willebrand factor, and who received or took Blood (as defined in Section 1.01 of the Hemophiliac HCV Plan) during the Class Period and who are:

(i) presently or formerly a resident in Ontario and received or took Blood in Ontario and who are or were infected with HCV;
(ii) resident in Ontario and received or took Blood in any other Province or Territory of Canada other than Quebec and who are or were infected with HCV;
(iii) resident elsewhere in Canada and received or took Blood in Canada other than in the Provinces of British Columbia and Quebec and who are or were infected with HCV;

(iv) resident outside Canada and received or took Blood in any Province or Territory in Canada, other than in the Province of Quebec, and who are or were infected with HCV; and

(v) resident anywhere and received or took Blood in Canada and who are not included as class members in the British Columbia Hemophiliac Class Action or the Quebec Hemophiliac Class Action;

(b) the Spouse of a person referred to in subparagraph (a) who is or was infected with HCV by such person; and

(c) the child of a person referred to subparagraph (a) or (b) who is or was infected with HCV by such person.

29 In addition in each of the actions, there is a "Family" class described, in the Ontario Transfused Class, as follows:

(a) the Spouse, child, grandchild, parent, grandparent or sibling of an Ontario Transfused Class Member;

(b) the spouse of a child, grandchild, parent or grandparent of an Ontario Transfused Class Member;

(c) a former Spouse of an Ontario Transfused Class Member;

(d) a child or other lineal descendant of a grandchild of an Ontario Transfused Class Member;

(e) a person of the opposite sex to an Ontario Transfused Class Member who cohabitated for a period of at least one year with that Class Member immediately before his or her death;

(f) a person of the opposite sex to an Ontario Transfused Class Member who was cohabitating with that Class Member at the date of his or her death and to whom that Class Member was providing support or was under a legal obligation to provide support on the date of his or her death; and

(g) any other person to whom an Ontario Transfused Class Member was providing support for a period of at least three years immediately prior to his or her death.

There is a similarly described Family Class in the Hemophiliac Action.

The Proposed Settlement

30 The parties have presented a comprehensive package to the court. Not only does it pertain to these actions, but it is also intended to be a Pan-Canadian agreement to settle the simultaneous class proceedings before the courts in Quebec and British Columbia. The settlement will not become final and binding until it is approved by courts in all three provinces. It consists of a Settlement Agreement, a Funding Agreement and Plans for distribution of the settlement funds in the Transfused Action and the Hemophiliac Action.

31 The Settlement Agreement creates the following two Plans:

(1) the Transfused HCV Plan to compensate persons who are or were infected with HCV through a blood transfusion received in Canada in the Class Period, their secondarily-infected Spouses and children and their other family members; and

(2) the Hemophiliac HCV Plan to compensate hemophiliacs who received or took blood or blood products in Canada in the Class Period and who are or were infected with HCV, their secondarily-infected Spouses and children and their other family members.

32 To fund the Agreement, the federal, provincial and territorial governments have promised to pay the settlement amount of $1,118,000,000 plus interest accruing from April 1, 1998. This will total approximately $1,207,000,000 as of September 30, 1999.

33 The Funding Agreement contemplates the creation of a Trust Fund on the following basis:

(i) a payment by the Federal Government to the Trust Fund, on the date when the last judgment or order approving the settlement of the Class Actions becomes final, of 8/11ths of the settlement amount, being the sum of approximately $877,818,181, subject to adjustments plus interest accruing after September 30, 1999 to the date of payment; and

(ii) a promise by each Provincial and Territorial Government to pay a portion of its share of the 3/11ths of the unpaid balance of the settlement amount as may be requested from time to time until the outstanding unpaid balance of the settlement amount together with interest accruing has been paid in full.

34 The Governments have agreed that no income taxes will be payable on the income earned by the Trust, thereby adding, according to the calculations submitted to the court, a present value of about $357,000,000 to the settlement amount.

35 The Agreement provides that the following claims and expenses will be paid from the Trust Fund:

(a) persons who qualify in accordance with the provisions of the Transfused HCV Plan;

(b) persons who qualify in accordance with the provisions of the Hemophiliac HCV Plan;

(c) spouses and children secondarily-infected with HIV to a maximum of 240 who qualify pursuant to the Program established by the Governments (which is not subject to Court approval);

(d) final judgments or Court approved settlements payable by any FPT Government to a Class Member or Family Class Member who opts out of one of the Class Actions or is not bound by the provisions of the Agreement or a person who

claims over or brings a third-party claim in respect of the Class Member's receiving or taking of blood or blood products in Canada in the Class Period and his or her infection with HCV, plus one-third of Court-approved defence costs;

(e) subject to the Courts' approval, the costs of administering the Plans, including the costs of the persons hereafter enumerated to be appointed to perform various functions under the Agreement;

(f) subject to the Courts' approval, the costs of administering the HIV Program, which Program administration costs, in the aggregate, may not exceed $2,000,000; and

(g) subject to Court approval, fees, disbursements, costs, GST and other applicable taxes of Class Action Counsel.

Class Members Surviving as of January 1, 1999

36 Other than the payments to the HIV sufferers, which I will deal with in greater detail below, the plans contemplate that compensation to the class members who were alive as of January 1, 1999, will be paid according to the severity of the medical condition of each class member. All class members who qualify as HCV infected persons are entitled to a fixed payment as compensation for pain and suffering and loss of amenities of life based upon the stage of his or her medical condition at the time of qualification under the Plan. However, the class member will be subsequently entitled to additional compensation if and when his or her medical condition deteriorates to a medical condition described at a higher compensation level. This compensation ranges from a single payment of $10,000, for a person who has cleared the disease and only carries the HCV antibody, to payments totaling $225,000 for a person who has decompensation of the liver or a similar medical condition.

37 The compensation ranges are described in the Agreement as "Levels". In addition to the payments for loss of amenities, class members with conditions described as being at compensation Level 3 or a higher compensation Level (4 or above), and whose HCV caused loss of income or inability to perform his or her household duties, will be entitled to compensation for loss of income or loss of services in the home.

38 The levels, and attendant compensation, for class members are described as follows:

(i) Level 1

Qualification	Compensation
A blood test demonstrates that the HCV an-	A lump sum payment of $10,000 plus reimbursement

tibody is present in the blood of a class member.	of uninsured treatment and medication costs and reimbursement for out-of-pocket expenses.

(ii) Level 2

Qualification	Compensation
A polymerase chain reaction test (PCR) demonstrates that HCV is present in the blood of a class member.	Cumulative compensation of $30,000 which comprises the the $10,000 payment at level 1, plus a payment of $15,000 immediately and another $5000 when the court determines that the Fund is sufficient to do so, plus reimbursement of uninsured treatment and medication costs and reimbursement for out-of-pocket expenses.

(iii) Level 3

Qualification	Compensation
If a class member develops non-bridging fibrosis, or receives compensable drug therapy (i.e. Interferon or Ribavirin), or meets a protocol for HCV compensable treatment regardless of whether the treatment is taken, then the class member qualifies for Level 3 benefits.	Option 1 - $60,000 comprised of the level 1 and 2 payments plus an additional $30,000 Option 2 - $30,000 from the Level 1 and 2 benefits, and if the additional $30,000 from Option 1 is waived, compensation for loss of income or loss of income or loss of services in the home, subject to a threshold qualification.

In addition, at this level, the class member is entitled to an additional $1000 per month for each month of completed drug therapy, plus reimbursement of uninsured treatment and medication costs and reiumbursement for out-of-pocket expenses.

(iv) Level 4

Qualification	Compensation
If a class member develops bridging fibrosis, he or she qualifies as a Level 4 claimant	There is no further fixed payment beyond that of Level 3 at this level. In addition to those previously defined benefits, the claimant is entitled to compensation for loss of income or loss of services in the home, $1000 per month for each month of completed drug therapy, plus reimbursement of uninsured treatment and medication costs and reiumbursement for out-of-pocket expenses.

(v) Level 5

Qualification	Compensation
A class member who develops (a) cirrhosis; (b) unresponsive porphyria cutanea tarda which is causing significant disfigurement and disability; (c) unresponsive thrombocytopenia (low platelets) which result in certain other conditions; or (d) glomerulonephritis not requiring dialysis, he or she qualifies as a Level 5 claimant.	$125,000 which consists of the prior $60,000, if the claimant elected Option 1 at Level 3, plus an additional $65,0000 plus the claimant is entitled to compensation for loss of income or loss of services in the home, $1,000 per month for each month of completed drug therapy, plus reimbursement of uninsured treatment and medication costs and reimbursement for out-of-pocket expenses.

(vi) Level 6

Qualification	Compensation
If a class member receives a liver transplant, or develops: (a) decompensation of the liver; (b) hepatocellular cancer; (c) B-cell lymphoma; (d) symptomatic mixed cryoglobullinemia; (e) glomerulonephritis requiring	$225,000 which consists of the $125,000 available at at the prior levels plus an additional $100,000 plus the claimant is entitled to compensation for loss of income or loss of services in the home, $1,000 per month for each month of completed drug therapy,

dialysis; or (f) renal failure, he or she qualifies as a Level 6 claimant.	plus reimbursement of uninsured treatment and medication costs and reimbursement for out-of-pocket expenses. The claimant is also entitled to reiumbursement for costs of care up to $50,000 per year.

39 There are some significant "holdbacks" of compensation at certain levels. As set out in the table above, a claimant who is entitled to the $20,000 compensation payment at level 2 will initially be paid $15,000 while $5,000 will be held back in the Fund. If satisfied that there is sufficient money in the Fund, the Courts may then declare that the holdback shall be removed in accordance with Section 10.01(1)(i) of the Agreement and Section 7.03 of the Plans. Claimants with monies held back will then receive the holdback amount with interest at the prime rate from the date they first became entitled to the payment at Level 2. In addition, any claimant that qualifies for income replacement at Level 4 or higher will be subjected to a holdback of 30% of the compensation amount. This holdback may be removed, and the compensation restored, on the same terms as the Level 2 payment holdback.

40 There is a further limitation with respect to income, namely, that the maximum amount subject to replacement has been set at $75,000 annually. Again this limitation is subject to the court's review. The court may increase the limit on income, after the holdbacks have been removed, and the held benefits restored, if the Fund contains sufficient assets to do so.

41 Payment of loss of income is made on a net basis after deductions for income tax that would have been payable on earned income and after deduction of all collateral benefits received by the Class Member. Loss of income payments cease upon a Class Member reaching age 65. A claim for the loss of services in the home may be made for the lifetime of the Class Member.

Class Members Dying Before January 1, 1999

42 If a Class Member who died before January 1, 1999, would have qualified as a HCV infected person but for the death, and if his or her death was caused by HCV, compensation will be paid on the following terms:

(a) the estate will be entitled to receive reimbursement for uninsured funeral expenses to a maximum of $5,000 and a fixed payment of $50,000, while approved family members will be entitled to compensation for loss of the deceased's guidance, care and companionship on the scale set out in the chart at paragraph 82 below and approved dependants may be entitled to compensation for their loss of support from the deceased or for the loss of the deceased's services in the home ("Option 1"); or

(b) at the joint election of the estate and the approved family members and dependants of the deceased, the estate will be entitled to reimbursement for uninsured funeral expenses to a maximum of $5,000, and the estate and the approved family members and dependants will be jointly entitled to

compensation of $120,000 in full settlement of all of their claims ("Option 2").

43 Under the Plans when a deceased HCV infected person's death is caused by HCV, the approved dependants may be entitled to claim for loss of support until such time as the deceased would have reached age 65 but for his death.

44 Payments for loss of support are made on a net basis after deduction of 30% for the personal living expenses of the deceased and after deduction of any pension benefits from CPP received by the dependants.

45 The same or similar holdbacks or limits will initially be imposed on the claim by dependants for loss of support under the Plans as are imposed on a loss of income claim. The $75,000 cap on pre-claim gross income will be applied in the calculation of support and only 70% of the annual loss of support will be paid. If the courts determine that the Trust Fund is sufficient and vary or remove the holdbacks or limits, the dependants will receive the holdbacks, or the portion the courts direct, with interest from the time when loss of support was calculated subject to the limit.

46 Failing agreement among the approved dependants on the allocation of loss of support between them, the Administrator will allocate loss of support based on the extent of support received by each of the dependants prior to the death of the HCV infected person.

Class Members Cross-Infected with HIV.

47 Notwithstanding any of the provisions of the Hemophiliac HCV Plan, a primarily infected hemophiliac who is also infected with HIV may elect to be paid $50,000 in full satisfaction of all of his or her claims and those of his or her family members and dependants.

48 Persons infected with HCV and secondarily-infected with HIV who qualify under a Plan (or, where the person is deceased, the estate and his or her approved family members and dependants) may not receive compensation under the Plan until entitlement exceeds the $240,000 entitlement under the Program after which they will be entitled to receive any compensation payable under the Plan in excess of $240,000.

49 Under the Hemophiliac HCV Plan, the estate, family members and dependants of a primarily-infected hemophiliac who was cross-infected with HIV and who died before January 1, 1999 may elect to receive a payment of $72,000 in full satisfaction of their claims.

The Family Class Claimants

50 Each approved family class member of a qualified HCV infected person whose death was caused by HCV is entitled to be paid the amount set out below for loss of the deceased's guidance, care and companionship:

Relationship	Compensation
Spouse	$25,000
Child under 21 at time of death of class member	$15,000
Child over 21 at time of death of class member	$5,000
Parent or sibling	$5,000
Grandparent or Grandchild	$500

51 If a loss of support claim is not payable in respect of the death of a HCV infected person whose death was caused by, his or her infection with HCV, but the approved dependants resided with that person at the time of the death, then these dependants are entitled to be compensated for the loss of any, services that the HCV infected person provided in the home at the rate of $12 per hour to a maximum of 20 hours per week.

52 The Agreement and/or the Plans also provide that:

(a) all compensation payments to claimants who live in Canada will be tax free;
(b) compensation payments will be indexed annually to protect against inflation;
(c) compensation payments other than payments for loss of income will not affect social benefits currently being received by claimants;
(d) life insurance payments received by or on behalf of claimants will not be taken into account for any purposes whatsoever under the Plans; and
(e) no subrogation payments will be paid directly or indirectly.

The Funding Calculations

53 Typically in settlements in personal injury cases, where payments are to be made on a periodic basis over an extended period of time, lump sum amounts are set aside to fund the extended liabilities. The amount set aside is based on a calculation which determines the "present value" of the liability. The present value is the amount needed immediately to produce payments in the agreed value over the agreed time. This calculation requires factoring in the effects of inflation, the return on the investment of the lump sum amount and any income or other taxes which might have to be paid on the award or the income it generates. Dealing with this issue in a single victim case may be relatively straightforward. Making an accurate determination in a class proceeding with a multitude of claimants suffering a broad range of damages is a complex matter.

54 Class counsel retained the actuarial firm of Eckler Partners Ltd. to calculate the present value of the liabilities for the benefits set out in the settlement. The calculations performed by Eckler were based on a natural history model of HCV constructed by the Canadian Association for the Study of the Liver ("CASL") at the request of the parties. As stated in the Eckler report at p. 3, "the results from the [CASL] study form the basis of our assumptions regarding the development of the various medical outcomes." However, the Eckler report also notes that in instances where the study was lacking in information, certain extensions to some of the probabilities were supplied by Dr. Murray Krahn who led the study. In certain other situations, additional or alternative assumptions were provided by class counsel.

55 The class in the Transfused Action is comprised of those persons who received blood transfusions during the class period and are either still surviving or have died from a HCV related cause. The CASL study indicates that the probable number of persons infected with HCV through blood transfusion in the class period, the "cohort" as it is referred to in the study, is 15,707 persons. The study also estimates the rates of survival of each infected person. From these estimates, Eckler projects that the cohort as of January 1, 1999 is 8,104 persons. Of those who have died in the intervening time, 76 are projected to be HCV related deaths and thus eligible for the death benefits under the settlement.

56 In the case of the Hemophiliac class, the added factor of cross-infection with HIV, and the provisions in the plan dealing with this factor, require some additional considerations. Eckler was asked to make the following assumptions based primarily on the evidence of Dr. Irwin Walker:

(a) the Hemophiliac cohort size is approximately 1645 persons
(b) 15 singularly infected and 340 co-infected members of this cohort have died prior to January 1, 1999; the 15 singularly infected and 15 of those co-infected will establish HCV as the cause of death and claim under the regular death provisions (but there is no $120,000 option in this plan); the remaining 325 co-infected will take the $72,000 option.
(c) a further 300 co-infected members are alive at January 1, 1999; of these, 80%, i.e. 240, will take the $50,000 option;
(d) 990 singularly infected hemophiliacs are alive at January 1, 1999

(e) the remaining 60 co-infected and the 990 singularly infected hemophiliacs will claim under the regular provisions and should be modeled in the same way as the transfused persons, i.e. apply the same age and sex profiles, and the same medical, mortality and other assumptions as for the transfused group, except that the 60 coinfected claimants will not have any losses in respect of income.

57 Because of the structure of this agreement, Eckler was not required to consider the impact of income or other taxes on the investment returns available from the Fund. With respect to the rate of growth of the Fund, Eckler states at p. 10 that:

> A precise present value calculation would require a formula incorporating the gross rate of interest and the rate of inflation as separate parameters. However, virtually the same result will flow from a simpler formula where the future payments are discounted at a net rate equal to the excess of the gross rate of interest over the assumed rate of inflation. Eckler calculates the annual rate of growth of the Fund will be 3.4% per year on this basis. This is referred to as the "net discount rate".

58 There is one other calculation that is worthy of particular note. In determining the requirements to fund the income replacement benefits set out in the settlement, Eckler used the average industrial aggregate earnings rate in Canada estimated for 1999. From this figure, income taxes and other ordinary deductions were made to arrive at a "pre-claim net income". Then an assumption is made that the class members claiming income compensation will have other earnings post-claim that will average 40% of the pre-claim amount. The 60% remaining loss, in dollars expressed as $14,500, multiplied by the number of expected claimants, is the amount for which funding is required. Eckler points out candidly at p. 20 that:

> [in regard to the assumed average of Post-claim Net Income] ... we should bring to your attention that without any real choice, the foregoing assumed level of 40% was still based to a large extent on anecdotal input and our intuitive judgement on this matter rather than on rigourous scientific studies which are simply not available at this time. There are other assumptions and estimates which will be dealt with in greater detail below.

59 The Eckler conclusion is that if the settlement benefits, including holdbacks, and the other liabilities were to be paid out of the Fund, there is a present value deficit of $58,533,000. Prior to the payment of holdbacks, the Fund would have a surplus of $34,173,000.

The Thalassemia Victims

60 Prior to analyzing the settlement, I turn to the concerns advanced by The Thalassemia Foundation of Canada. The organization raises the objection that the plan contains a fundamental unfairness as it relates to claims requirements for members of the class who suffer from

Thalassemia.

61 Thalassemia, also known as Mediterranean Anemia or Cooley's Anemia, is an inherited form of anemia in which affected individuals are unable to make normal hemoglobin, the oxygen carrying protein of the red blood cell. Mutations of the hemoglobin genes are inherited. Persons with a thalassemia mutation in one gene are known as carriers or are said to have thalassemia minor. The severe form of thalassemia, thalassemia major, occurs when a child inherits two mutated genes, one from each parent. Children born with thalassemia major usually develop the symptoms of severe anemia within the first year of life. Lacking the ability to produce normal adult hemoglobin, children with thalassemia major are chronically fatigued; they fail to thrive; sexual maturation is delayed and they do not grow normally. Prolonged anemia causes bone deformities and eventually will lead to death, usually by their fifth birthday.

62 The only treatment to combat thalassemia major is regular transfusions of red blood cells. Persons with thalassemia major receive 15 cubic centimeters of washed red blood cells per kilogram of weight every 21 to 42 days for their lifetime. That is, a thalassemia major person weighing 60 kilograms (132 pounds) may receive 900 cubic centimeters of washed red blood cells each and every transfusion. Such a transfusion corresponds to four units of blood. Persons with thalassemia major have not been treated with pooled blood. Therefore, in each transfusion a thalassemia major person would receive blood from four different donors and over the course of a year would receive 70 units of blood from potentially 70 different donors. Over the course of the Class Period, a class member with thalassemia major might have received 315 units of blood from potentially 315 different donors.

63 Over the past three decades, advances in scientific research have allowed persons with thalassemia major in Canada to live relatively normal lives. Life expectancy has been extended beyond the fourth decade of life, often with minimal physical symptoms. In Canada approximately 300 persons live with thalassemia major.

64 Of the 147 transfused dependent thalassemia major patients currently being treated in the Haemoglobinopathy Program at the Hospital for Sick Children and Toronto General Hospital, 48 have tested positive using HCV antibody tests. Fifty-one percent of the population at TGH have tested positive; only 14% of the population of HSC have tested positive. The youngest of these persons was born in 1988; 9 of them are 13 years of age or older but less than 18 years of age; the balance are adults. Nine thalassemia major patients in the Haemoglobinopathy Program have died since HCV testing was available in 1991. Seven of these persons were HCV positive. The Foundation estimates that there are approximately 100 thalassemia major patients across Canada who are HCV positive.

65 The unfairness pointed to by the Thalassemia Foundation is that class members suffering from thalassemia are included in the Transfused Class, and therefore must follow the procedures for that class in establishing entitlement. It is contended that this is fundamentally unfair to thalassemia

victims because of the number of potential donors from whom each would have received blood or blood products. It is said that by analogy to the hemophiliac class, and the lesser burden of proof placed on members of that class, a similar accommodation is justified. I agree.

66 This is a situation where it is appropriate to create a sub-class of thalassemia victims from the Transfused Class. Sub-classes are provided for in s. 5(2) of the CPA and the power to amend the certification order is contained in s. 8(3) of the Act. The settlement should be amended to apply the entitlement provisions in the Hemophiliac Plan mutatis mutandis to the Thalassemia sub-class.

Law and Analysis

67 Section 29(2) of the CPA provides that:

> A settlement of a class proceeding is not binding unless approved by the court.

68 While the approval of the court is required to effect a settlement, there is no explicit provision in the CPA dealing with criteria to be applied by the court on a motion for approval. The test to be applied was, however, stated by Sharpe J. in Dabbs v. Sun Life Assurance, [1998] O.J. No. 1598 (Gen. Div.) (Dabbs No. 1) at para. 9:

> ... the court must find that in all the circumstances the settlement is fair, reasonable and in the best interests of those affected by it.

69 In the context of a class proceeding, this requires the court to determine whether the settlement is fair, reasonable and in the best interests of the class as a whole, not whether it meets the demands of a particular member. As this court stated in Ontario New Home Warranty Program v. Chevron Chemical Co., [1999] O.J. No. 2245 (Sup. Ct.) at para. 89:

> The exercise of settlement approval does not lead the court to a dissection of the settlement with an eye to perfection in every aspect. Rather, the settlement must fall within a zone or range of reasonableness.

70 Sharpe J. stated in Dabbs v. Sun Life Assurance (1998), 40 O.R. (3d) 429 (Gen. Div.), aff'd 41 O.R. (3d) 97 (C.A.). leave to appeal to S.C.C. dismissed October 22, 1998, (Dabbs No. 2) at 440, that "reasonableness allows for a range of possible resolutions." I agree. The court must remain flexible when presented with settlement proposals for approval. However, the reasonableness of any settlement depends on the factual matrix of the proceeding. Hence, the "range of reasonableness" is not a static valuation with an arbitrary application to every class proceeding, but rather it is an objective standard which allows for variation depending upon the subject matter of the litigation and the nature of the damages for which the settlement is to provide compensation.

71 Generally. in determining whether a settlement is "fair, reasonable and in the best interests of the class as a whole", courts in Ontario and British Columbia have reviewed proposed class

proceeding settlements on the basis of the following factors:

1. Likelihood of recovery, or likelihood of success;
2. Amount and nature of discovery evidence;
3. Settlement terms and conditions;
4. Recommendation and experience of counsel;
5. Future expense and likely duration of litigation;
6. Recommendation of neutral parties if any;
7. Number of objectors and nature of objections; and
8. The presence of good faith and the absence of collusion.

See Dabbs No. 1 at para. 13, Haney Iron Works Ltd v. Manufacturers Life Insurance Co. (1998), 169 D.L.R. (4th) 565 (B.C.S.C.) at 571, See also Conte, Newberg on Class Actions, (3rd ed) (West Publishing) at para. 11.43.

72 In addition to the foregoing, it seems to me that there are two other factors which might be considered in the settlement approval process: i) the degree and nature of communications by counsel and the representative plaintiff with class members during the litigation; and ii) information conveying to the court the dynamics of, and the positions taken by the parties during, the negotiation. These two additional factors go hand-in-glove and provide the court with insight into whether the bargaining was interest-based, that is reflective of the needs of the class members, and whether the parties were bargaining at equal or comparable strength. A reviewing court, in exercising its supervisory jurisdiction is, in this way, assisted in appreciating fully whether the concerns of the class have been adequately addressed by the settlement.

73 However, the settlement approval exercise is not merely a mechanical seriatim application of each of the factors listed above. These factors are, and should be, a guide in the process and no more. Indeed, in a particular case, it is likely that one or more of the factors will have greater significance than others and should accordingly be attributed greater weight in the overall approval process.

74 Moreover, the court must take care to subject the settlement of a class proceeding to the proper level of scrutiny. As Sharpe J. stated in Dabbs No. 2 at 439-440:

> A settlement of the kind under consideration here will affect a large number of individuals who are not before the court, and I am required to scrutinize the proposed settlement closely to ensure that it does not sell short the potential rights of those unrepresented parties. I agree with the thrust of Professor Watson's comments in "Is the Price Still Right? Class Proceedings in Ontario", a paper delivered at a CIAJ Conference in Toronto, October 1997, that class action settlements "must be seriously scrutinized by judges" and that they should be "viewed with some suspicion". On the other hand, all settlements are the product of compromise and a process of give and take and settlements rarely give all

parties exactly what they want. Fairness is not a standard of perfection.

75 The preceding admonition is especially apt in the present circumstances. Class counsel described the agreement before the court as "the largest settlement in a personal injury action in Canadian history." The settlement is Pan-Canadian in scope, affects thousands of people, some of whom are thus far unaware that they are claimants, and is intended to be administered for over 80 years. It cannot be seriously contended that the tragedy at the core of these actions does not have a present and lasting impact on the class members and their families. While the resolution of the litigation is a noteworthy aim, an improvident settlement would have repercussions well into the future.

76 Consequently, this is a case where the proposed settlement must receive the highest degree of court scrutiny. As stated in the Manual for Complex Litigation, 3rd Ed. (Federal Judicial Centre: West Publishing, 1995) at 238:

> Although settlement is favoured, court review must not be perfunctory; the dynamics of class action settlement may lead the negotiating parties - even those with the best intentions - to give insufficient weight to the interests of at least some class members. The court's responsibility is particularly weighty when reviewing a settlement involving a non-opt-out class or future claimants. (Emphasis added.)

77 The court has been assisted in scrutinizing the proposed settlement by the submissions of several intervenors and objectors. I note that some of the submissions, as acknowledged by counsel for the objectors, raised social and political concerns about the settlement. Without in any way detracting from the importance of these objections, it must be remembered that these matters have come before the court framed as class action lawsuits. The parties have chosen to settle the issues on a legal basis and the agreement before the court is part of that legal process. The court is therefore constrained by its jurisdiction, that is, to determine whether the settlement is fair and reasonable and in the best interests of the classes as a whole in the context of the legal issues. Consequently, extra-legal concerns even though they may be valid in a social or political context, remain extra-legal and outside the ambit of the court's review of the settlement.

78 However, although there may have been social or political undertones to many of the objections, legal issues raised by those objections, either directly or peripherally, are properly considered by the court in reviewing the settlement. Counsel for the objectors described the legal issues raised, in broad terms, as objections to:

> (a) the adequacy of the total value of the settlement amount;
> (b) the extent of compensation provided through the settlement;
> (c) the sufficiency of the settlement Fund to provide the proposed compensation;
> (d) the reversion of any surplus;

(e) the costs of administering the Plans; and
(f) the claims process applicable to Thalassemia victims.

I have dealt with the objection regarding the Thalassemia victims above. The balance of these objections will be addressed in the reasons which follow.

79 It is well established that settlements need not achieve a standard of perfection. Indeed, in this litigation, crafting a perfect settlement would require an omniscient wisdom to which neither this court nor the parties have ready recourse. The fact that a settlement is less than ideal for any particular class member is not a bar to approval for the class as a whole. The CPA mandates that class members retain, for a certain time, the right to opt out of a class proceeding. This ensures an element of control by allowing a claimant to proceed individually with a view to obtaining a settlement or judgment that is tailored more to the individual's circumstances. In this case, there is the added advantage in that a class member will have the choice to opt out while in full knowledge of the compensation otherwise available by remaining a member of the, class.

80 This settlement must be reviewed on an objective standard, taking into account the need to provide compensation for all of the class members while at the same time recognizing the inherent difficulty in crafting a universally satisfactory settlement for a disparate group. In other words, the question is does the settlement provide a reasonable alternative for those Class Members who do not wish to proceed to trial?

81 Counsel for the class and the Crown defendants urged this court to consider the question on the basis of each class member's likely recovery in individual personal injury tort litigation. They contend that the benefits provided at each level are similar to the awards class members who are suffering physical manifestations of HCV infection approximating those set out in the different levels of the structure of this settlement would receive in individual litigation. In my view, this approach is flawed in the present case.

82 An award of damages in personal injury tort litigation is idiosyncratic and dependent on the individual plaintiff before the court. Here, although the settlement is structured to account for Class Members with differing medical Conditions by establishing benefits on an ascending classification scheme, no allowances are made for the spectrum of damages which individual class members within each level of the structure may suffer. The settlement provides for compensation on a "one-size fits all" basis to all Class Members who are grouped at each level. However, it is apparent from the evidence before the court on this motion that the damages suffered as a result of HCV infection are not uniform, regardless of the degree of progression.

83 The evidence of Dr. Frank Anderson, a leading practitioner working with HCV patients in Vancouver, describes in detail the uncertain prognosis that accompanies HCV and the often debilitating, but unevenly distributed, symptomology that can occur in connection with infection. He states:

Once infected with HCV, a person will either clear HCV after an acute stage of develop chronic HCV infection. At present, the medical literature establishes that approximately 20-25% of all persons infected clear HCV within approximately one year of infection. Those persons will still test positive for the antibody and will probably do so for the rest of their lives, but will not test positive on a PCR test, nor will they experience any progressive liver disease due to HCV.

Persons who do not clear the virus after the acute stage of the illness have chronic HCV. They may or may not develop progressive liver disease due to HCV, depending on the course HCV takes in their body and whether treatment subsequently achieves a sustained remission. A sustained remission means that the virus is not detectable in the blood 6 months after treatment, the liver enzymes are normal, and that on a liver biopsy, if one were done, there would be no inflammation. Fibrosis in the liver is scar tissue caused by chronic inflammation, and as such is not reversible, and will remain even after therapy. It is also possible to spontaneously clear the virus after the acute phase of the illness but when this happens and why is not well understood. The number of patients spontaneously clearing the virus is small.

HCV causes inflammation of the liver cells. The level of inflammation varies among HCV patients. ... the inflammation may vary in intensity from time to time.

...

Inflammation and necrosis of liver cells results in scarring of liver tissue (fibrosis). Fibrosis also appears in various patterns in HCV patients .... Fibrosis can stay the same or increase over time, but does not decrease, because although the liver can regenerate cells, it cannot reverse scarring. On average it takes approximately 20 years from point of infection with Hepatitis C until cirrhosis develops, and so on a scale of 1 to 4 units the best estimate is that the rate of fibrosis progression is 0. 133 units per year.

...

Once a patient is cirrhotic, they are either a compensated cirrhotic, or a decompensated cirrhotic, depending on their liver function. In other words, the

liver function may, still be normal even though there is fibrosis since there may, be enough viable liver cells remaining to maintain function. These persons would have compensated cirrhosis. If liver function fails the person would then have decompensated cirrhosis. The liver has very many functions and liver failure may involve some or many of these functions. Thus decompensation may present in a number of ways with a number of different signs and symptoms.

A compensated cirrhotic person has generally more than one third of the liver which is still free from fibrosis and whose liver can still function on a daily basis. They may have some of the symptoms discussed below, but they may also be asymptomatic.

Decompensated cirrhosis occurs when approximately 2/3 of the liver is compromised (functioning liver cells destroyed) and the liver is no longer able to perform one or more of its essential functions. It is diagnosed by the presence of one or more conditions which alone or in combination is life threatening without a transplant. This clinical stage of affairs is also referred to as liver failure or end stage liver disease. The manifestations of decompensation are discussed below. Once a person develops decompensation, life expectancy is short and they will generally die within approximately 2-3 years unless he or she receives a liver transplant.

Patients who progress to cirrhosis but not to decompensated cirrhosis may develop hepatocellular cancer ("HCC"). This is a cancer, which originates from liver cells, but the exact mechanism is uncertain. The simple occurrence of cirrhosis may predispose to HCC, but the virus itself may also stimulate the occurrence of liver cell cancer. Life expectancy after this stage is approximately 1-2 years.

...

The symptoms of chronic HCV infection, prior to the disease progressing to cirrhosis or HCC include: fatigue, weight loss, upper right abdominal pain, mood disturbance, and tension and anxiety ...

Of those symptoms, fatigue is the most common, the most subjective and the most difficult to assess .... There is also general consensus that the level of

> fatigue experienced by an individual infected with HCV does not correlate with liver enzyme levels, the viral level in the blood, or the degree of inflammation or fibrosis on biopsy. It is common for the degree of fatigue to fluctuate from time to time.

Dr. Anderson identifies some of the symptoms associated with cirrhosis which can include skin lesions, swelling of the legs, testicular atrophy in men, enlarged spleen and internal hemorrhaging. Decompensated cirrhosis symptomatic effects, he states, can include jaundice, hepatic encephalopathy, protein malnutrition, subacute bacterial peritonitis and circulatory and pulmonary changes. Dr. Anderson also states, in respect of his own patients, that "at least 50% of my HCV infected patients who have not progressed to decompensated cirrhosis or HCC are clinically asymptomatic."

84 It is apparent, in light of Dr. Anderson's evidence, that in the absence of evidence of the individual damages sustained by class members, past precedents of damage awards in personal injury actions cannot be applied to this case to assess the reasonableness of the settlement for the class.

85 This fact alone is not a fatal flaw. There have long been calls for reform of the "once and for all" lump sum awards that are usually provided in personal injury actions. As stated by Dickson J, in Andrews v. Grand & Toy Alberta Ltd, [1978] 2 S.C.R. 229 at 236:

> The subject of damages for personal injury is an area of the law which cries out for legislative reform. The expenditure of time and money in the determination of fault and of damage is prodigal. The disparity resulting from lack of provision for victims who cannot establish fault must be disturbing. When it is determined that compensation is to be made, it is highly irrational to be tied to a lump sum system and a once-and-for-all award.
>
> The lump sum award presents problems of great importance. It is subject to inflation, it is subject to fluctuation on investment, income from it is subject to tax. After judgment new needs of the plaintiff arise and present needs are extinguished; yet, our law of damages knows nothing of periodic payment. The difficulties are greatest where there is a continuing need for intensive and expensive care and a long-term loss of earning capacity. It should be possible to devise some system whereby payments would be subject to periodic review and variation in the light of the continuing needs of the injured person and the cost of meeting those needs.

86 The "once-and-for-all" lump sum award is the common form of compensation for damages in tort litigation. Although the award may be used to purchase annuities to provide a "structured" settlement, the successful claimant receives one sum of money that is determined to be proper

compensation for all past and future losses. Of necessity, there is a great deal of speculation involved in determining the future losses. There is also the danger that the claimant's future losses will prove to be much greater than are contemplated by the award of damages received because of unforeseen problems or an inaccurate calculation of the probability of future contingent events. Thus even though the claimant is successful at trial, in effect he or she bears the risk that there may be long term losses in excess of those anticipated. This risk is especially pronounced when dealing with a disease or medical condition with an uncertain prognosis or where the scientific knowledge is incomplete.

87 The present settlement is imaginative in its provision for periodic subsequent claims should the class member's condition worsen. The underlying philosophy upon which the settlement structure is based is set forth in the factum of the plaintiffs in the Transfused Action. They state at para. 10 that:

> The Agreement departs from the common law requirement of a single, once-and-for-all lump sum assessment and instead establishes a system of periodic payments to Class Members and Family Class Members depending on the evolving severity of their medical condition and their needs.

88 This forward-looking provision addresses the concern expressed by Dickson J. with respect to the uncertainty and unfairness of a once and for all settlement. Indeed, the objectors and intervenors acknowledge this in that they do not take issue with the benefit distribution structure of the settlement as much as they challenge the benefits provided at the levels within the structure.

89 These objections mirror the submissions in support of the settlement, in that they are largely based on an analogy to a tort model compensation scheme. For the reasons already stated, this analogy is not appropriate because the proper application of the tort model of damages compensation would require an examination of each individual case. In the absence of an individualized examination, the reasonableness, or adequacy, of the settlement cannot be determined by a comparison to damages that would be obtained under the tort model. Rather the only basis on which the court can proceed in a review of this settlement is to consider whether the total amount of compensation available represents a reasonable settlement, and further, whether those monies are distributed fairly and reasonably among the class members.

90 The total value of the Pan-Canadian settlement is estimated to be $1.564 billion dollars. This is calculated as payment or obligation to pay by the federal, provincial and territorial governments in the an amount of $1.207 billion on September 30, 1999, plus the tax relief of $357 million over the expected administrative term of the settlement. This amount is intended to settle the class proceedings in Ontario, British Columbia and Quebec. The Ontario proceeding, as stated above, covers all of those class members in Canada other than those included in the actions in British Columbia and Quebec.

91 Counsel for the plaintiffs and for the settling defendants made submissions to the court with

respect the length and intensity of the negotiations leading up to the settlement. There was no challenge by any party as to the availability of any additional compensation. I am satisfied on the evidence that the negotiations achieved the maximum total funding that could be obtained short of trial.

92 In applying the relevant factors set out above to the global settlement figure proposed, I am of the view that the most significant consideration is the substantial litigation risk of continuing to trial with these actions. The CRCS is the primary defendant. It is now involved in protracted insolvency proceedings. Even if the court-ordered stay of litigation proceedings against it were to be lifted, it is unlikely that there would be any meaningful assets available to satisfy a judgment. Secondly, there is a real question as to the liability of the Crown defendants. Counsel for the plaintiffs candidly admit that there is a probability, which they estimate at 35%, that the Crown defendants would not be found liable at trial. Counsel for the federal government places the odds on the Crown successfully defending the actions somewhat higher at 50%. I note that none of the opposing intervenors or objectors challenge these estimates. In addition to the high risk of failure at trial, given the plethora of complex legal issues involved in the proceedings, there can be no question that the litigation would be lengthy, protracted and expensive, with a final result, after all appeals are exhausted, unlikely until years into the future.

93 Moving to the remaining factors, although there have been no examinations for discovery, the extensive proceedings before the Krever Commission serve a similar purpose. The settlement is supported by the recommendation of experienced counsel as well as many of the intervenors. There is no suggestion of bad faith or collusion tainting the settlement. The support of the intervenors, particularly the Canadian Hemophilia Society which made submissions regarding the meetings held with class members, is indicative of communication between class counsel and the class members. Although, there were some objectors who raised concerns about the degree of communication with the Transfused Class members, these complaints were not strenuously pursued. Perhaps the most compelling evidence of the adequacy of the communications with the class members regarding the settlement is the relatively low number of objections presented to the court considering the size of the classes. Finally, counsel for all parties made submissions, which I accept, regarding the rigourous negotiations that resulted in the final settlement.

94 In conclusion, I find that the global settlement represents a reasonable settlement when the significant and very real risks of litigation are taken into account.

95 The next step in the analysis is to determine whether the monies available are allocated in such a way as to provide for a fair and reasonable distribution among the class members. In my view, as the settlement agreement is presently constituted, they are not. My concern lies with the provision dealing with opt out claimants. Under the agreement, if opt out claimants are successful in individual litigation, any award such a claimant receives will be satisfied out of the settlement Fund. While this has the potential of depleting the Fund to the detriment of the class members, thus rendering the settlement uncertain, the far greater concern is the risk of inequity that this creates in

the settlement distribution. The Manual for Complex Litigation states at 239 that whether "claimants who are not members of the class are treated significantly differently" than members of the class is a factor that may "be taken into account in the determination of the settlement's fairness, adequacy and reasonableness ...".

96 In principle, there is nothing egregious about the payment of settlement funds to non-class members. Section 26(6) of the CPA provides the court with the discretion to sanction or direct payments to non-class members. In effect, the opt out provision reflects the intention of the defendants to settle all present and future litigation. This objective is not contrary to the scheme of the CPA per se. See, for example, the reasons of Brenner J. in Sawatzky v. Societe Chirurgiale Instrumentarium Inc. [1999] B.C.J. No. 1814 (S.C.), adopted by this court in Bisignano v. La Corporation Instrumentarium Inc. (September 1, 1999, Court File No. 22404/96, unreported.)

97 However, given that the settlement must be "fair, reasonable and in the best interests of the class", the court cannot sanction a provision which gives opt out claimants the potential for preferential treatment in respect of access to the Fund. The opt out provision as presently written has this potential effect where an opt out claimant either receives an award or settlement in excess of the benefits that he or she would have received had they not opted out and which must be satisfied out of the Fund. Alternatively, the preferential treatment could also occur where the opt out claimant receives an award similar to their entitlement under the settlement in quantum but without regard for the time phased payment structure of the settlement.

98 In my view, where a defendant wishes to settle a class proceeding by providing a single Fund to deal with both the claims of the class members and the claims of individuals opting out of the settlement, the payments out of the Fund must be made on an equitable basis amongst all of the claimants. Fairness does not require that each claimant receive equal amounts but what cannot be countenanced is a situation where an opt out claimant who is similarly situated to a class member receives a preferential payment.

99 The federal government argues that fairness ensues, even in the face of the different treatment, because the opt out claimant assumes the risk of individual litigation. I disagree. Because the defendants intend that all claims shall be satisfied from a single fund, individual litigation by a claimant opting out of the class pits that claimant against the members of the class. The opt out claimant stands to benefit from success because he or she may achieve an award in excess of the benefits provided under the settlement. This works to the detriment of the class members by the reducing the total amount of the settlement. More importantly however, the benefits to the class members will not increase as a result of unsuccessful opt out claimants.

100 In the instant case, fairness requires a modification to the opt out claimant provision of the settlement. The present opt out provision must be deleted and replaced with a provision that in the event of successful litigation by an opt out claimant, the defendants are entitled to indemnification from the Fund only to the extent that the claimant would have been entitled to claim from the Fund

had he or she remained in the class. This must of necessity include the time phasing factor. Such a provision ensures fairness in that there is no prospect of preferential distribution from the Fund, nor will the class suffer any detrimental effect as a result of the outcome of the individual litigation. The change also provides a complete answer to the complaint that the current opt out provision renders the settlement uncertain. Similarly, the modification renders the provision for defence costs to be paid out of the Fund unnecessary and thus it must be deleted.

101 Accordingly, the opt out provision of the settlement would not bean impediment to court approval with the modifications set out above.

102 In my view, the remainder of distribution scheme is fair and reasonable with this alteration to the opt out provision. It is beyond dispute that the compensation at any level will not be perfect, nor will it be tailored to individual cases but perfection is not the standard to be applied. The benefit levels are fair. More pointedly, fairness permeates the settlement structure in that each and every class member is provided an opportunity to make subsequent claims if his or her condition deteriorates. An added advantage is that there is a pre-determined, objective qualifying scheme so that class members will be able to readily assess their eligibility for additional benefits. Thus, while a claimant may not be perfectly compensated at any particular level, the edge to be gained by a scheme which terminates the litigation while avoiding the pitfalls of an imperfect, one-time-only lump sum settlement is compelling.

103 In any, event, the settlement structure also provides a reasonable basis for the distribution of the funds available. Class counsel described the distribution method as a "need not greed" system, where compensation is meant, within limits, to parallel the extent of the damages. There were few concerns raised about the compensation provided at the upper levels of the scheme. Rather, the majority of the objections centred on the benefits provided at Levels 1, 2 and 3. The damages suffered by those whose conditions fall within these Levels are clearly the most difficult to assess. This is particularly true in respect of those considered to be at Level 2. However, in order to provide for the subsequent claims, compromises must be made and in this case, I am of the view that the one chosen is reasonable.

104 Regardless of the submissions made with respect to comparable awards under the tort model, it is clear from the record that the compensatory, benefits assigned to claimants at different levels were largely influenced by the total of the monies available for allocation. As stated in the CASL study at p. 3:

> At the request of the Federal government of Canada, provincial governments, and Hepatitis C claimants, i.e. individuals infected with hepatitis C virus during the period of 1986 to 1990, an impartial group, the Canadian Association for the Study of the Liver (CASL) was asked to construct a natural history model of Hepatitis C. The intent of this effort was to generate a model that would be used by all parties, as guide to disbursing funds set aside to compensate patients

infected with hepatitis C virus through blood transfusion.

105 Of necessity, the settlement cannot, within each broad category, deal with individual differences between victims. Rather it must be general in nature. In my view, the allocation of the monies available under the settlement is "fair, reasonable and in the best interests of the class as a whole."

106 In making this determination, I have not ignored the submissions made by certain objectors and intervenors regarding the sufficiency of the Fund. They asserted that the apparent main advantage of this settlement, the ability to "claim time and time again" is largely illusory because the Fund may well be depleted by the time that the youngest members of the class make claims against it.

107 I cannot accede to this submission. The Eckler report states that with the contemplated holdbacks of the lump sum at Level 2 and the income replacement at Level 4 and above, the Fund will have a surplus of $334,173,000. Admittedly, Eckler currently projects a deficit of $58,533,000 if the holdbacks are released.

108 However, the Eckler report contains numerous caveats regarding the various assumptions that have been made as a matter of necessity, including the following, which is stated in section 12.2:

> A considerable number of assumptions have been made in order to calculate the liabilities in this report. Where we have made the assumptions, we used our best efforts based on our understanding of the plan benefits; in general, where we have made simplifying assumptions or approximations, we have tried to err on the conservative side, i.e. increasing costs and liabilities. In many instances we have relied on counsel for the assumptions and understand that they, have used their best efforts in making these. Nevertheless, the medical outcomes are very unclear - e.g. the CASL report indicates very wide ranges in its confidence intervals for the various probabilities it developed. There is substantial room for variation in the results. The differences will emerge in the ensuing years as more experience is obtained on the actual cohort size and characteristics of the infected claimants. These differences and the related actuarial assumptions will be re-examined at each periodic assessment of the Fund.

109 Unfortunately, but not unexpectedly, the limitations of the underlying medical studies upon which Eckler has based its report require the use of assumptions. For example. the report prepared by Dr. Remis, dated July 6, 1999, states at p. 642:

> There are important limitations to the analyses presented here and, in particular, with the precision of the estimates of the number of HCV-infected recipients who are likely to qualify for benefits under the Class Action Settlement ...

> The proportion of transfusion recipients who will ultimately be diagnosed is particularly important in this regard and has substantial impact on the final estimate. We used an estimate of 70% as the best case estimate for this proportion based on the BC experience but the actual proportion could be substantially different from this, depending on the type, extent and success of targeted notification activities that will be undertaken, especially, in Ontario and Quebec. This could alter the ultimate number who eventually qualify for benefits by as much as 1,500 in either direction.

110 The report of the CASL study states at. 22:

> Our attempt to project the natural history of the 1986-1990 post transfusion HCV infected cohort has limitations. Perhaps foremost among these is our lack of understanding of the long-term prognosis of the disease. For periods beyond 25 years, projections remain particularly uncertain. The wide confidence intervals surrounding long-term projections highlight this uncertainty.
>
> Other key, limitations are lack of applicability of these projections to children and special groups.

111 The size of the cohort and the percentage of the cohort which will make claims against the Fund are critical assumptions. Significant errors in either assumption will have a dramatic impact on the sufficiency of the Fund. Recognizing this, Eckler has chosen to use the most conservative estimates from the information available. The cohort size has been estimated from the CASL study rather than other studies which estimate approximately 20% less surviving members. Furthermore, Eckler has calculated liabilities on the basis that 100% of the estimated cohort will make claims against the Fund.

112 Class counsel urged the court to consider the empirical evidence of the "take-up rate" demonstrated in the completed class proceeding, Nantais v. Telectronics Proprietary (Canada) Ltd. (1995), 25 O.R. (3d) 331 (Gen. Div.), leave to appeal dismissed (1995), 129 D.L.R. (4th) 110 (Ont. Div. Ct.), to support a conclusion that the Fund is sufficient. In Nantais, all of the class members were known and accordingly received actual notice of the settlement. Seventy-two percent of the class chose to make claims, or "take-up" the settlement. It was contended that this amounted to strong evidence that less than one hundred per cent of the classes in these proceedings would take up this settlement. I cannot accept the analogy. While I agree that it is unlikely that the entire estimated cohort will take up the settlement, it is apparent from the caveats expressed in the reports provided to the court that the estimate of the cohort size may be understated by a significant number. Accordingly, for practical purposes, a less than one hundred per cent take up rate could well be counter-balanced by a concurrent miscalculation of the cohort size.

113 Although I cannot accept the Nantais experience as applicable on this particular point, the Eckler report stands alone as the only and best evidence before the court from which to determine the sufficiency of the Fund. Eckler has recognized the deficiencies inherent in the information available by using the most conservative estimates throughout. This provides the court with a measure of added comfort. Not to be overlooked as well, the distribution of the Fund will be monitored by this court and the courts in Quebec and British Columbia, guided by periodically, revised actuarial projections. In my view, the risk that the Fund will be completely depleted for latter claimants is minimal.

114 Consequently, given the empirical evidence proffered by Dr. Anderson as to the asymptomatic potential of HCV infection, the conservative approach taken by Eckler in determining the likely claims against the Fund and the role of the courts in monitoring the ongoing distributions, I am of the view that the projected shortfall of $58,000.000 considered in the context of the size of the overall settlement, is within acceptable limits. I find on the evidence before me, that the Fund is sufficient to provide the benefits and, thus, in this respect, the settlement is reasonable.

115 I turn now to the area of concern raised by counsel for the intervenor the Hepatitis C Society of Canada (the "Society"), namely the provision that mandates reversion of the surplus of the Plans to the defendants. The Society contends that this provision simpliciter is repugnant to the basis on which this settlement is constructed. It argues that the benefit levels were established on the basis of the total monies available, rather than a negotiation of benefit levels per se. Thus, it states there is a risk that the Fund will not be sufficient to provide the stated benefits and further, that this risk lies entirely with the class members because the defendants have no obligation to supplement the Fund if it proves to be deficient for the intended purpose. Moreover, the Society argues that the use of conservative estimates in defining the benefit levels, although an attempt at ensuring sufficiency, has the ancillary negative effect of minimizing the benefits payable to each class member under the settlement. Therefore, the Society contends that a surplus, if any develops in the ongoing administration of the Fund, should be used to augment the benefits for the class members.

116 The issue here is whether a reversion clause is appropriate in a settlement agreement in this class proceeding, and by extension, whether the inclusion of this clause is such that it would render the overall settlement unacceptable.

117 It is important to frame the submission of the Society in the proper context. This is not a case where the question of entitlement to an existing surplus is presented. Indeed, given the deficit projected by the Eckler report, it is conjectural at this stage whether the Fund will ever generate a surplus. If the Fund accumulates assets over and above the current Eckler projections, they must first be directed toward eliminating the deficit so that the holdbacks may be released.

118 The plan also provides that after the release of the holdbacks, the administrator may make an application to raise the $75,000 annual cap on income replacement if the Fund has sufficient assets to do so. It is only after these two areas of concern have been fully addressed that a surplus could be

deemed to exist.

119 The clause in issue does not, according to the interpretation given to the court by class counsel, permit the withdrawal by the defendants of any actuarial surplus that may be identified in the ongoing administration of the Fund. Rather, they state that it is intended that the remainder of the Fund, if any, revert to the defendants only after the Plans have been fully administered in the year 2080.

120 Remainder provisions in trusts are not unusual. Further, I reiterate that it is, at this juncture, complete speculation as to whether a surplus, either ongoing or in a remainder amount, will exist in the Fund. However, accepting the submission of class counsel at face value, the reversion provision is anomalous in that it is neither in the best interests of the plaintiff classes nor in the interests of defendants. The period of administration of the Fund is 80 years. No party took issue with class counsel's submission that the defendants are not entitled under the current language to withdraw any surplus in the Fund until this period expires. Likewise, there is no basis within the settlement agreement upon which the class members could assert any entitlement to access any surplus during the term of the agreement. Thus, any surplus would remain tied up, benefitting neither party during the entire 80 year term of the settlement.

121 Quite apart from the question of tying up the surplus for this unreasonable period of time, there is the underlying question of whether in the context of this settlement, it is appropriate for the surplus to revert in its entirety to the defendants.

122 The court is asked to approve the settlement even though the benefits are subject to fluctuation and regardless that the defendants are not required to make up any shortfall should the Fund prove deficient. This is so notwithstanding that the benefit levels are not perfect. It is therefore in keeping with the nature of the settlement and in the interests of consistency and fairness that some portion of a surplus may be applied to benefit class members.

123 This is not to say that it is necessary, as the Society suggests, that in order to be in the best interests of the class members, any surplus must only be used to augment the benefits within the settlement agreement. There are a range of possible uses to which any surplus may be put so as to benefit the class as a whole without focusing on any particular class member or group of class members. This is in keeping with the CPA which provides in s. 26(4) that surplus funds may "be applied in any manner that may reasonably be expected to benefit class members, even though the order does not provide for monetary relief to individual class members ...". On the other hand, in the proper circumstances, it may not be beyond the realm of reasonableness to allow the defendants access to a surplus within the Fund prior to the expiration of the 80 year period.

124 To attempt to determine the range of reasonable solutions at present, when the prospect of a surplus is uncertain at best, would be to pile speculation upon speculation. In the circumstances therefore, the only appropriate course, in my opinion, is to leave the question of the proper application of any surplus to the administrator of the Fund. The administrator may recommend to

the court from time to time, based on facts, experience with the Fund and future considerations, that all or a portion of the surplus be applied for the benefit of the class members or that all or a portion be released to the defendants. In the alternative, the surplus may be retained within the Fund if the administrator determines that this is appropriate. Any option recommended by the administrator would, of course, be subject to requisite court approval. This approach is in the best interests of the class and creates no conflicts between class members. Moreover, it resolves the anomaly created by freezing any surplus for the duration of the administration of the settlement. If the present surplus reversion clause is altered to conform with the foregoing reasons, it would meet with the court's approval.

125 There was an expressed concern as to the potential for depletion of the Fund through excessive administrative costs. The court shares this concern. However, the need for efficient access to the plan benefits for the class members and the associated costs that this entails must also be recognized. This requires an ongoing balancing so as to keep administrative costs in line while at the same time providing a user friendly claims administration. The courts, in their supervisory role, will be vigilant in ensuring that the best interests of the class will be the predominant criterion.

Disposition

126 In ordinary circumstances, the court must either approve or reject a settlement in its entirety. As stated by Sharpe J. in Dabbs No. 1 at para. 10:

> It has often been observed that the court is asked to approve or reject a settlement and that it is not open to the court to rewrite or modify its terms; Poulin v. Nadon, [1950] O.R. 219 (C.A.) at 222-3.

127 These proceedings, emanating from the blood tragedy, are novel and unusually complex. The parties have adverted to this in the settlement agreement which contemplates the necessity for changes of a non-material nature in Clause 12.01:

> This Agreement will not be effective unless and until it is approved by the Court in each of the Class Actions, and if such approvals are not granted without any material differences therein, this Agreement will be thereupon terminated and none of the Parties will be liable to any other Parties hereunder. (Emphasis added.)

128 The global settlement submitted to the court for approval is within the range of reasonableness having regard for the risk inherent in carrying this matter through to trial. Moreover, the levels of benefits ascribed within the settlement are acceptable having regard for the accessibility of the plan to successive claims in the event of a worsening of a class member's condition. This progressive approach outweighs any deficiencies which might exist in the levels of benefits.

129 I am satisfied based on the Eckler report that the Fund is sufficient, within acceptable tolerances to provide the benefits stipulated. There are three areas which require modification, however, in order for the settlement to receive court approval. First, regarding access to the Fund by opt out claimants, the benefits provided from the Fund for an opt out claimant cannot exceed those available to a similarly injured class member who remains in the class. This modification is necessary for fairness and the certainty of the settlement. Secondly, the surplus provision must be altered so as to accord with these reasons. Thirdly, in the interests of fairness, a sub-class must be created for the thalassemia victims to take into account their special circumstances.

130 The defendants have expressed their intention to be bound by the settlement if it receives court approval absent any material change. As stated, this reflects their acknowledgment of the complexity of the case, the scientific uncertainty surrounding the infections and the fact this settlement is crafted with a degree of improvisation.

131 The changes to the settlement required to obtain the approval of this court are not material in nature when viewed from the perspective of the defendants. Accepting the assumed value of $10,000,000 attributed to the opt outs by class counsel, a figure strongly supported by counsel for the defendants, the variation indicated is de minimis in the context of a $1.564 billion dollar settlement. The change required in respect of the surplus provision resolves the anomaly of tying up any surplus for the entire 80 year period of the administration of the settlement. In any event, given the projected $58,000,000 deficit, the question of a surplus is highly conjectural. The creation of the sub-class of thalassemia victims, in the context of the cohort size is equally de minimis. I am prepared to approve the settlement with these changes.

132 However, should the parties to the agreement not share the view that these changes are not material in nature, they may consider the proposed changes as an indication of "areas of concern" within the meaning the words of Sharpe J. in Dabbs No. 1 at para. 10:

> As a practical matter, it is within the power of the court to indicate areas of concern and afford the parties the opportunity to answer and address those concerns with changes to the settlement ...

133 The victims of the blood tragedy in Canada cannot be made whole by this settlement. No one can undo what has been done. This court is constrained in these settlement approval proceedings by its jurisdiction and the legal framework in which these proceedings are conducted. Thus, the settlement must be reviewed from the standpoint of its fairness, reasonableness and whether it is in the best interests of the class as a whole. The global settlement, its framework and the distribution of money within it, as well the adequacy of the funding to produce the specified benefits, with the modifications suggested in these reasons, are fair and reasonable. There are no absolutes for purposes of comparison, nor are there any assurances that the scheme will produce a perfect solution for each individual. However, perfection is not the legal standard to be applied nor could it be achieved in crafting a settlement of this nature. All of these points considered, the settlement,

with the required modifications, is in the best interests of the class as a whole.

133a I am obliged to counsel, the parties and the intervenors and especially to the individual objectors who took the time to either file a written objection or appear in person at the hearings. [The Court did not number this paragraph. QL has assigned the number 133a.] WINKLER J.

Case Name:
Robertson v. ProQuest Information and Learning Co.

RE: 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 Canwest Publishing Inc./Publications Canwest Inc., Canwest Books Inc. and Canwest (Canada) Inc.
AND RE: Heather Robertson, Plaintiff, and ProQuest Information and Learning Company, Cedrom-SNI Inc., Toronto Star Newspapers Ltd., Rogers Publishing Limited and Canwest Publishing Inc., Defendants

[2011] O.J. No. 1160

2011 ONSC 1647

Court File Nos. 03-CV-252945CP, CV-10-8533-00CL

Ontario Superior Court of Justice
Commercial List

S.E. Pepall J.

March 15, 2011.

(34 paras.)

Bankruptcy and insolvency law -- Companies' Creditors Arrangement Act (CCAA) matters -- Compromises and arrangements -- Sanction by court -- Application by the representative plaintiff and by one of the defendants, who was governed by an order under the Companies' Creditors Arrangement Act, for approval of a settlement that would resolve plaintiff's class proceeding and claim under the Act allowed -- Settlement would result in fair and reasonable outcome -- Settlement was recommended by all of the involved parties and it was not opposed by the defendants in the class proceeding who were not included in it.

Bankruptcy and insolvency law -- Proceedings -- Practice and procedure -- Settlements -- Application by the representative plaintiff and by one of the defendants, who was governed by an order under the Companies' Creditors Arrangement Act, for approval of a settlement that would

resolve plaintiff's class proceeding and claim under the Act allowed -- Settlement would result in fair and reasonable outcome -- Settlement was recommended by all of the involved parties and it was not opposed by the defendants in the class proceeding who were not included in it.

Civil litigation -- Civil procedure -- Parties -- Class or representative actions -- Settlements -- Approval -- Application by the representative plaintiff and by one of the defendants, who was governed by an order under the Companies' Creditors Arrangement Act, for approval of a settlement that would resolve plaintiff's class proceeding and claim under the Act allowed -- Settlement would result in fair and reasonable outcome -- Settlement was recommended by all of the involved parties and it was not opposed by the defendants in the class proceeding who were not included in it.

Application by Robertson and by the defendant Canwest Publishing Inc. for approval of a settlement. Robertson, who was a plaintiff in her own capacity and was also the representative plaintiff in a class proceeding, commenced this action in July 2003. The action was certified as a class proceeding in October 2008. Robertson claimed compensatory damages of $500 million and punitive and exemplary damages of $250 million against the defendants for copyright infringement. In January 2010 Canwest was granted an initial order pursuant to the Companies' Creditors Arrangement Act. In April 2010 Robertson filed a claim under the Arrangement Act for $500 million. The Monitor's opinion was that this claim was worth $0. The proposed settlement would resolve the class proceeding and the proceeding under the Arrangement Act. Court approval was not required for the claim under the Arrangement Act but it was required for the class proceeding. Under the settlement the claim under the Arrangement Act would be allowed in the amount of $7.5 million for voting and distribution purposes. Robertson undertook to vote in favour of the proposed Plan under the Arrangement Act. The action would be dismissed against Canwest, which did not admit liability. The action would not be dismissed against the other defendants. The Monitor was involved in the negotiation of the settlement and recommended approval for it concluded that the settlement agreement was a fair and reasonable resolution for Canwest.

HELD: Application allowed. The settlement agreement met the tests for approval under the Arrangement Act and under the Class Act. No one, including the non-settling defendants who received notice, opposed the settlement. Robertson was a very experienced and sophisticated litigant who previously resolved a similar class proceeding against other media companies. The settlement agreement was recommended by experienced counsel and it was entered into after serious negotiations between sophisticated parties. It would result in a fair and reasonable outcome, partly because Canwest was in an insolvency proceeding with all of its attendant risks and uncertainties.

Statutes, Regulations and Rules Cited:

Class Proceedings Act, 1992, S.O. 1992, c. 6, s. 29, s. 34

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36,

Counsel:

Kirk Baert, for the Plaintiff.

Peter J. Osborne and *Kate McGrann*, for Canwest Publishing Inc.

Alex Cobb, for the CCAA Applicants.

Ashley Taylor and *Maria Konyukhova*, for the Monitor.

REASONS FOR DECISION

S.E. PEPALL J.:--

Overview

1 On January 8, 2010, I granted an initial order pursuant to the provisions of the *Companies' Creditors Arrangement Act* ("*CCAA*") in favour of Canwest Publishing Inc. ("CPI") and related entities (the "LP Entities"). As a result of this order and subsequent orders, actions against the LP Entities were stayed. This included a class proceeding against CPI brought by Heather Robertson in her personal capacity and as a representative plaintiff (the "Representative Plaintiff"). Subsequently, CPI brought a motion for an order approving a proposed notice of settlement of the action which was granted. CPI and the Representative Plaintiff then jointly brought a motion for approval of the settlement of both the class proceeding as against CPI and the *CCAA* claim. The Monitor supported the request and no one was opposed. I granted the judgment requested and approved the settlement with endorsement to follow. Given the significance of the interplay of class proceedings with *CCAA* proceedings, I have written more detailed reasons for decision rather than simply an endorsement.

Facts

2 The Representative Plaintiff commenced this class proceeding by statement of claim dated July 25, 2003 and the action was case managed by Justice Cullity. He certified the action as a class proceeding on October 21, 2008 which order was subsequently amended on September 15, 2009.

3 The Representative Plaintiff claimed compensatory damages of $500 million plus punitive and exemplary damages of $250 million against the named defendants, ProQuest Information and Learning LLC, Cedrom-SNI Inc., Toronto Star Newspapers Ltd., Rogers Publishing Limited and CPI for the alleged infringement of copyright and moral rights in certain works owned by class

members. She alleged that class members had granted the defendants the limited right to reproduce the class members' works in the print editions of certain newspapers and magazines but that the defendant publishers had proceeded to reproduce, distribute and communicate the works to the public in electronic media operated by them or by third parties.

4 As set out in the certification order, the class consists of:

A. All persons who were the authors or creators of original literary works ("Works") which were published in Canada in any newspaper, magazine, periodical, newsletter, or journal (collectively "Print Media") which Print Media have been reproduced, distributed or communicated to the public by telecommunication by, or pursuant to the purported authorization or permission of, one or more of the defendants, through any electronic database, excluding electronic databases in which only a precise electronic reproduction of the Work or substantial portion thereof is made available (such as PDF and analogous copies) (collectively "Electronic Media"), excluding:

(a) persons who by written document assigned or exclusively licensed all of the copyright in their Works to a defendant, a licensor to a defendant, or any third party; or

(b) persons who by written document granted to a defendant or a licensor to a defendant a license to publish or use their Works in Electronic Media; or

(c) persons who provided Works to a not for profit or non-commercial publisher of Print Media which was licensor to a defendant (including a third party defendant), and where such persons either did not expect or request, or did not receive, financial gain for providing such Works; or

(d) persons who were employees of a defendant or a licensor to a defendant, with respect to any Works created in the course of their employment.

Where the Print Media publication was a Canadian edition of a foreign publication, only Works comprising of the content exclusive to the Canada edition shall qualify for inclusion under this definition.

(Persons included in clause A are thereinafter referred to as "Creators". A "licensor to a defendant" is any party that has purportedly authorized or provided permission to one or more defendants to make Works available in Electronic Media. References to defendants or licensors to defendants include their predecessors and successors in interest)

B. All persons (except a defendant or a licensor to a defendant) to whom a Creator,

or an Assignee, assigned, exclusively licensed, granted or transmitted a right to publish or use their Works in Electronic Media.

(Persons included in clause B are hereinafter referred to as "Assignees")

C. Where a Creator or Assignee is deceased, the personal representatives of the estate of such person unless the date of death of the Creator was on or before December 31, 1950.

5 As part of the *CCAA* proceedings, I granted a claims procedure order detailing the procedure to be adopted for claims to be made against the LP Entities in the *CCAA* proceedings. On April 12, 2010, the Representative Plaintiff filed a claim for $500 million in respect of the claims advanced against CPI in the action pursuant to the provisions of the claims procedure order. The Monitor was of the view that the claim in the *CCAA* proceedings should be valued at $0 on a preliminary basis.

6 The Representative Plaintiff's claim was scheduled to be heard by a claims officer appointed pursuant to the terms of the claims procedure order. The claims officer would determine liability and would value the claim for voting purposes in the *CCAA* proceedings.

7 Prior to the hearing before the claims officer, the Representative Plaintiff and CPI negotiated for approximately two weeks and ultimately agreed to settle the *CCAA* claim pursuant to the terms of a settlement agreement.

8 When dealing with the consensual resolution of a *CCAA* claim filed in a claims process that arises out of ongoing litigation, typically no court approval is required. In contrast, class proceeding settlements must be approved by the court. The notice and process for dissemination of the settlement agreement must also be approved by the court.

9 Pursuant to section 34 of the *Class Proceedings Act*, the same judge shall hear all motions before the trial of the common issues although another judge may be assigned by the Regional Senior Judge (the "RSJ") in certain circumstances. The action had been stayed as a result of the CCAA proceedings. While I was the supervising CCAA judge, I was also assigned by the RSJ to hear the class proceeding notice and settlement motions.

10 Class counsel said in his affidavit that given the time constraints in the *CCAA* proceedings, he was of the view that the parties had made reasonable attempts to provide adequate notice of the settlement to the class. It would have been preferable to have provided more notice, however, given the exigencies of insolvency proceedings and the proposed meeting to vote on the *CCAA* Plan, I was prepared to accept the notice period requested by class counsel and CPI.

11 In this case, given the hybrid nature of the proceedings, the motion for an order approving

notice of the settlement in both the class action proceeding and the *CCAA* proceeding was brought before me as the supervising *CCAA* judge. The notice procedure order required:

1) the Monitor and class counsel to post a copy of the settlement agreement and the notice order on their websites;
2) the Monitor to publish an English version of the approved form of notice letter in the National Post and the Globe and Mail on three consecutive days and a French translation of the approved form of notice letter in La Presse for three consecutive days;
3) distribution of a press release in an approved form by Canadian Newswire Group for dissemination to various media outlets; and
4) the Monitor and class counsel were to maintain toll-free phone numbers and to respond to enquiries and information requests from class members.

12 The notice order allowed class members to file a notice of appearance on or before a date set forth in the order and if a notice of appearance was delivered, the party could appear in person at the settlement approval motion and any other proceeding in respect of the class proceeding settlement. Any notices of appearance were to be provided to the service list prior to the approval hearing. In fact, no notices of appearance were served.

13 In brief, the terms of the settlement were that:

a) the *CCAA* claim in the amount of $7.5 million would be allowed for voting and distribution purposes;
b) the Representative Plaintiff undertook to vote the claim in favour of the proposed *CCAA* Plan;
c) the action would be dismissed as against CPI;
d) CPI did not admit liability; and
e) the Representative Plaintiff, in her personal capacity and on behalf of the class and/or class members, would provide a licence and release in respect of the freelance subject works as that term was defined in the settlement agreement.

14 The claims in the action in respect of CPI would be fully settled but the claims which also involved ProQuest would be preserved. The licence was a non-exclusive licence to reproduce one or more copies of the freelance subject works in electronic media and to authorize others to do the same. The licence excluded the right to licence freelance subject works to ProQuest until such time as the action was resolved against ProQuest, thereby protecting the class members' ability to pursue ProQuest in the action. The settlement did not terminate the lawsuit against the other remaining defendants. Under the *CCAA* Plan, all unsecured creditors, including the class, would be entitled to share on a pro rata basis in a distribution of shares in a new company. The Representative Plaintiff would share pro rata to the extent of the settlement amount with other affected creditors of the LP

Entities in the distributions to be made by the LP Entities, if any.

15 After the notice motion, CPI and the Representative Plaintiff brought a motion to approve the settlement. Evidence was filed showing, among other things, compliance with the claims procedure order. Arguments were made on the process and on the fairness and reasonableness of the settlement.

16 In her affidavit, Ms. Robertson described why the settlement was fair, reasonable and in the best interests of the class members:

> In light of Canwest's insolvency, I am advised by counsel, and verily believe, that, absent an agreement or successful award in the Canwest Claims Process, the prospect of recovery for the Class against Canwest is minimal, at best. However, under the Settlement Agreement, which preserves the claims of the Class as against the remaining defendants in the class proceeding in respect of each of their independent alleged breaches of the class members' rights, as well as its claims as against ProQuest for alleged violations attributable to Canwest content, there is a prospect that members of the Class will receive some form of compensation in respect of their direct claims against Canwest.
>
> Because the Settlement Agreement provides a possible avenue of recovery for the Class, and because it largely preserves the remaining claims of the Class as against the remaining defendants in the class proceeding, I am of the view that the Settlement Agreement represents a reasonable compromise of the Class claim as against Canwest, and is both fair and reasonable in the circumstances of Canwest's insolvency.

17 In the affidavit filed by class counsel, Anthony Guindon of the law firm Koskie Minsky LLP noted that he was not in a position to ascertain the approximate dollar value of the potential benefit flowing to the class from the potential share in a pro rata distribution of shares in the new corporation. This reflected the unfortunate reality of the *CCAA* process. While a share price of $11.45 was used, he noted that no assurance could be given as to the actual market price that would prevail. In addition, recovery was contingent on the total quantum of proven claims in the claims process. He also described the litigation risks associated with attempting to obtain a lifting of the *CCAA* stay of proceedings. The likelihood of success was stated to be minimal. He also observed the problems associated with collection of any judgment in favour of the Representative Plaintiff. He went on to state:

> ... The Representative Plaintiff, on behalf of the Class, could have elected to challenge Canwest's initial valuation of the Class claim of $0 before a Claims Officer, rather than entering into a negotiated settlement. However, a number of factors militated against the advisability of such a course of action. Most

> importantly, the claims of the Class in the class proceeding have not been proven, and the Class does not enjoy the benefit of a final judgment as against Canwest. Thus, a hearing before the Claims Officer would necessarily necessitate a finding of liability as against Canwest, in addition to a quantification of the claims of the Class against Canwest.
>
> ... a negative outcome in a hearing before a Claims Officer could have the effect of jeopardizing the Class claims as against the remaining defendants in the class proceeding. Such a finding would not be binding on a judge seized of a common issues trial in the class proceeding; however, it could have persuasive effect.
>
> Given the likely limited recovery available from Canwest in the Claims Process, it is the view of Class Counsel that a negotiated resolution of the quantification of Class claim as against Canwest is preferable to risking a negative finding of liability in the context of a contested Claims hearing before a Claims Officer.

18 The Monitor was also involved in the negotiation of the settlement and was also of the view that the settlement agreement was a fair and reasonable resolution for CPI and the LP Entities' stakeholders. The Monitor indicated in its report that the settlement agreement eliminated a large degree of uncertainty from the *CCAA* proceeding and facilitated the approval of the Plan by the requisite majorities of stakeholders. This of course was vital to the successful restructuring of the LP Entities. The Monitor recommended approval of the settlement agreement.

19 The settlement of the class proceeding action was made prior to the creditors' meeting to vote on the Plan for the LP Entities. The issues of the fees and disbursements of class counsel and the ultimate distribution to class members were left to be dealt with by the class proceedings judge if and when there was a resolution of the action with the remaining defendants.

<u>Discussion</u>

20 Both motions in respect of the settlement were heard by me but were styled in both the *CCAA* proceedings and the class proceeding.

21 As noted by Jay A. Swartz and Natasha J. MacParland in their article "*Canwest Publishing - A Tale of Two Plans*"[1]:

> "There have been a number of *CCAA* proceedings in which settlements in respect of class proceedings have been implemented including *McCarthy v. Canadian Red Cross Society*, *(Re:) Grace Canada Inc.*, *Muscletech Research and Development Inc.*, and *(Re:) Hollinger Inc.* ... The structure and process for notice and approval of the settlement used in the LP Entities restructuring

appears to be the most efficient and effective and likely a model for future approvals. Both motions in respect of the Settlement, discussed below, were heard by the *CCAA* judge but were styled in both proceedings." [citations omitted]

(a) Approval

(i) *CCAA* Settlements in General

22 Certainly the court has jurisdiction to approve a *CCAA* settlement agreement. As stated by Farley J. in *Re Lehndorff General Partner Ltd.*,[2] the *CCAA* is intended to provide a structured environment for the negotiation of compromises between a debtor company and its creditors for the benefit of both. Very broad powers are provided to the *CCAA* judge and these powers are exercised to achieve the objectives of the statute. It is well settled that courts may approve settlements by debtor companies during the *CCAA* stay period: *Re Calpine Canada Energy Ltd.*[3]; *Re Air Canada*[4]; and *Re Playdium Entertainment Corp.*[5] To obtain approval of a settlement under the *CCAA*, the moving party must establish that: the transaction is fair and reasonable; the transaction will be beneficial to the debtor and its stakeholders generally; and the settlement is consistent with the purpose and spirit of the *CCAA*. See in this regard *Re Air Canada*[6] and *Re Calpine.*[7]

(ii) Class Proceedings Settlement

23 The power to approve the settlement of a class proceeding is found in section 29 of the *Class Proceedings Act*, 1992[8]. That section states:

> 29(1) A proceeding commenced under this *Act* and a proceeding certified as a class proceeding under this *Act* may be discontinued or abandoned only with the approval of the court, on such terms as the court considers appropriate.
>
> (2) A settlement of a class proceeding is not binding unless approved by the court.
>
> (3) A settlement of a class proceeding that is approved by the court binds all class members.
>
> (4) In dismissing a proceeding for delay or in approving a discontinuance, abandonment or settlement, the court shall consider whether notice should be given under section 19 and whether any notice should include,

(a) an account of the conduct of the proceedings;
(b) a statement of the result of the proceeding; and
(c) a description of any plan for distributing settlement funds.

24 The test for approval of the settlement of a class proceeding was described in *Dabbs v. Sun Life Assurance Co. of Canada*[9]. The court must find that in all of the circumstances the settlement is fair, reasonable and in the best interests of those affected by it. In making this determination, the court should consider, amongst other things:

a) the likelihood of recovery or success at trial;
b) the recommendation and experience of class counsel; and
c) the terms of the settlement.

As such, it is clear that although the *CCAA* and class proceeding tests for approval are not identical, a certain symmetry exists between the two.

25 A perfect settlement is not required. As stated by Sharpe J. (as he then was) in *Dabbs v. Sun Life Assurance Co. of Canada*[10]:

> Fairness is not a standard of perfection. Reasonableness allows for a range of possible resolutions. A less than perfect settlement may be in the best interests of those affected by it when compared to the alternative of the risks and costs of litigation.

26 Where there is more than one defendant in a class proceeding, the action may be settled against one of the defendants provided that the settlement is fair, reasonable and in the best interests of the class members: *Ontario New Home Warranty Program et al. v. Chevron Chemical et al.*[11]

(iii) The Robertson Settlement

27 I concluded that the settlement agreement met the tests for approval under the *CCAA* and the *Class Proceedings Act*.

28 As a general proposition, settlement of litigation is to be promoted. Settlement saves time and expense for the parties and the court and enables individuals to extract themselves from a justice system that, while of a high caliber, is often alien and personally demanding. Even though settlements are to be encouraged, fairness and reasonableness are not to be sacrificed in the process.

29 The presence or absence of opposition to a settlement may sometimes serve as a proxy for reasonableness. This is not invariably so, particularly in a class proceeding settlement. In a class proceeding, the court approval process is designed to provide some protection to absent class members.

30 In this case, the proposed settlement is supported by the LP Entities, the Representative Plaintiff, and the Monitor. No one, including the non-settling defendants all of whom received notice, opposed the settlement. No class member appeared to oppose the settlement either.

31 The Representative Plaintiff is a very experienced and sophisticated litigant and has been so recognized by the court. She is a freelance writer having published more than 15 books and having been a regular contributor to Canadian magazines for over 40 years. She has already successfully resolved a similar class proceeding against Thomson Canada Limited, Thomson Affiliates, Information Access Company and Bell Global Media Publishing Inc. which was settled for $11 million after 13 years of litigation. That proceeding involved allegations quite similar to those advanced in the action before me. In approving the settlement in that case, Justice Cullity described the involvement of the Representative Plaintiff in the class proceeding:

> The Representative Plaintiff, Ms. Robertson, has been actively involved throughout the extended period of the litigation. She has an honours degree in English from the University of Manitoba, and an M.A. from Columbia University in New York. She is the author of works of fiction and non-fiction, she has been a regular contributor to Canadian magazines and newspapers for over 40 years, and she was a founder member of each of the Professional Writers' Association of Canada and the Writers' Union of Canada. Ms. Robertson has been in communication with class members about the litigation since its inception and has obtained funds from them to defray disbursements. She has clearly been a driving force behind the litigation: *Robertson v. Thomson Canada*[12].

32 The settlement agreement was recommended by experienced counsel and entered into after serious and considered negotiations between sophisticated parties. The quantum of the class members' claim for voting and distribution purposes, though not identical, was comparable to the settlement in *Robertson v. Thomson Canada*. In approving that settlement, Justice Cullity stated:

> Ms. Robertson's best estimate is that there may be 5,000 to 10,000 members in the class and, on that basis, the gross settlement amount of $11 million does not appear to be unreasonable. It compares very favourably to an amount negotiated among the parties for a much wider class in the U.S. litigation and, given the risks and likely expense attached to a continuation of the proceeding, does not appear to be out of line. On this question I would, in any event, be very reluctant to second guess the recommendations of experienced class counsel, and their well informed client, who have been involved in all stages of the lengthy litigation.[13]

33 In my view, Ms. Robertson's and Mr. Guindon's description of the litigation risks in this class proceeding were realistic and reasonable. As noted by class counsel in oral argument, issues relating

to the existence of any implied license arising from conduct, assessment of damages, and recovery risks all had to be considered. Fundamentally, CPI was in an insolvency proceeding with all its attendant risks and uncertainties. The settlement provided a possible avenue for recovery for class members but at the same time preserved the claims of the class against the other defendants as well as the claims against ProQuest for alleged violations attributable to CPI content. The settlement brought finality to the claims in the action against CPI and removed any uncertainty and the possibility of an adverse determination. Furthermore, it was integral to the success of the consolidated plan of compromise that was being proposed in the *CCAA* proceedings and which afforded some possibility of recovery for the class. Given the nature of the CCAA Plan, it was not possible to assess the final value of any distribution to the class. As stated in the joint factum filed by counsel for CPI and the Representative Plaintiff, when measured against the litigation risks, the settlement agreement represented a reasonable, pragmatic and realistic compromise of the class claims.

34 The Representative Plaintiff, Class Counsel and the Monitor were all of the view that the settlement resulted in a fair and reasonable outcome. I agreed with that assessment. The settlement was in the best interests of the class and was also beneficial to the LP Entities and their stakeholders. I therefore granted my approval.

S.E. PEPALL J.

cp/e/qllxr/qlvxw/qlbdp

1 Annual Review of Insolvency Law, 2010, J.P. Sarra Ed, Carswell, Toronto at page 79.

2 (1993), 17 C.B.R. (3d) 24 (Ont. Gen. Div.) at 31.

3 2007 ABQB 504 at para. 71; leave to appeal dismissed 2007 ABCA 266 (Alta. C.A.).

4 (2004), 47 C.B.R. (4th) 169 (Ont. S.C.J.).

5 (2001), 31 C.B.R. (4th) 302 (Ont. S.C.J.) at para. 23.

6 *Supra.* at para. 9.

7 *Supra.* at para. 59.

8 S.O. 1992, c. 6.

9 [1998] O.J. No. 1598 (Ont. Gen. Div.) at para. 9.

10 (1998), 40 O.R. (3d) 429 at para 30.

11 [1999] O.J. No. 2245 (Ont. S.C.J.) at para. 97.

12 [2009] O.J. No. 2650 at para. 15.

13 *Robertson v. Thomson Canada*, [2009] O.J. No. 2650 para. 20.

Case Name:

Marcantonio v. TVI Pacific Inc.

Between
Joe Marcantonio, Plaintiff, and
TVI Pacific Inc., Clifford M. James, Robert C. Armstrong, C. Brian Cramm, Jan R. Horejsi, Peter C.G. Richards, and John W. Adkins, Defendants
PROCEEDING UNDER the Class Proceedings Act, 1992

[2009] O.J. No. 3409

82 C.P.C. (6th) 305

2009 CarswellOnt 4850

179 A.C.W.S (3d) 761

Court File No. CV-08-35806100CP

Ontario Superior Court of Justice
Toronto, Ontario

J.L. Lax J.

Heard: June 17, 2009.
Judgment: August 10, 2009.

(38 paras.)

Civil litigation -- Civil procedure -- Parties -- Class or representative actions -- Certification -- Settlements -- Approval -- Costs -- Particular items -- Counsel fees -- Particular circumstances -- After discontinuance of action -- Motion by parties for certification of class proceeding for settlement purposes allowed -- Plaintiff class properly defined as those who purchased securities from defendant over limited period -- Pleadings adequately alleged negligence, misrepresentation and conspiracy on part of company and officers -- Representative plaintiff appropriate -- Settlement of $2.1 million reasonable given statutory limits on recovery at and risks of trial -- Contingency fees of 25 percent of settlement amount reasonable -- Class Proceedings Act, 1992, s. 33.

Legal profession -- Barristers and solicitors -- Compensation -- Contingency agreements -- Fair and reasonable -- Motion by parties for certification of class proceeding for settlement purposes allowed -- Plaintiff class properly defined as those who purchased securities from defendant over limited period -- Pleadings adequately alleged negligence, misrepresentation and conspiracy on part of company and officers -- Representative plaintiff appropriate -- Settlement of $2.1 million reasonable given statutory limits on recovery at and risks of trial -- Contingency fees of 25 percent of settlement amount reasonable.

Professional responsibility -- Self-governing professions -- Remuneration -- Contingency fees -- Professions -- Legal -- Barristers and solicitors -- Motion by parties for certification of class proceeding for settlement purposes allowed -- Plaintiff class properly defined as those who purchased securities from defendant over limited period -- Pleadings adequately alleged negligence, misrepresentation and conspiracy on part of company and officers -- Representative plaintiff appropriate -- Settlement of $2.1 million reasonable given statutory limits on recovery at and risks of trial -- Contingency fees of 25 percent of settlement amount reasonable.

Securities regulation -- Civil liability -- Public statements or release of documents by influential persons -- Motion by parties for certification of class proceeding for settlement purposes allowed -- Plaintiff class properly defined as those who purchased securities from defendant over limited period -- Pleadings adequately alleged negligence, misrepresentation and conspiracy on part of company and officers -- Representative plaintiff appropriate -- Settlement of $2.1 million reasonable given statutory limits on recovery at and risks of trial -- Contingency fees of 25 percent of settlement amount reasonable -- Securities Act, s. 138.

Motion by all parties to certify an action as a class proceeding for settlement purposes. The action was launched against TVI, a publicly-traded mining company, and its directors and officers by shareholders who alleged the defendants conspired to issue materially false or misleading financial statements and otherwise contravening securities law. The action proceeded in Ontario and Quebec. On the eve of the due date for the defendants to file materials in response to the certification record, settlement negotiations were initiated. They resulted in a settlement agreement under which TVI would pay $2.1 million, would try to re-price certain outstanding stock options, and would adopt corporate governance measures to prevent future options manipulation. The parties jointly sought certification for the purposes of settlement, settlement approval and approval of legal fees for the Ontario class of plaintiffs, defined as those who acquired TVI securities during the defined class period and held those securities on August 9, 2007, as well as exempt Quebec class members. The experienced class counsel retained by the representative plaintiff recommended approval of the settlement as it was half of what the plaintiffs were limited to achieve at trial, and would avoid the time and expense of trial which would significantly erode the benefits to the class members of the ultimate award. Litigation would have been complex because of recent changes to securities law. Class counsel sought approval for fees totalling $525,000, or 25 percent of the settlement amount. The retainer agreement provided for this sum.

HELD: Motion allowed. The pleadings disclosed a cause of action in negligence, negligent and fraudulent misrepresentation and conspiracy. There was ain identifiable class of plaintiffs. The claims raised common issues. Individual litigation of each plaintiff's claim would be difficult, time-consuming and expensive. The representative plaintiff had no interests in conflict with those of the other Ontario class members. The settlement was the product of arm's length bargaining by experienced counsel and presumed fair. In light of the risks faced by the plaintiffs, the range of damages they stood to recover, and the recommendations of class counsel, the court approved the settlement. Legal fees were awarded to class counsel as claimed, because they were fair and reasonable.

Statutes, Regulations and Rules Cited:

Class Proceedings Act, 1992, S.O. 1992, c. 6, s. 33

Securities Act, R.S.O. 1990, c. S.5, s. 138.3, s. 138.5, s. 138.8(1)

Counsel:

A. Dimitri Lascaris and *Monique L. Radlein*, for the Plaintiff.

Eric R. Hoaken, for the Defendants.

ENDORSEMENT

1 **J.L. LAX J.**:-- This is a securities class action brought pursuant to the *Class Proceedings Act, 1992*, S.O. 1992, c. 6 ("CPA") arising from alleged misrepresentations and stock options manipulation. The parties settled the action on April 22, 2009, and brought a motion for, among other things, an order certifying the action as a class proceeding for settlement purposes, approving the settlement and approving class counsel fees. I granted the order with reasons to follow. These are my reasons.

Nature of the Claim

2 TVI Pacific Inc. ("TVI") is a publicly-traded mining company with its shares listed on the Toronto Stock Exchange ("TSX"). The individual defendants were directors of TVI. This action is brought on behalf of an Ontario class of persons and entities who acquired TVI securities on or after March 30, 2006, and held some or all of the securities on August 9, 2007. It is alleged that during the class period the defendants (1) conspired and breached their duty of care to TVI shareholders by issuing materially false and/or inaccurate audited financial statements for years ended 2005 and 2006 and interim unaudited financial statements for the quarter ended March 31, 2007; and (2)

granted in-the-money stock options in contravention of TVI's Stock Option Plan, TSX rules and securities legislation in Ontario and Quebec. With respect to the financial statements, TVI subsequently issued two corrective disclosures on August 9, 2007 and December 18, 2007.

3 On March 3, 2008, Siskinds LLP filed a class proceeding against the defendants on behalf of Mr. Florent Audette, a Quebec resident. At that time, no Ontario resident had come forward to represent the interests of the class in Ontario. On April 10, 2008, this action was filed on behalf of Mr. Joe Marcantonio, an Ontario resident, alleging claims similar to those made in the Audette Ontario action. On July 25, 2008, the Quebec affiliate of Siskinds, filed the Petition styled *Audette c. TVI Pacific Inc. et al*, [2009] J.Q. no 4647, in Quebec Superior Court and Mr. Audette gave instructions to hold the Audette Ontario action in abeyance. After the settlement was reached, Mr. Audette instructed Siskinds to request the discontinuance of the Audette Ontario action.

4 Mr. Marcantonio served his certification record in October 2008. On the eve of the due date for the filing of the defendants' responding materials, the defendants initiated settlement discussions. Following several months of negotiations, the parties concluded a settlement agreement that provides for:

(a) a gross settlement fund of $2.1 million;
(b) TVI's agreement to make efforts to re-price certain outstanding stock options; and
(c) the adoption of corporate governance measures designed to prevent future options manipulation.

5 As a result of the settlement, the parties jointly sought certification for the purposes of settlement, settlement approval and approval of legal fees and disbursements on behalf of an Ontario class defined as:

> All persons and entities, who acquired securities of TVI during the Class Period, and who held some or all of those securities on August 9, 2007, other than Excluded Persons and Quebec Class Members, but specifically including the Exempt Quebec Members.

Certification

6 Numerous cases hold that where certification is sought for the purposes of settlement, the certification requirements must be met, but are not applied as stringently. Perell J. has helpfully gathered the authorities together and they can be found in *Corless v. KPMG LLP*, [2008] O.J. No. 3092 at para. 30 (S.C.J.) (QL).

7 For settlement purposes, I am satisfied that each of the criteria for certification is satisfied. The pleadings disclose a cause of action against the defendants for negligence, negligent and fraudulent misrepresentation, and conspiracy. The pleading asserts that the plaintiff intends to seek leave under

s. 138.8(1) of the *Securities Act*, R.S.O. 1990, c. S.5 ("OSA") to amend the Statement of Claim to plead the cause of action in s. 138.3 of the *OSA*. There is an identifiable class defined by objective criteria that (a) identifies persons with a potential claim, (b) describes who is entitled to notice, and (c) defines those who will be bound by the result: *Bywater v. Toronto Transit Commission*, [1998] O.J. No. 4913 at para. 10 (Gen. Div.) (QL).

8 The claims of the class members raise the following common issue:

> Did the defendants, or any of them, breach duties of care owed to the Ontario class, by reason of the alleged acts, omissions, disclosures or non-disclosures relating to the issuance and/or restatement of TVI's audited consolidated financial statements for the years ended December 31, 2005 and 2006, and its interim unaudited consolidated financial statements for the quarter ended March 31, 2007, and or to TVI's stock option practices during or prior to the Class Period?

9 Individual litigation of securities cases can be difficult, time-consuming and expensive. Many claims would never be advanced because they are uneconomic for an individual investor to pursue. A class action is the optimal method of procuring a remedy for a group of investors who allege they have been harmed in similar ways as a single determination of the defendants' liability eliminates duplication of fact-finding and legal analysis. Further, a class action has the potential to act as an essential and useful supplement to the deterrent effects of regulatory oversight. It enhances the incentive for directors and officers to ensure that their disclosures to the investing public are materially accurate, thereby enhancing investor protection. Consequently, a class proceeding is the preferable procedure because it provides a fair, efficient and manageable method of determining the common issue, and advances the proceeding in accordance with the goals of access to justice, judicial economy and behaviour modification.

10 Mr. Marcantonio is a member of the proposed Ontario class and would fairly and adequately represent its interests. He does not have, regarding the common issues or any issues arising out of the common issues, any interests in conflict with the interests of other Ontario class members. He has an understanding of the issues and allegations raised in the Ontario action and has actively participated in the litigation and the settlement process.

Settlement Approval

11 To approve a settlement, the court must find that the settlement is fair, reasonable and in the best interests of the class as a whole: *Dabbs v. Sun Life Assurance Co. of Canada*, [1998] O.J. No. 1598 at para. 9 (Gen. Div.) (QL); *Parsons v. Canadian Red Cross Society*, [1999] O.J. No. 3572 at paras. 68-69 (S.C.J.) (QL). To be approved, the settlement must fall within a zone or range of reasonableness: *Ontario New Home Warranty Program v. Chevron Chemical Co.* (1999), 46 O.R. (3d) 130 at para. 89 (S.C.J.), Winkler J. (now C.J.O.).

12 In determining whether to approve a settlement, the court uses the following factors as a

guide, although some will have more or less significance than others and some may not be present in a particular case: (a) the likelihood of recovery or likelihood of success; (b) the amount and nature of discovery, evidence or investigation; (c) the settlement terms and conditions; (d) the recommendation and experience of counsel; (e) the risk, future expense and likely duration of litigation; (f) the recommendation of neutral parties, if any; (g) the number of objectors and nature of objections; (h) the presence of good faith, arm's length bargaining and the absence of collusion; (i) the information conveying to the court the dynamics of, and the positions taken by the parties during the negotiations; and (j) the degree and nature of communications by counsel and the representative plaintiff with class members during the litigation. See *Parsons v. Canadian Red Cross Society, supra* at paras. 71-72.

13 Before the court is a comprehensive affidavit of Mr. Charles Wright who is a Siskinds' partner and an experienced class action lawyer. He was directly involved in the prosecution and resolution of this action. His evidence points to a number of factors that commend this settlement as fair and reasonable and in the best interests of the class. I review some of these below.

14 Securities class actions are not that common perhaps because there are substantial risks in prosecuting them. Unlike purchasers in the primary market, who are provided a right of action under the *OSA*, until recently, secondary market purchasers had to persuade the court that the defendants owed them a duty of care. In response, defendants have argued, and courts have often held, that secondary market purchasers have to demonstrate that they actually relied upon the defendants' misrepresentations. On December 31, 2005, Bill 198, now embodied in Part XXIII.1 of the *OSA*, came into force. It was a response to the perceived failure of the common law to provide an effective remedy for secondary market misrepresentation. Part XXIII.1 removes the reliance requirement through the creation of a statutory right of action. However, the right of action is subject to obtaining leave of the court and there has never been a leave decision under the new legislation.

15 In addition to the uncertainty surrounding the ability to advance the statutory cause of action, the plaintiff in this action also faced the risk of not being able to establish (i) that the representations or omissions were materially misleading; (ii) that the class had incurred the damages claimed; and (iii) to the extent necessary for purposes of the common law claims, detrimental reliance.

16 Class counsel's estimate of class damages was $16 million. In the course of settlement discussions, class counsel retained Mr. Paul Mulholland, an expert in the measurement of securities class action damages, to assess actual damages suffered by the class during the class period. It is Mr. Mulholland's opinion that class damages as assessed by a court would not approach this number, but rather would likely fall between the lowest and highest estimates of the statutorily established limits on the defendants' liability, as explained below.

17 The statutory claim under Part XXIII.1 of the *OSA* is subject to liability limits. It caps the issuer's liability at the greater of 5% of the pre-misrepresentation market capitalization of the

defendant issuer and $1 million. The statute directs how market capitalization is to be calculated. Class counsel performed this calculation and determined that TVI's liability limit fell within the range of about $2.8 million to $4.2 million.

18 Part XXIII.1 of the *OSA* also sets caps on the liability of directors and officers. Class counsel performed this calculation and determined that these liability limits were $189,500 (rounded to $200,000). The application of the liability limits (absent proof of fraud) would thus limit total recovery from the defendants to a range of approximately $3 million to $4.4 million. As a result, even if the plaintiff and class members were completely successful at trial, they would have had difficulty obtaining damages greater than $4.4 million, and could be limited to damages of as little as $3 million.

19 The caps discussed above do not apply to the common law claims for damages arising from negligence and negligent and fraudulent misrepresentation. However, as I have mentioned, the damages assessment of Mr. Mulholland is that these damages, if proved, would fall within the statutory limits. Moreover, as noted earlier, misrepresentation claims can be difficult to certify as reliance is a necessary element of proof: *Hercules Management Ltd. v. Ernst & Young*, [1997] 2 S.C.R. 165 at para. 18. As well, the defendants had due diligence and reasonable reliance defences available to them and there was a risk that these defences would succeed.

20 The court requires sufficient evidence in order to exercise an objective, impartial and independent assessment of the fairness of the settlement: *Dabbs, supra* at para. 15. However, it is not necessary for formal discovery to have occurred at the time of settlement, and settlements reached at an early stage of the proceedings can be appropriate. In this case, no discoveries or other examinations were completed, but I am satisfied that class counsel had significant information about the case as a result of their own investigations and the information that was obtained from the defendants in the course of settlement discussions. In particular, the defendants provided to class counsel an expert opinion which they had obtained. The defendants' expert concluded that the damages of the class were negligible as all or virtually all of the share price decreases resulted from news affecting the mining industry as a whole and were unrelated to the erroneous financial statements. Although class counsel disputed this, it was in light of this opinion that Mr. Mulholland was retained.

21 The settlement amount of $2.1 million represents a substantial portion of the potentially recoverable damages of between $3 million and $4.4 million assessed by Mr. Mulholland. As a percentage of gross recovery, it represents between 48% and 70% of his assessment of loss. On a net recovery basis, taking into account class counsel's requested fees and administration expenses, which together are in the amount of $809,287.17, the class would recover between 29% and 43% of the loss. This recovery is fair and reasonable and compares very favourably with the percentage net recovery in other securities class action settlements, such as *Mondor v. Fisherman*, [2002] O.J. No. 1855 (S.C.J.) (QL), and *Lawrence et al. v. Atlas Cold Storage et al.* (February 12, 2009), Toronto 04-CV-263289CP (S.C.J.) where net recovery was in the range of 20%.

22 With respect to the options-related allegations, the information provided by the defendants made it clear that many of the problems were a result of poor procedures, rather than intentional fault. It also became clear that any benefits to the defendants were negligible due to the decrease in TVI's share price. This resulted in certain options becoming substantially out-of-the-money.

23 Nonetheless, in order to address the allegations concerning the granting of in-the-money stock options, the settlement agreement provides that TVI will make all reasonable efforts to effect the re-pricing of these options. In addition, it provides that TVI will develop and implement corporate governance measures as specified in the agreement to address its stock option granting practices. For the purpose of obtaining advice concerning the recommended corporate governance measures, class counsel retained and relied on advice from Dr. Richard Leblanc, Assistant Professor of Law, Corporate Governance & Ethics at York University. In the opinion of class counsel, these reforms are productive enhancements of significant value to shareholders.

24 Although Ontario class counsel received a number of inquiries about the settlement following publication of the notices approved by the court, there are no objectors. The distribution protocol harmonizes the plaintiff's theory of damages with s. 138.5 of the *OSA*. The result is a formula that takes into account the two corrective disclosures and is designed to fairly and rationally allocate the proceeds of the net settlement amount among authorized claimants based on the relative strength of the class members' claims as the class period progressed and damages were incurred.

25 At the time of settlement, the action was still in the early stages of litigation. Without a settlement, the plaintiff would have faced the expense of a leave motion under the new secondary market liability provisions of the *OSA*, a contested certification motion, discovery, a trial of the common issues, and inevitable appeals at each stage. Absent a settlement, there would have been no payment to class members for a number of years. A settlement brings the significant benefit of finality and an immediate payment to class members.

26 This settlement is the product of arm's length bargaining by very experienced counsel. There is a strong initial presumption of fairness when a proposed class settlement, which was negotiated at arm's length by class counsel, is presented for court approval. As Justice Sharpe (as he then was) stated in *Dabbs v. Sun Life Assurance Co. of Canada*, [1998] O.J. No. 2811 (Gen. Div.) (QL) at para. 32:

> ... The recommendation of counsel of high repute is significant. While class counsel have a financial interest at stake, their reputation for integrity and diligent effort on behalf of their clients is also on the line. ...

27 In light of the risks the plaintiff faced, the possible range of damages recoverable, the substantial benefit available to class members, and the recommendation of class counsel who have extensive experience in litigating class actions and particular expertise in securities class actions and stock options manipulation, I am satisfied that the settlement is fair, reasonable and in the best interests of the class. For these reasons, it was approved.

Class Counsel Fees

28 The fees of class counsel are to be fixed and approved on the basis of whether they are fair and reasonable in all of the circumstances. This is determined in light of the risk undertaken and the degree of success or result achieved: *Maxwell v. MLG Ventures Ltd.* (1996), 30 O.R. (3d) 304 (Gen. Div.); *Windisman v. Toronto College Park Ltd.*, [1996] O.J. No. 2897 (Gen. Div.); *Serwaczek v. Medical Engineering Corp.*, [1996] O.J. No. 3038 (Gen. Div.); *Parsons v. Canadian Red Cross Society* (2000), 49 O.R. (3d) 281 (S.C.J.). This approach was approved in *Gagne v. Silcorp Ltd.* (1998), 41 O.R. (3d) 417 at 423 (C.A.).

29 In the context of the *CPA*, a premium on fees is the reward for taking on meritorious but difficult matters. The courts have recognized that the objectives of the *CPA* - judicial economy, access to justice and behaviour modification - are dependent, in part, upon counsel's willingness to take on class proceedings, which in turn depends on the incentives available to counsel to assume the risks and burden of class proceedings: *Gagne, supra*; *Parsons, supra*; *Vitapharm Canada Ltd. v. F. Hoffmann-La Roche Ltd.*, [2005] O.J. No. 1117 (S.C.J.) (QL).

30 The need for a meaningful premium on fees is particularly important in cases involving more modest damage amounts where the maximum potential upside to class counsel is limited. Otherwise, there is a risk that counsel would decline to pursue cases giving rise to modest damages and smaller issuers would effectively become immunized from class litigation. This need is heightened in the context of the evolving practice of securities class actions where notice and administration costs are fixed expenses whether the settlement amount is $20 million or $2 million. As a result, in smaller settlements, costs and legal fees represent a larger percentage of the settlement fund. For example, in this case, these administrative costs (roughly $210,000) together with the requested fees of 25% of the settlement amount represent 39% of gross recovery, whereas in a $20 million settlement, the same costs with the same fee request would represent 27% of gross recovery.

31 Class counsel request fees in accordance with a written fee agreement dated April 10, 2008. It provides that legal fees will be charged on a percentage basis in an amount representing 25% of "all benefits obtained for the class members, including costs, notice and administration," plus disbursements and GST. Ontario class counsel and Quebec class counsel agreed to request legal fees such that their cumulative requests for legal fees do not exceed 25% of the settlement amount plus disbursements and applicable taxes. They estimated that the Ontario class constitutes 90% of the class defined in the settlement agreement, and that the Quebec class constitutes 10% of the class. As a result, Ontario class counsel request legal fees in the amount of $472,500, which represents 25% of the portion of the settlement amount allocated to the Ontario class, plus GST and disbursements in the amount of $42,667.69. Quebec class counsel will request legal fees in the amount of $52,500. The combined legal fee requests total $525,000 or 25% of the monetary settlement benefit of $2.1 million. The amount requested is consistent with the retainer agreement and in line with percentage contingency fees that have been awarded in other class actions.

32 In *VitaPharm, supra* at para. 67, Justice Cumming summarized some of the factors to be considered by the court when fixing class counsel's fees: (a) the factual and legal complexities of the matters dealt with; (b) the risk undertaken, including the risk that the matter might not be certified; (c)the degree of responsibility assumed by class counsel; (d) the monetary value of the matters in issue; (e) the importance of the matter to the class; (f) the degree of skill and competence demonstrated by class counsel; (g) the results achieved; (h) the ability of the class to pay; (i) the expectations of the class as to the amount of fees; and (j) the opportunity cost to class counsel in the expenditure of time in pursuit of the litigation and settlement.

33 The risks in undertaking this litigation include the following:

(a) that the court would dismiss certain of the claims on a preliminary motion;
(b) that there has never been a leave decision under the new investor protection legislation under Part XXIII.1 of the *OSA*, and the court may not have granted leave to plead causes of action under s. 138.3;
(c) that the court would not certify the action, or would not certify a national class;
(d) that the plaintiff would not be able to establish actionable misrepresentations, or would fail to establish a causal connection between the misrepresentations and some or all of the losses alleged; and
(e) that any judgment in favour of the plaintiff and the class would be appealed, so that the benefits of any such judgment would be significantly delayed.

34 In determining a fee award, the court may consider the manner in which counsel has conducted the proceeding. Whether counsel have agreed to indemnify the representative plaintiff against an adverse costs award, thereby saving the class from having to pay the statutory 10% to the Class Proceedings Fund, is a relevant factor in fixing fees: *Bellaire v. Daya*, [2007] O.J. No. 4819 at para. 81 (S.C.J.) (QL). Counsel in this case have done this. The class also benefits from class counsel having requested and reviewed fixed-fee quotations from several Administrators to ensure the most cost-effective administration of the settlement agreement.

35 In assessing the success achieved, I have already noted that the settlement amount of $2.1 million represents recovery of a substantial portion of the damages sustained by the class. The implementation of the corporate governance measures and the re-pricing of stock options also provide a benefit to class members and future TVI shareholders. Counsel are not asking the court to attach value to this aspect of the settlement, even though the retainer agreement provides for legal fees to be calculated as a percentage of "all benefits obtained for the class" and these are benefits obtained for the class. Further, class members benefit from a settlement term that required the defendants to pay the settlement amount into an escrow account which is earning interest. This will increase the net settlement amount available to class members. It will also decrease the fee request as a percentage of the recovery because class counsel do not seek interest on their legal fees and

disbursements.

36 The method of determining fees set out in s. 33 of the *CPA* - the 'lodestar' method - has been the subject of judicial and academic criticism. Justice Cullity recently commented on its deficiencies in *Martin v. Barrett*, [2008] O.J. No. 2105 at paras. 38-39 (S.C.J.) (QL); see also, *Endean v. Canadian Red Cross Society*, [2000] B.C.J. No. 1254 at paras. 15-16, 19 (S.C.) (QL); Benjamin Alarie, "Rethinking the Approval of Class Counsel's Fees in Ontario Class Actions" (2007) 4(1) *Canadian Class Action Review* 15 at 37-38.

37 A multiplier can reward lawyers who accumulate unnecessary time and punish those who are able to do things effectively in less time. I do not have to grapple with these difficulties in this case as the retainer agreement does not provide that fees are to be calculated by applying a multiplier and none is requested. Nonetheless, based on time included in the evidence on the motion, and based on consideration of only the monetary benefits obtained for the class, by the time the litigation is concluded and interest accrues on the settlement amount, counsel estimate the multiplier will be approximately 2.5. This settlement was achieved at an early stage, but if a multiplier were to be applied, I consider a multiplier in this range to be acceptable having regard to the risks assumed and the results obtained for class members in the circumstances of this case.

38 For these reasons, I concluded that the fees requested were fair and reasonable and I awarded legal fees in the amount of $472,500, plus applicable taxes, and disbursements in the amount of $42,667.69 to Ontario class counsel. The settlement that I approved settles the claims asserted in this action and the Audette Ontario action. As the classes are identical, the interests of the class proposed in the Audette Ontario action are resolved by the settlement of the Ontario action. Accordingly, the discontinuance of the Audette Ontario action does not prejudice the putative class in that action and an order was granted discontinuing that action.

J.L. LAX J.

cp/e/qllxr/qljxr/qlaxw/qlced/qljyw/qlcal

Case Name:

Metzler Investment GmbH v. Gildan Activewear Inc.

Between
Metzler Investment GmbH, Plaintiff, and
Gildan Activewear Inc., Glenn J. Chamandy, Glenn Chamandy Holdings Corporation and Laurence G. Sellyn, Defendants

[2011] O.J. No. 885

2011 ONSC 1146

17 C.P.C. (7th) 190

2011 CarswellOnt 1252

198 A.C.W.S. (3d) 609

Court File No. 58574CP

Ontario Superior Court of Justice

L.C. Leitch J.

Heard: January 25 and February 1, 2011.
Judgment: February 28, 2011.

(40 paras.)

Counsel:

Anthony O'Brien, Dimitri Lascaris and Michael G. Robb for the Plaintiff.

Steve Tenai and Suzanne Wood, for the Defendants.

[Editor's note: A corrigendum was released by the Court March 4, 2011; the corrections have been made to the text and the corrigendum is appended to this document.]

REASONS FOR JUDGMENT

1 L.C. LEITCH J.:-- The plaintiff seeks an order that the settlement provided for in a settlement agreement dated August 2, 2010 (the "Settlement Agreement") is fair, reasonable and in the best interest of the Ontario Class and is approved pursuant to s. 29 of the *Class Proceedings Act, 1992*, S.O. 1992, c. 6.

2 The form of order sought by counsel contains provisions releasing the defendants from claims by the representative plaintiff and each member of the Ontario Class and incorporates and adopts the definitions set out in the Settlement Agreement.

3 The Settlement Agreement resolves this action and parallel proceedings in Québec and the United States.

4 The settlement is conditional upon approval by this court and the court in Québec and the United States.

The factors for consideration in approving negotiated settlements

5 The case law has made clear that the following are factors to be considered on settlement approvals:

- likelihood of recovery or likelihood of success

- amount and nature of discovery, evidence or investigation

- settlement terms and conditions

- recommendation and experience of counsel

- future expense and likely duration of litigation and risk

- recommendation of neutral parties, if any

- number of objectors and nature of objections

- the presence of good faith, arms length bargaining and the absence of collusion

- the degree and nature of communications by counsel and the representative plaintiffs with class members during this litigation

- information conveying to the court the dynamics of, and then positions taken by the parties during the negotiation

(see *Dabbs v. Sun Life Assurance Co. of Canada*, [1998] O.J. No. 1598 (Gen. Div.) (QL) at para. 13, *Parsons v. Canadian Red Cross Society*, [1999] O.J. No. 3572 (S.C.J.) (QL) at paras. 71-72.)

Terms and Conditions of the Settlement

6 Pursuant to the Settlement Agreement, the defendants caused its insurers to pay into an escrow account 22.5 million dollars in U.S. dollars. As the Settlement Agreement states, it is not a claims made settlement and none of the settlement amount shall be returned or otherwise paid to the defendants or its insurers funding the settlement unless the Settlement Agreement is terminated in accordance with its terms.

7 The settlement amount will be distributed amongst all class members who submit valid claim forms to the administrator after payment of any administration costs and legal fees and expenses awarded by the courts.

8 The Settlement Agreement contains a plan of allocation which provides that 89% of the net settlement amount is allocated for pro-rata distribution among Authorized Canadian Claimants, while the remaining 11% of the net settlement amount is allocated for pro-rata distribution among Authorized U.S. Claimants.

9 Pursuant to the definitions in the Settlement Agreement, all Canadian residents are within the definition of an Authorized Canadian Claimant. Based on the trading volume on the New York Stock Exchange (NYSE) and the Toronto Stock Exchange (TSX) Mr. Wright, who has filed an affidavit in support of the settlement approval, has deposed that Authorized Canadian Claimants will fare substantially better than authorized U.S. Claimants under the settlement. A majority of the trading during the Class Period occurred on the NYSE but the NYSE purchasers (excluding the small member of Canadian residents) will receive only 11% of the net settlement amount.

10 As Mr. Wright has also deposed, ultimately the amount of each Class Member's compensation from the net settlement amount will depend upon: (i) the number and the price of Eligible Shares purchased by the Class Member; (ii) the time and the price at which the Class Member sold such Eligible Shares, if at all; (iii) the total number and value of claims for compensation filed with the

administrator; (iv) whether the Class Member falls within the Authorized Canadian Claimant or the Authorized U.S. Claimant category.

11 The operative part of the Settlement Agreement makes sense. The allocation amongst the Class Members seems appropriate.

12 In considering the approval of the Settlement Agreement in Ontario, the submission of Mr. Wright's affidavit that the settlement is significantly weighted in favour of Canadian Class Members is important.

13 I am satisfied that the Class Members will have their claims administered in a timely matter and that the administration of the settlement can be conducted in a fair, efficient, independent and manageable manner.

14 As counsel submitted, the Settlement Agreement represents very significant recovery in a challenging, hotly contested case.

15 Furthermore, the amount provided for in the Settlement Agreement is within the range specified in the retainer agreement as a reasonable settlement in the action.

16 The foregoing factors favour approval of the settlement.

How was the settlement reached?

17 The Settlement Agreement resulted from extensive negotiations conducted over several months. The parties were assisted in their settlement negotiations by The Honourable Judge Layn R. Phillips, a former United States attorney and United States District Judge. As Mr. Wright deposed, the mediation was complex and after two days of mediation the parties had not agreed on the essential financial terms of a settlement. However, negotiations continued. Thereafter, Judge Phillips made a mediator's recommendation that the case settle for the amount provided for in the Settlement Agreement, and all parties accepted that recommendation.

18 The proposed settlement provides certainty to the class members facing hotly contested lengthy litigation fraught with uncertainties and provides a measure of recovery, which Judge Phillips, a neutral party, recommended.

19 It is clear the settlement resulted from good faith, arms length bargaining in the absence of collusion.

20 Counsel for the plaintiff had the opportunity to review mediation briefs prepared by each of the parties for the purposes of the two day mediation, as well as documentary production from the defendants for the purposes of confirmatory discovery prior to the execution of the Settlement Agreement.

21 As Mr. Wright deposed, plaintiff's counsel had more than adequate information available from which to make an appropriate recommendation concerning the resolution of this action.

22 Consideration of the above noted factors supports approval of the settlement.

Are there any objections to these settlements? Have any Class Members opted out?

23 Counsel advised that the Notice Program was very effective. There was a focused and targeted mailing that was possible because of the information provided by the defendants. As a result, there was a direct mailing to almost 25,000 people.

24 No class members have opted out of the proposed settlement. There were three pieces of correspondence received as a result of the Notice Program but no valid opt out requests were received.

25 There have been no objections to the settlement.

26 Considering the extent of direct mailing pursuant to the Notice Program it is significant that there have been no objections or opts out and the fact that there were no objections and no valid opt outs favours approval of the Settlement Agreement.

Recommendation from counsel and the representative plaintiff

27 Experienced counsel recommends the approval of the Settlement Agreement. As Mr. Wright deposed, the Settlement Agreement delivers a substantial, immediate benefit to Ontario Class Members on claims which plaintiff's counsel consider meritorious but which undoubtedly face significant risks.

28 As plaintiff's counsel submitted, they were well informed and had a good basis on which to assess the plaintiff's prospects in the litigation.

29 I am satisfied that counsel has undertaken sufficient investigation to analyze the settlement and the benefits to class members.

30 In addition, it is significant that the plaintiff instructed Class Counsel to seek the Court's approval of the Settlement Agreement. The plaintiff is a sophisticated commercial investor with a very significant direct interest in the action.

31 The recommendation of experienced counsel is entitled to considerable weight given their ability to weigh the factors bearing on the reasonableness of the settlement.

Was the plaintiff's claim likely to be challenged if the action was not settled?

32 This litigation involved numerous and substantial risks as particularized in Mr. Wright's

affidavit.

33 In particular, the defendants intended to challenge the plaintiff's common-law claims on an appeal from the motion to strike decision, when the motion for certification was heard and ultimately at trial. There remained a contentious issue that the plaintiff's negligent misrepresentation claim could not succeed because it could not establish actual reliance on the alleged misrepresentations. There is a very significant issue with respect to whether an alternate theory of liability can be advanced to avoid the need to prove individual reliance. As observed by Mr. Wright, the defendant's position on this issue was strengthened by the decision in *McKenna v. Gammon Gold Inc.*, [2010] O.J. No. 1057.

34 There also was a contentious issue with whether a representation with respect to a future event is actionable. In other words, can statements or forecasts about the future sustain a claim for misrepresentation?

35 In addition, the plaintiff faced the risks of obtaining the required leave under Part XXIII.I of the Ontario *Securities Act*. As counsel observed, there is minimal guidance from case law in relation to such leave applications with only one decision having been released which was the subject of an appeal at the time of this hearing (leave to appeal that decision was subsequently denied: 2011 ONSC 1035).

36 Furthermore, as a result of the Schulman affidavit having been struck, confidential witnesses referred to in that affidavit were required to swear affidavits in support of the plaintiff's motion for leave. Mr. Wright deposed in his affidavit at the time of settlement, none of those witnesses had agreed to swear such affidavits. Thus, the plaintiff faced the uncertainty of whether it could satisfy its evidentiary burden on the motion for leave.

37 In addition, as Mr. Wright outlined, there were risks relating to the scope of any certified Class as well as issues with respect to the quantum of damages. As Mr. Wright deposed, the defendant's mediation brief foreshadowed a number of arguments that the defendants would have advanced in mitigation of the quantum of damages.

38 Finally it is clear as Mr. Wright deposed, that continued pursuit of the Ontario action would involve the expense of arguing a contested leave and certification motion, holding oral discoveries containing documentary discovery, attendance at a trial of common issues and perhaps holding trials to make determinations regarding any individual issues and even if the plaintiff was successful at all stages of the proceeding, the Ontario action would not have resolved for many years. Therefore, the Settlement Agreement provides the additional advantage of delivering immediate benefits to Class Members without the risk and delay inherent in protracted litigation.

39 The formidable risks and barriers in the litigation and the inevitable delay before trial favour approval of the Settlement Agreement.

Conclusion

40 Considering the foregoing factors, I am satisfied that in all the circumstances the Settlement Agreement is a fair and reasonable resolution of this action and in the best interest of the Ontario Class Members.

L.C. LEITCH J.

* * * * *

Corrigendum
Released: March 4, 2011

[1] To correct a typographical error, TSX in the last sentence of para. 9 is deleted and replaced with the word NYSE.

[2] For clarity para. 9 will now read as follows:

> Pursuant to the definitions in the Settlement Agreement, all Canadian residents are within the definition of an Authorized Canadian Claimant. Based on the trading volume on the New York Stock Exchange (NYSE) and the Toronto Stock Exchange (TSX) Mr. Wright, who has filed an affidavit in support of the settlement approval, has deposed that Authorized Canadian Claimants will fare substantially better than authorized U.S. Claimants under the settlement. A majority of the trading during the Class Period occurred on the NYSE but the NYSE purchasers (excluding the small member of Canadian residents) will receive only 11% of the net settlement amount.

L.C. LEITCH J.

Case Name:
Robinson v. Rochester Financial Ltd.

**RE: Kathryn Robinson and Rick Robinson,
Plaintiffs/Moving Parties, and
Rochester Financial Limited et al., Defendants/Respondents**

[2012] O.J. No. 534

2012 ONSC 911

[2012] 5 C.T.C. 24

2012 CarswellOnt 1368

212 A.C.W.S. (3d) 20

Court File No. 08-CV-349792 CP

Ontario Superior Court of Justice

G.R. Strathy J.

Heard: January 17, 2012.
Judgment: February 7, 2012.

(45 paras.)

Counsel:

David Thompson and Matthew G. Moloci, for the Plaintiffs.

Glenn Smith and Sean O'Donnell, for the Defendant Fraser Milner Casgrain LLP.

John Finnigan, for the Monitor, Grant Thornton Limited.

ENDORSEMENT

(Settlement Approval and Class Counsel Fee Approval)

1 G.R. STRATHY J.:-- This endorsement sets out my reasons for approving the settlement of this class action and approving the fees and disbursements of class counsel, an Order to that effect having been issued on January 17, 2012.

2 The action relates to a tax shelter called the Banyan Tree Foundation Gift Program, which operated in 2003-2007. It has been referred to as a "leveraged" charitable donation program because, in return for a proportionately small out-of-pocket payment, a taxpayer was purportedly entitled to ratchet-up his or her donation and to receive a charitable tax receipt equivalent to 3 1/2 times the amount of his or her cash outlay.

3 The leverage was supposed to be provided by a "loan" to the participant, made by one of the defendants, Rochester Financial Limited, secured by a promissory note. Part of the participant's cash payment was described as a "security deposit", which was supposed to be invested so that it would pay off the loan before the taxpayer was ever called upon to pay it.

4 The effect of this was to allow the taxpayer to profit from his or her donation -- in the case of a taxpayer in the highest bracket, a payment of $2,700 would secure a tax credit of $4,600, resulting in a profit of about $1,900.

5 The program was promoted by the Banyan Tree Foundation through a network of salespeople who were paid substantial commissions.

6 Canada Revenue Agency ("C.R.A.") disallowed the charitable donation tax credits claimed by participants in the Gift Program. It took the position that the "donation" made by the taxpayer was not a gift for the purposes of the *Income Tax Act*, because the loan was not *bona fide* and there were nothing more than book-keeping entries to give an aura of respectability to the transaction. It said that the participants were never at risk to repay their loans and that the program was a sham, designed to have the appearance of a legitimate charitable donation, when the real purpose was to enrich the taxpayer rather than benefit a charity. It therefore disallowed the charitable donation tax credits, and the participants were required to repay the taxes they had deducted, with interest.

7 Not only did the participants lose their deductions, their security deposits have disappeared, apparently due to defalcation by the investment manager.

8 In January 2010, Justice Lax certified this action as a class proceeding: *Robinson v. Rochester Financial Ltd.*, 2010 ONSC 463, [2010] O.J. No. 187.

9 There is no realistic prospect of recovery from any of the parties directly responsible for the Gift Program. This leaves the defendant law firm, Fraser Milner Casgrain LLP ("FMC"), as the last party standing. It provided legal opinions that the Gift Program complied with the applicable tax

legislation and that the tax receipts issued by the Banyan Tree Foundation should be recognized by C.R.A.

10 As a result of mediation before a former judge of this Court, class counsel negotiated a settlement, subject to Court approval, of class members' claims against FMC for the total sum of $11 million. Approximately $7.75 million of this amount will be paid to class members in proportion to the charitable contributions they made, under a distribution plan that will be administered by class counsel. The balance will be used to pay the fees and disbursements of class counsel and the costs of administration of the settlement. In addition to this cash distribution, the plaintiffs asked the Court to make a declaration that the promissory notes executed by class members in connection with the Gift Program are unenforceable.

11 The proposed settlement, and the order I have granted, are somewhat unusual in that all individuals who have previously opted-out of this action, will have the opportunity to opt back in and to enjoy the benefits of the settlement. One of the reasons for this is that, following certification, Banyan Tree Foundation engaged in a misinformation campaign, designed to encourage class members to opt-out of this proceeding, suggesting that class members who opted out would be unable to challenge their C.R.A. reassessments. When this was brought to my attention by class counsel, I issued an order dated June 25, 2010, providing for further notice to class members and an opportunity to revoke their opt-outs. I am satisfied that, in the particular circumstances of this case, it is appropriate to extend this relief in connection with the settlement.

12 Those class members who have previously opted-out, and wish to remain outside the Class, need not do anything further.

13 There were approximately 2,825 participants in the Gift Program. They have received extensive individual notice of the proposed settlement. Approximately 500 objections to the settlement have been delivered. Almost all of these objectors have sent a standard form letter that appears to have been authored by Mr. Tim Millard, an accountant who was also a salesman for the Gift Program and who had approximately 40 clients who are class members. Mr. Millard and two other class members, Mr. Harrington and Dr. Maier, attended the hearing and made submissions. About seven or eight other class members attended the hearing but made no submissions.

14 The uniform concern expressed by Mr. Millard, Mr. Harrington and Dr. Maier, who spoke at the hearing, and by those class members who sent in the standard form letter, related not to the amount of the settlement, but rather to the proposed term of the settlement that would declare the "loan" portion of the taxpayer's contribution to the Gift Program (i.e., the leveraged portion), void and unenforceable. These objectors were concerned that a declaration to this effect would potentially adversely affect any future appeals they may make of their tax assessments or re-assessments.

15 This issue was raised at the hearing and, as a result of further discussions between class counsel and the objectors, a revised form of order, satisfactory to Messrs Millard, Harrington and

Maier, was approved. That form of order, simply declares that the loan agreements and promissory notes executed by class members in connection with the Gift Program are unenforceable by the defendants, their successors and assigns.

16 A handful of objectors who sent written communications were concerned about the relatively modest amount they would receive under the settlement in comparison to the loss of their contributions, the loss of their anticipated deductions and any penalties and interest they may be required to pay. I will discuss this issue below.

17 In order to approve a settlement, the court must be satisfied that it is fair, reasonable and in the best interests of the class: *Nunes v. Air Transat A.T. Inc.*, [2005] O.J. No. 2527, 2005 CarswellOnt 2503 (S.C.J.) at para. 7; *Vitapharm Canada Ltd. v. F. Hoffmann-La Roche Ltd.*, [2005] O.J. No. 1118 (S.C.J.). The "fairness and reasonableness" analysis will vary from case to case, but courts frequently turn to the factors set out in *Dabbs v. Sun Life Assurance Company of Canada*, [1998] O.J. No. 1598 at 13 (Gen. Div.); and (1998), 40 O.R. (3d) 429 at 440-444 (Gen. Div.); aff'd (1998), 41 O.R. (3d) 97 (C.A.); leave to appeal to S.C.C. denied [1998] S.C.C.A. No. 372:

(a) the presence of arm's length bargaining and the absence of collusion;
(b) the proposed settlement terms and conditions;
(c) the number of objectors and nature of objections;
(d) the amount and nature of discovery, evidence or investigation;
(e) the likelihood of recovery or likelihood of success;
(f) the recommendations and experience of counsel;
(g) the future expense and likely duration of litigation;
(h) information conveying to the court the dynamics of, and the positions taken by the parties during the negotiations;
(i) the recommendation of neutral parties, if any; and
(j) the degree and nature of communications by counsel and the representative plaintiff with class members during the litigation.

18 I am satisfied that most of these factors have been addressed in this settlement. The settlement is clearly the product of hard bargaining at arms' length, facilitated by an experienced mediator. It comes with the recommendation of highly qualified and reputable counsel, who have engaged the assistance of expert tax counsel. The concerns of the overwhelming majority of objectors have been satisfied. The settlement is clearly a compromise, but liability of FMC was a very contentious issue. FMC would argue, if the matter proceeded to trial, that its opinions were consistent with the state of the law as it existed at the time and that the subsequent hardening of the position of C.R.A. and, it would appear, the appellate case law, was not something that could have been foreseen at the time. There were other issues that would also be brought into play by FMC, including whether class members relied on its opinions. A significant discount of the claim was warranted to reflect the real risk that the claim against FMC would not succeed.

19 While a very small number of objectors have expressed concerns about the amount of the settlement, the vast majority of the objectors were concerned only with the issue of the proposed relief in relation to their loans. Over eighty percent of class members have made no comment on the settlement. I acknowledge, however, that some class members think that the settlement amount is too low. Every settlement is necessarily a compromise. It reflects the possibility that the class may recover nothing if the action goes to trial and that there is a benefit to early resolution.

20 For the purposes of a settlement approval motion, I should assume that if the settlement is not approved, the action will proceed to trial. In effect, I would be substituting my view of the prospects of success for the views of class counsel, who have lived with this action since its outset and who are familiar with the risks and benefits of continuing with the action. While I can, in appropriate cases, appoint *amicus* to assist my examination of the settlement, I have in this case a high level of confidence in the fairness and reasonableness of the settlement and I approve it.

Fee of Class Counsel

21 Class counsel entered into a contingency fee retainer agreement with the representative plaintiffs that provided for a contingent fee of 25% of the total value of any settlement. They request approval of the payment of $3,252,682.65 for their fees, disbursements and taxes.

22 I find that the fee agreement meets the requirements of s. 32(1) of the *Class Proceedings Act,* S.O. 1992, c. 6 (the "*C.P.A.*") and that it is fair and reasonable, having regard to the factors set out in the case law, as summarized in *Vitapharm Canada Ltd. v. F. Hoffmann-LaRoche Ltd.*, [2005] O.J. NO. 1117 (S.C.J.) at para. 67.

23 In this case, I consider the following circumstances of particular significance:

(a) this action would never have been commenced, let alone successfully resolved, had it not been for the initiative, tenacity and persistence of class counsel in the face of widespread apathy on the part of all class members;
(b) class counsel funded disbursements of almost $200,000, making it unnecessary to apply to the Class Proceedings Fund;
(c) class counsel have gone without any compensation at all through four years of litigation;
(d) class counsel gave an indemnity to the representative plaintiffs with respect to any adverse costs award -- the assumption of a significant risk of not only receiving no fees and disbursements, but the possibility of a substantial six figure costs award against them;
(e) the matter was complex and the outcome was far from certain;
(f) the result achieved is financially significant and every class member will receive actual cash compensation;
(g) in addition to the cash value of the settlement, class members will receive the added benefit of a declaration that their loans and promissory notes are

unenforceable, a matter of some concern to class members;

(h) the time spent by class counsel was about 4,600 hours with a face value of about $1.8 million, and the proposed fee represents a multiplier of less than 2;

(i) there has been no real opposition to class counsel's fee by class members, whose only significant objection related to the scope of the proposed declaration; and

(j) the payment of the proposed fee does not significantly dilute the recovery by class members, and their ability to pay the fee is not an issue.

24 Having supervised this proceeding for more than two years, I am satisfied that class counsel have demonstrated commendable diligence, perseverance and skill in pursuing a very challenging piece of litigation and bringing it to a successful conclusion.

25 I do not propose to repeat the observations I made in *Baker Estate v. Sony BMG Music (Canada) Inc.*, [2011] O.J. No. 5781, concerning the value of contingency fees in the fair compensation of class counsel. In my view, with the benefit of hindsight, it is fair and reasonable that class members should pay the fee requested by class counsel and I approve that fee.

Compensation for the Representative Plaintiffs

26 Class counsel have made a request for compensation in the amount of $5,000 for each of the representative plaintiffs, relying on the authority of *Windisman v. Toronto College Park Ltd.*, [1996] O.J. No. 2897 (Gen. Div.), on the basis that the plaintiffs have rendered "active and necessary assistance" in the prosecution of the case.

27 In *Baker Estate v. Sony BMG Music* (Canada Inc.), 2011 ONSC 7105, [2011] O.J. No. 5781, I set out the principles applicable to this request at para. 93:

> The payment of compensation to a representative plaintiff is exceptional and rarely done: *McCarthy v. Canadian Red Cross Society* [2007] O.J. No. 2314 (S.C.J.) at para. 20; *Windisman v. Toronto College Park Ltd.*, [1996] O.J. No. 2897 (Gen. Div.); *Sutherland v. Boots Pharmaceutical plc*, [2002] O.J. No. 1361 (S.C.J.); *Bellaire v. Daya* [2007] O.J. No. 4819 (S.C.J.) at para. 71. It should not be done as a matter of course. Any proposed payment should be closely examined because it will result in the representative plaintiff receiving an amount that is in excess of what will be received by any other member of the class he or she has been appointed to represent: *McCutcheon v. Cash Store Inc.* [2008] O.J. No. 5241 (S.C.J.) at para. 12. That said, where a representative plaintiff can show that he or she rendered active and necessary assistance in the preparation or presentation of the case and that such assistance resulted in monetary success for the class, it may be appropriate to award some compensation: *Windisman v. Toronto College Park Ltd.*, [1996] O.J. No. 2897 (Gen. Div.) at para. 28.

28 Class counsel says that this is one of those exceptional cases in which compensation should be paid. As I have noted, class counsel faced considerable apathy on the part of class members and it was exceedingly difficult to find someone prepared to take on the role of representative plaintiff until Mr. and Mrs. Robinson stepped up to the plate. Taking on that role required that they expose private personal financial information, including their income tax returns for the years they participated in the Gift Program. They each spent more than 300 hours in assisting class counsel in the prosecution of the action. In comparison, they will receive a modest award of about $6,000 under the settlement.

29 In *Windisman*, above, Sharpe J. observed, at para. 28:

> Ordinarily, an individual litigant is not entitled to be compensated for the time and effort expended in relation to prosecuting an action. In my view, there is an important distinction to be drawn with reference to class proceedings. The representative plaintiff undertakes the proceedings on behalf of a wider group and that wider group will, if the action is successful, benefit by virtue of the representative plaintiff's effort. If the representative plaintiff is not compensated in some way for time and effort, the plaintiff class would be enriched at the expense of the representative plaintiff to the extent of that time and effort. In my view, where a representative plaintiff can show that he or she rendered active and necessary assistance in the preparation or presentation of the case and that such assistance resulted in monetary success for the class, the representative plaintiff may be compensated on a quantum meruit basis for the time spent. I agree with the American commentators that such awards should not be seen as routine. The evidence here is that Ms. Windisman took a very active part at all stages of this action. It seems clear that the case would not have been brought but for her initiative. She assumed the risk of costs and she devoted an unusual amount of time and effort to communicating with other class members, acting as a liaison with the solicitors, and assisting the solicitors at all stages of the proceeding. She kept careful records of her time and effort.

30 In that case, the representative plaintiff had kept docketed time entries showing 81.2 hours of time and estimated a further 25 hours of undocketed time. Sharp J. awarded compensation of $4,000, to be deducted from the net recovery of the class.

31 This issue brings into play some conflicting values. On the one hand, we do not wish to create a conflict of interest between the representative plaintiffs and the class, by giving the former more substantial contribution. This was discussed by Winkler J. in *Sutherland v. Boots Pharmaceutical Plc.,* [2002] O.J. No. 1361 (S.C.J.):

> In the present circumstances the work of the Representative Plaintiffs was unnecessary to the preparation or presentation of the case. Indeed, their work did

> not begin until after the settlement had been structured. Their work did not result in any monetary success for the class. If they were to be compensated in the manner requested they would be the only class members to receive any direct monetary compensation. The entire settlement is in the form of Cy-pres distribution. The representative plaintiffs are seeking some $80,000 in total which is to be deducted from the settlement. By way of contrast, in Windisman, the representative plaintiff took an active part at all stages of the proceeding, the case would not have been brought except for her initiative, she assumed the risk of costs, and devoted an unusual amount of time communicating with class members and assisting counsel. The class members received a direct monetary benefit due in part to her efforts.
>
> While the work of the representative plaintiffs is commendable, to compensate them for the work when the settlement funds for the entire class are being donated to research without a single penny finding its way into the hands of a class member would be contrary to the precept of the Cy-pres distribution in particular and to a class proceeding generally. Compensation for representative plaintiffs must be awarded sparingly. The operative word is that the functions undertaken by the Representative Plaintiffs must be "necessary", such assistance must result in monetary success for the class and in any event, if granted, should not be in excess of an amount that could be purely compensatory on a quantum meruit basis. Otherwise, where a representative plaintiff benefits from the class proceeding to a greater extent than the class members, and such benefit is as a result of the extraneous compensation paid to the representative plaintiff rather than the damages suffered by him or her, there is an appearance of a conflict of interest between the representative plaintiff and the class members. A class proceeding cannot be seen to be a method by which persons can seek to receive personal gain over and above any damages or other remedy to which they would otherwise be entitled on the merits of their claims. This request is denied.

32 In *Hislop v. Canada (Attorney General)*, [2004] O.J. No. 1867 (S.C.J.), an action claiming CPP survivor's pensions for same sex partners, E. Macdonald J. awarded compensation of $15,000 to one representative plaintiff, two others received $10,000 each and two others received $5,000 each.

33 In *Garland v. Enbridge Gas Distribution Inc.*, [2006] O.J. No. 4907, Cullity J. awarded the representative plaintiff $25,000 for his efforts, which he described as an "exceptional contribution". He made the following observations at paras. 45 and 46:

> ... Mr Garland has, in my judgment, made out a strong case for compensation. He took the initiative in seeking legal advice with respect to the legality of late

> payment penalties and in instructing counsel to commence the proceedings. He was instrumental in keeping the legal team together when members of the class counsel sought to withdraw from the proceedings on the ground of a business conflict, and he accepted a large part of the responsibility for communicating with class members personally or through interviews with representatives of the media. He also played an active part in the settlement negotiations and, in particular, in obtaining agreement to the nature and details of the *cy pres* distribution -- one of the matters for which he found it desirable to retain separate counsel.
>
> The litigation was commenced, and continued, by Mr Garland in the public interest and, I am satisfied, that throughout it his primary concern has been to protect and serve the interests of the class. It was on this ground that he firmly opposed counsel's proposal to replace the method of calculating their fee under the 1998 fee agreement with the application of a multiplier to be applicable irrespective of the gross recovery.

34 In *McCutcheon v. Cash Store Inc.,* [2008] O.J. No. 5241, Cullity J. approved a payment of $10,000, stating at paras. 22 and 23:

> Although I am not oblivious to the risk of engendering expectations that such payments will be approved as a matter of course, the request in this case is strongly supported by class counsel who have sworn to the significant amount of time expended by Mr McCutcheon in advancing the interests of the class. His efforts were not confined to meetings with class counsel but extended to communicating with other class members, monitoring developments in the pay-day loan industry and providing input and assistance to class counsel in the settlement negotiations. Counsel have testified to his active part in all stages of the litigation and his time and energy spent in liaising between them and class members. They have sworn that he accepted the personal exposure to an adverse costs award and, to the benefit of the class, that he did not choose to seek assistance from the Class Proceedings Fund. They have stated that the request for compensation was made entirely at their suggestion. While I consider the amount requested to be on the high side, I am satisfied that, independently of this payment and the payment of counsel fees, the settlement merits approval and that the total amount of class counsel fees and the representative plaintiff's compensation could be justified if, as in *Garland*, it consisted of counsel fees from which the representative plaintiff's compensation was to be paid. On the basis of the strong support provided by class counsel, I will approve the amount of $10,000. I will, however, reiterate what I have said in other cases that, as a general rule, all benefits and payments to be made by defendants should be

> treated as a single package when considering the fairness and reasonableness of a settlement from the viewpoint of a class. This, I believe, should be accepted whether or not there are expressed to be separate agreements for fees to be paid directly by defendants rather than out of a settlement amount otherwise earmarked for the benefit of the class. As in other parts of the law, substance must prevail over form.

35 In *Fakhri v. Alfalfa's Canada Inc.*, 2005 BCSC 1123, [2005] B.C.J. No. 1723, Gerow J. of the British Columbia Supreme Court awarded $5,000 as compensation for the representative plaintiff. In that case, the defendant had agreed to pay the amount directly to the representative, with the result that it would not dilute the recovery of the class. It was found that the plaintiff had delivered multiple affidavits, reviewed pleadings, provided instructions, attended the mediation and court hearings, and helped shape the final settlement. The judge found that the plaintiff's efforts on behalf of the class had an impact on the successful resolution of the proceeding.

36 In *Walker v. Union Gas, Ltd.*, [2009] O.J. No. 536, Cumming J. approved a payment of $5,000 to the representative payment, out of the fees of class counsel. He observed that the plaintiff had spent more than 70 hours in the conduct of the litigation, including reviewing some 10 bankers' boxes of documents, cross-referencing documents and isolating bills, and traveling to Toronto for the meeting with the Class Proceedings Committee.

37 In the recent case of *Smith Estate v. National Money Mart Co.* 2011 ONCA 233, [2011] O.J. No. 1321, the Court of Appeal affirmed the motion judge's decision to award $3,000 compensation to the representative plaintiff. It suggested that generally such a fee should be paid out of the settlement fund, rather than out of class counsel's fees, to avoid any spectre of fee-splitting. In that case, the Court of Appeal observed, at para. 134, that judges of this court have taken different approaches with respect to the payment of fees for the representative plaintiffs. It noted that it had not previously dealt with the issue. We can take from the Court of Appeal's decision that the court may award compensation to a representative plaintiff in an "appropriate case".

38 In *McCarthy v. Canadian Red Cross Society* [2007] O.J. No. 2314 (S.C.J.) there was a request for fees and disbursements to be paid to the representative plaintiff, in the amount of $75,000. In dismissing the request, Winkler J. observed at para. 20:

> Mr. McCarthy has fulfilled his obligation to the class as their representative. However, a distinction must be drawn between the professional advisors to the class and the representative plaintiff with respect to fees. Where it is necessary for the representative plaintiff to incur out-of-pocket expenses in acting in that capacity, such as attendance at discoveries as one example, it may be appropriate for class counsel to reimburse such amounts and claim it as a disbursement subject to recovery on approval by the Court. While each case turns on its facts, in my view, it is not generally appropriate for a representative plaintiff to receive

> a payment for fees or for time expended in the pursuit of the action. Further, any payment made to a representative plaintiff in connection with the action, whether directly or indirectly, and whether for reimbursement or otherwise, must be disclosed to the Court.

39 It would appear that judges in British Columbia have been less reluctant to award compensation for representative plaintiffs. In addition to *Fakhi v. Alfalfa's Canada Inc.*, above, I will mention *Reid v. Ford Motor Co.,* 2006 BCSC 1454, in which a payment of $3,000 was approved on a *quantum meruit* basis, to be paid from class counsel fees and *MacKinnon v. Vancouver City Savings Credit Union,* 2004 BCSC 1604, 34 B.C.L.R. (4th) 322 in which a payment of $5,000 was approved to be paid as a disbursement.

40 In a recent decision of the British Columbia Court of Appeal in *Parsons v. Coast Capital Savings Credit Union,* 2010 BCCA 311, [2010] B.C.J. No. 1184, the representative plaintiff appealed an order of the settlement approval motion judge refusing to award compensation to the representative plaintiff in the amount of $10,000. The motion judge had concluded that British Columbia law only permitted compensation to be paid to the representative plaintiff where he or she has made a contribution that is over and above the contribution expected of a representative plaintiff, although it need not be an extraordinary contribution.

41 After a thorough review of the authorities in both Canada and the United States, the Court of Appeal concluded that it was not necessary for the class representative to show that he or she performed services of special significance. It said that where the representative plaintiff has fulfilled his or her duties, and a favourable settlement has been achieved, a "modest award in recognition of the effort expended on behalf of the class" would be appropriate. The Court stated, at paras. 20-3:

> I consider it is too narrow to say, as the judge did here, that services of special significance beyond the usual responsibilities under the *Act* are required for a separate award to the representative plaintiff. Where the representative plaintiff has fulfilled his or her duties, which will include attendance for examination in discovery, providing instructions on all steps taken in the litigation and on the settlement (which necessarily requires immersion in the substance of the case), and where a monetary settlement in favour of the class members is achieved, a modest award in recognition of the effort expended on behalf of the class members is consistent with restitutionary principles and recognition of the principle of *quantum meruit.* This expectation is further justified by the exposure to costs assumed by the representative plaintiff in commencing the action. While that risk is mitigated upon certification, there is a real exposure to costs assumed on commencing the action. Other intangible costs also are borne by such a plaintiff, including the sometimes not inconsiderable weight of being the leader of the claimants.

> In other words, I do not consider exceptional service is required. Rather competent service accompanied by positive results should be sufficient for recognition in this way, weighing in this factor the quantum of personal benefit achieved by the representative plaintiff with the overall benefit achieved for the class.
>
> In considering the quantum of such a payment, where the representative plaintiff's personal benefit is small but the collective benefit is great, there may be disproportion between personal benefit on the one hand and effort and responsibility on the other, so as to weigh in favour of a somewhat larger award. Nevertheless, in no case should the award be so large as to create the impression that the representative plaintiff was put into a conflict of interest. The outer bounds of what could be an appropriate compensatory award may vary from case to case, depending on factors such as the terms of settlement or award at issue and the personal circumstances of the representative plaintiff.
>
> In this case Ms. Parsons was a representative plaintiff in another action, and in the course of that proceeding her counsel observed the overdraft payment that grounded this action. In other words, Ms. Parsons did not initiate the claim. Nonetheless she exposed herself to costs in any proceedings that might have arisen prior to the certification application, she assumed responsibility for deriving benefit for others, she attended at an examination for discovery, she was available for conversation during the mediation, and in the end result she fronted an action that was significantly successful. In my view these features of the case, while not extraordinary, militate in favour of payment to her of a modest sum, described by her counsel as an honourarium.

42 The Court held that an award of $3,500, payable as a disbursement, would be appropriate. I note that one of the factors the Court of Appeal considered was the representative plaintiff's exposure to costs, a factor not relevant in this case due to the indemnity agreement.

43 In this particular case, while I acknowledge the contribution made by Kathryn Robinson and by Rick Robinson, and commend them on the work they have done to bring this matter to a successful conclusion on behalf of their fellow class members, I am not prepared to award such compensation. In my respectful view, requests for compensation for the representative plaintiff are becoming routine, as Sharpe J. anticipated in *Windisman*, above. I agree with those who have expressed the opinion that compensation should be reserved to those cases where, considering all the circumstances, the contribution of the plaintiff has been exceptional. The factors that might be appropriate for consideration could include:

(a) active involvement in the initiation of the litigation and retainer of counsel;
(b) exposure to a real risk of costs;
(c) significant personal hardship or inconvenience in connection with the prosecution of the litigation;
(d) time spent and activities undertaken in advancing the litigation;
(e) communication and interaction with other class members; and
(f) participation at various stages in the litigation, including discovery, settlement negotiations and trial.

44 I conclude, with some regret, that in this particular case the application of these factors, considered as a whole, do not dictate payment of compensation.

Conclusion

45 The settlement is therefore approved, as are the fees and disbursements of class counsel. I have also issued an order, on consent, discharging the Monitor, Grant Thornton Limited.

G.R. STRATHY J.

Case Name:

Semple v. Canada (Attorney General)

Between
Christine Semple, Jane McCallum, Stanley Thomas Nepetaypo, Peggy Good, Adrian Yellowknee, Kenneth Sparvier, Denis Smokeday, Rhonda Buffalo, Marie Gagnon, Simon Scipio, as representatives and claimants on behalf of themselves and all other individuals who attended residential schools in Canada, including but not limited to all residential schools' clients of the proposed class counsel, Merchant Law Group, as listed in part Schedule 1 to this claim and the John and Jane Does named herein, and such further John and Jane Does and other individuals belonging to the proposed class, including John Doe I, Jane Doe I, John Doe II, Jane Doe II, John Doe III, Jane Doe III, John Doe IV, Jane Doe IV, John Doe V, Jane Doe V, John Doe VI, Jane Doe VI, John Doe VII, Jane Doe VII, John Doe VIII, Jane Doe VIII, John Doe IX, Jane Doe IX, John Doe X, Jane Doe X, John Doe XI, Jane Doe XI, John Doe XII, Jane Doe XII, John Doe XIII, Jane Doe XIII being a Jane and John Doe for each Canadian Province and Territory, and other John and Jane Does, individual, estates next-of-kin and entities to be added, Plaintiffs, and
The Attorney General of Canada, the Presbyterian Church in Canada, the General Synod of the Anglican Church of Canada, the United Church of Canada, the Board of Home Missions in the United Church of Canada, the Women's Missionary Society of the Presbyterian Church, the Baptist Church in Canada, Board of Home Missions and Social Services of the Presbyterian Church in Bay, the Canada Impact North Ministries, the Company for the Propagation of the Gospel in New England (also known as the New England Company), the Diocese of Saskatchewan, the Diocese of

the Synod of Cariboo, the Foreign Mission of the Presbyterian Church in Canada, the Incorporated Synod of the Diocese of Huron, the Methodist Church of Canada, the Missionary Society of the Anglican Church of Canada, the Missionary Society of the Methodist Church of Canada (also known as the Methodist Missionary Society of Canada), the Incorporated Synod of the Diocese of Algoma, the Synod of the Anglican Church of the Diocese of Quebec, the Synod of the Diocese of Athabasca, the Synod of the Anglican Church of the Diocese of Brandon, the Anglican Synod of the Diocese of British Columbia, the Synod of the Diocese of Calgary, the Synod of the Diocese of Keewatin, the Synod of the Diocese of Qu'appelle, the Synod of the Diocese of New Westminster, the Synod of the Diocese of Yukon, the Trustee Board of the Presbyterian Church in Canada, the Board of Home Missions and Social Service of the Presbyterian Church of Canada, the Women's Missionary Society of the United Church of Canada, Sisters of Charity, a body corporate also known as Sisters of Charity of St. Vincent de Paul, Halifax, also known known as Sisters of Charity Halifax, Roman Catholic Episcopal Episcopal Corporation of Halifax, Les Soeurs de Notre Dame-Auxiliatrice, les Soeurs de St. Francois d'Assise, Institut des Soeurs du Bon Conseil, les Soeurs de Saint-Joseph de Saint-Hyacinthe, les Oeuvres de Jesus-Marie, les Soeurs de l'Assomption de la Sainte Vierge, les Soeurs de l'Assomption de la Saint Vierge de l'Alberta, les Soeurs de la Charite de St.-Hyacinthe, les Soeurs Oblates de l'Ontario, les Residences Oblates du Quebec, la Corporation Episcopale Catholique Romaine de la Baie James (the Roman Catholic Episcopal Corporation of James Bay) the Catholic Diocese of Moosonee, Soeurs Grises de Montreal/Grey Nuns of Montreal, Sisters of Charity (Grey Nuns) of Alberta, les Soeurs de la Charite des T.N.O. Hotel-Dieu de Nicolet, the Grey Nuns of Manitoba Inc. - les Soeurs Grises du Manitoba Inc., la Corporation Episcopale Catholique Romaine de la

Baie d'Hudson-the Roman Catholic Episcopal Corporation of Hudson's Bay, Missionary Oblates-Grandin, les Oblats de Marie Immaculee du Manitoba, the Archiepiscopal Corporation of Regina, the Sisters of the Presentation, the Sisters of St. Joseph of Sault St. Marie, Sisters of Charity of Ottawa, Oblates of Mary Immaculate-St. Peter's Province, the Sisters of Saint Ann, Sisters of Instruction of the Child Jesus, the Benedictine Sisters of Mt. Angel Oregon, les Peres Montfortains, the Roman Catholic Bishop of Kamloops Corporation Sole, the Bishop of Victoria, Corporation Sole, the Roman Catholic Bishop of Nelson Corporation Sole, order of the Oblates of Mary Immaculate in the Province of British Columbia, the Sisters of Charity of Providence of Western Canada, la Corporation Episcopale Catholique Romaine de Grouard, Roman Catholic Episcopal Corporation of Keewatin, la Corporation Archiepiscopale Catholique Romaine de St. Boniface, les Missionaires Oblates Sisters de St. Boniface - the Missionary Oblates Sisters of St. Boniface, Roman Catholic Archiepiscopal Corporation of Winnipeg, la Corporation Episcopale Catholique Romaine de Prince Albert, the Roman Catholic Bishop of Thunder Bay, Immaculate Heart Community of Los Angeles CA, Archdiocese of Vancouver-the Roman Catholic Archbishop of Vancouver, Roman Catholic Diocese of Whitehorse, the Catholic Episcopale Corporation of Mackenzie-Fort Smith, the Roman Catholic Episcopal Corporation of Prince Rupert, Episcopal Corporation of Saskatoon, OMI Lacombe Canada Inc., Defendants

[2006] M.J. No. 498

2006 MBQB 285

40 C.P.C. (6th) 314

213 Man.R. (2d) 220

156 A.C.W.S. (3d) 751

2006 CarswellMan 482

Docket: CI 05-01-43585

Manitoba Court of Queen's Bench
Winnipeg Centre

Schulman J.

Judgment: December 15, 2006.

(34 paras.)

Civil procedure -- Parties -- Class or representative actions -- Certification -- Motion for certification of class action and approving settlement of residential school litigation -- Plaintiff Aboriginal people were former residential school residents and sued for damages for sexual, physical and emotional abuse -- There were 78,000 Aboriginal persons alive who attended residential schools -- Motion allowed -- Class proceeding was preferable proceeding to alternative which faced 78,000 claimant.

Civil procedure -- Settlements -- Approval of -- Motion for certification of class action and approving settlement of residential school litigation -- Plaintiff Aboriginal people were former residential school residents and sued for damages for sexual, physical and emotional abuse -- Proposed settlement provided for payment by Canada with participation by several church defendants of six kinds of payments and for payment of legal costs from separate fund -- Motion allowed -- Settlement approved unconditionally -- Settlement negotiated with legal counsel and consented to by all parties -- Expectation had been created on part of class members that they would receive payments and many had received interim payments.

Motion for certification of class action and approving settlement of residential school litigation -- Plaintiff Aboriginal people were former residential school residents and sued for damages for sexual, physical and emotional abuse -- There were 78,000 Aboriginal persons alive who attended residential schools -- Numerous actions had been commenced -- Proposed settlement provided for payment by Canada with participation by several church defendants of six kinds of payments, two of which were to residential students directly -- Rest addressed broad social implications of the residential school legacy -- Canada established fund of $1.9 billion dollars to fund payments to every student -- Canada bore risk of any insufficiency in fund -- Any surplus to be paid according to formula -- Settlement provided for initial payment of $8,000 -- Class members entitled to seek additional payments for serious physical abuse, sexual abuse and specified wrongful acts through Independent Assessment Process -- Settlement provided for Canada to fund setting up of Truth and Reconciliation process and for commemorative initiatives at national and community levels and to

fund Aboriginal healing programs -- Canada to be paying from separate fund legal fees for conduct of various Court actions and for negotiation of settlement agreement -- All parties consented to settlement -- HELD: Motion allowed -- All criteria met for certification of action as class action -- Action certified as class action -- Settlement approved unconditionally -- Class action preferable proceeding to alternative which faced 78,000 claimants -- Proposed settlement was reasonable and in best interest of parties -- Settlement negotiated with help of experienced counsel -- Settlement was historic and, once implemented, Canadians would look back with pride on way parties agreed to put to rest issues arising from residential school legacy -- Expectation had been created on part of class members that they would receive payments and many had received interim payments.

Statutes, Regulations and Rules Cited:

Class Proceedings Act, C.C.S.M. c. C130, s. 4(a), s. 4(b), s. 4(c), s. 4(d), s. 4(e), s. 35(1), s. 35(2), s. 35(3)

Legal Profession Act, S.M. 2002 c. 44, s. 55

Limitation of Actions Act, C.C.S.M. c. L 150,

Counsel:

Plaintiffs:

National Certification Committee: Mr. K. Baert, Ms. C. Poltak, Mr. W. Percy and Mr. J. Horyski.

Assembly of First Nations and National Chief Phil Fontaine: Mr. J.K. Phillips.

Merchant Law Group: Mr. N. Rosenbaum.

Defendants:

The Attorney General of Canada: Ms. K. Coughlan, Ms. J. Oltean and Ms. A. Kenshaw.

United Church of Canada, Anglican Church in Canada, Presbyterian Church in Canada: Mr. A. Pettingill.

All Catholic entities: Mr. R. Donlevy and Mr. P. Baribeau.

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1 SCHULMAN J.:-- It is rare for this Court to have an opportunity to determine an issue of national and historic importance. This motion for an order certifying a class action and approving settlement of Residential School Litigation presents this Court with such an opportunity.

2 The motion has been brought with the consent of all parties. For more than a century the Government of Canada, hereafter referred to as Canada, implemented a policy under which it compelled Aboriginal children to leave their homes and attend Indian Residential Schools, hereafter referred to as IRS, that were supervised by Canada and run by various churches. This policy was designed to reengineer Aboriginal people into a European model by educating them to abandon their language, culture and way of life and adopt the language, culture and religions of other Canadians. Looking back on the policy in 2006, it is an understatement to say that it is well below standards by which we like to think we treat other people and created problems for the Aboriginal people which require being addressed on a pan Canadian basis. There were 130 schools and they were located in all the provinces and territories of Canada except Newfoundland, New Brunswick and Prince Edward Island. While attending the schools many of the children were abused physically, sexually and emotionally and they suffered damage that in turn has adversely affected generations of Aboriginal people. The proposed settlement, which the parties are anxious to have concluded, provides for and creates unique and comprehensive remedies to solve a serious problem that has confronted this country for decades. The agreement provides that it must be approved by judges in nine provinces and territorial courts and the settlement will fail unless all nine judges approve the settlement on substantially the same terms and conditions as provided in the settlement agreement.

3 As in all cases where a Court is asked to approve a settlement involving vulnerable plaintiffs, this Court must ask itself before considering a rejection of the settlement, whether it can guarantee a better result. Before granting approval subject to conditions which call for significant changes to the agreement, a Court must ask itself whether it is worth risking the unravelling of the agreement and leaving nearly 80,000 Aboriginal people and their families to pursue the remedies available to them prior to the agreement being signed.

4 As I understand it one or more of the judgments released by my colleagues in other provinces attach at least four conditions to their approval of the settlement. One of the conditions relates to the question of who is going to supervise the administration of the settlement. The agreement provides that the administration is to be supervised by the defendant, the Attorney General of Canada, whom I refer to as Canada. The condition of the judgments is that there be independent supervision subject to reporting to the Court. The judgment suggests that this may not be a material change in the agreement. I will discuss the risks that are created by the attaching of that and other conditions, in para. 33 of this judgment.

5 In addressing the issues presented, I deal with the following matters;

a) the present plight of litigants and other persons who may wish to make a claim;
b) an outline of the proposed settlement;
c) the principles applicable to a motion for certification and how they relate to this case;

d) the principles relating to Court approval and how they relate to this case;
e) the recommendation of counsel for the represented parties;
f) the positions advanced by persons not represented by counsel either in writing or in person;
g) improvements suggested by Winkler J. in the Baxter case;
h) the risks of a conditional approval; and
i) conclusion.

a) The present plight of litigants and other injured persons;

6 There are approximately 78,000 Aboriginal persons alive who attended and resided in Indian Residential Schools. Most of them live in Canada, although some live in the United States. Their numbers reduce weekly as 25 of them die. Ten thousand of them have sued the federal government and churches and perpetrators of abuse. Of them, 11 per cent or 1100 have sued in Manitoba in one or another of 289 actions. If these 78,000 people were to pursue the remedies to which they may be entitled, through the court process, it would present our court system and all those people with a daunting challenge. As a result of pre-trial procedures including Judicially Assisted Dispute Resolution Conferences the vast majority of civil actions in Manitoba are settled before trial. In our Court fewer than 100 civil cases each year are brought to trial. These abuse claims are claims which are least likely to settle before trial. It is hard to imagine, in the event of claims being commenced for 11 percent of 78,000 or 8500 persons, when we would next take on any other civil trial if all the Manitoba claims were readied for trial. What would happen to the workload of the other Courts in Canada if the rest of the claims were sued and set down for trial?

7 Now let us look at the situation confronting Aboriginal people who were devastated over the years by the events referred to in the pleadings. Many of them are impoverished. Many of them are illiterate. Culturally many of them are shy, reserved and reluctant to give evidence in Court. Relatively few of their claims have been tried to date. At the trials held to date, the plaintiffs have suffered the embarrassment of being required to give evidence publicly about the abuse they suffered many years before. In many of the cases they were required to recount their painful experience on prolonged examinations for discovery. One case took 16 years to wend its way to trial, appeal and the Supreme Court. The trial lasted 60 days. Another claim by 26 plaintiffs lasted six years. The trial was conducted in three segments a total of 108 days. Other cases have taken between two and six years from start to finish. Many of the plaintiffs are of very modest means and the cost of engaging experts, conducting assessments and leading the evidence at trial is very great.

8 In the context of this litigation, every plaintiff must overcome enormous hurdles in order to succeed in an action and realize on any judgment obtained. Starting with the question of realizing a judgment, it is in most cases of abuse, not good enough to obtain judgment against the perpetrator of abuse, because he or she may not have sufficient assets to pay the judgment. Consequently, it is necessary for each and every plaintiff to find a legal basis for holding Canada or a church liable, and in the case of the churches there is a real question of their ability to pay one or more of the judgments.

9 While we live in an era where unrepresented litigants are filing their own claims in unprecedented numbers, making a claim in these circumstances requires the preparation of a written pleading which will test the skills of an experienced pleader. Pleadings prepared below the minimum standard run the risk of being struck out or dismissed fairly early in a proceeding. Legal representation is pretty well a must in these claims.

10 If the Aboriginal plaintiffs find lawyers who will represent them and have the required expertise, one of the first problems to be addressed is whether the claim can be brought on a timely basis or whether it will be barred by the **Limitation of Actions Act** C.C.S.M. c. L 150 and like legislation in other provinces. In Manitoba the legislature attempted in 2002 to amend the statute and relieve plaintiffs from the harshness of a 30 year ultimate limitation period (S.M. 2002, c. 5, s. 4) but the amendment is unlikely to help many of this class of plaintiff because it is a principle of law that a defendant acquires a vested right to have the benefit of any limitation period in place at the time a wrong is committed even if the limitation provision is later repealed.

11 If a member of this class of plaintiffs is able to overcome the limitation problem which is inherent in these decades old claims, the claims may be met with attempts by the defendants to defeat the claims on a long list of grounds, a few of which I will describe briefly, many of which have not been tested in Court. Firstly, it may be argued that loss of language, culture and identity is not an item of damage for which Courts are able to award compensation. Secondly, the only legal basis for imposing liability against the federal government is by proof that a servant of Canada would be personally liable, if sued and that Canada is vicariously liable. In the case of claims pre-dating 1953, one would have to base the claim in negligence and show that the acts in question took place in the course of the wrong-doers employment. It was only by means of a legislative change in 1953 that Canada became liable for intentional torts of its servants. However, it may be argued that Canada is not liable for the tortious acts of all its employees. In one case the Supreme Court held that in order to support a finding of vicarious liability there had to be a strong connection between what the employer was asking the employee to do and the wrongful conduct. The Court rejected a claim against a school where a man who was employed as a baker, driver and odd-job man assaulted a student in his living quarters. In negligence claims defendants might try to justify the actions of their servants by establishing that the operation of the schools and treatment of students met the standards of the times or contemporary standards. When one makes a claim in a civil action against another based on conduct that amounts to a crime, the burden of proof to be satisfied is proof on a balance of probabilities commensurate with the seriousness of the allegation. This is higher than the usual burden of proof in a civil trial.

12 In November 2003 Canada created an ADR system as an alternative to litigation. Under the ADR program victims of IRS are permitted to make claims for damages for acts of physical and sexual abuse by school employees. The amount of the award is set by one of 32 full time adjudicators based on a grid consisting of several categories for which an adjudicator is able to make an award to a limit of $245,000.00. The amounts awarded vary from province to province. The adjudicators do not have the authority to award damages for lost earnings. Canada pays 70

percent of the amount of the award leaving it to the claimant to collect the other 30 percent from the church sponsor of the IRS in question. Since inception 5000 claims have been filed and 4000 of them are outstanding.

b) An outline of the proposed settlement;

13 The settlement makes provision for payment by Canada with participation by several church defendants, of six kinds of payments, two of which are to residential students directly provided they were alive on May 30, 2005, and the rest of which address the broad social implications of the IRS legacy. Firstly, all former students alive at the above date will receive the sum of $10,000.00 for the first year of attendance in an IRS and a further sum of $3,000.00 for each year of attendance thereafter. An IRS student who attended one or more schools for say 12 years will receive $10,000.00 plus 11 times $3,000.00 or $43,000.00 without proof of legal liability on the part of anyone else and without proof of physical or sexual abuse. This category of payment is described as a Common Experience Payment (C.E.P.). It recognizes the common experience of all former students and arguably recognizes the loss of their culture, family ties and identity. Unless the student intends to make a claim for serious physical or sexual abuse or wrongful acts which are defined, the recipient must sign a release of all claims in exchange for payment. Canada has established a fund of $1.9 billion dollars to fund payments to every student. Canada bears the risk of any insufficiency in the fund. If there is a surplus it is not repaid to Canada but is to be paid according to a formula. The first sum up to $40 million goes to the National Indian Brotherhood Trust Fund and the Inuvialuit Education Foundation to be used for educational programs for all class members. If the surplus exceeds that amount, each C.E.P. recipient receives a pro rata share in the form of personal credits for personal or group education up to $3,000.00. Canada also pays the cost of verifying the claims and the administrative cost of distribution.

14 Under the terms of the proposed settlement, Canada has instituted a process under which it pays, pending finalization of the settlement, the sum of $8,000.00 as an interim payment to all persons otherwise entitled to a C.E.P. who were on May 30, 2005 over the age of 65.

15 Secondly, class members have the right to seek and obtain payment of additional compensation for serious physical abuse, sexual abuse and specified wrongful acts through an Independent Assessment Process known as IAP. The parties, having observed the ADR process in action for more than a year, conducted studies, noted the shortcomings and proposed a series of significant improvements that have been incorporated into the settlement agreement. The awards under IAP consist not only of the damage award of the ADR process with a limit increasing to $275,000.00 but also compensation for lost earnings of up to $250,000.00. Compensation is paid in full by Canada not only for acts of employees but also for acts of any adult lawfully on the IRS premises. Where the claim is for abuse by fellow students the onus shifts to Canada and the Churches to show that it had reasonable supervision in place at the time. Unlike the Court process, the IAP process follows the inquisitorial mode. The adjudicator questions the witnesses at a closed or private hearing. Canada has committed itself to provide resources to ensure that at least 2500 IAP

hearings will be conducted each year and that all claims described as continuing claims be resolved within 6 years. There is provision for claims being referred to the courts in some circumstances, for example where the amount that a court might award exceeds the limit that the adjudicator might award. Any major changes to the IAP requires Court approval.

16 In addition to the fact that the IAP process is an improvement over the former ADR system as described in para. 15, there are eight additional improvements as follows: an expanded list of compensable acts; a decreased threshold for proof of abuse; for claims resolved prior to the IAP without church contribution, a 30 per cent top up where less than 100 per cent was received; for claims processed under IAP payment on a scale that is uniform across the country; for claims referred to the Courts, a waiver of all limitation defences; a means to compensate non student invitees for abuse suffered up to the age of 21; an independent screening process for IAP claims; and a means for claimants to give evidence by video conference in cases of failing health.

17 Thirdly, the settlement provides for Canada to fund to the extent of $60 million for five years, the setting up of a Truth and Reconciliation process, directed by a Commission consisting of nominees of former students, Aboriginal organizations, Churches and Canada. The goals of the Commission are to acknowledge the IRS experience; provide a safe setting for individuals to address the Commission; witness, promote and facilitate truth and reconciliation events at both national and community levels; educate the Canadian public about the IRS system and its impacts; create and make public a record for future study; prepare a report on the legacy of the IRS; and support commemorative events.

18 Fourthly, the settlement provides for a number of commemorative initiatives at national and community levels with a budget of $20 million and for the establishment of a $125 million dollar endowment over five years to fund Aboriginal healing programs.

19 In addition, Canada has made the following commitment:

> Health Canada will expand its current Indian Residential Schools Mental Health Support Program to be available to individuals who are eligible to receive compensation through the Independent Assessment Process, as well as to Common Experience Payment Recipients, and to those participating in Truth and Reconciliation and Commemoration activities. It will offer mental health counselling, transportation to access counselling and/or Elder/Traditional Healer services and emotional support services, which include Elder support. Health Canada will offer these services through its regional offices, including the Northern Secretariat which has an office located in Whitehorse, Yukon.

20 In addition, the Church organizations have agreed as part of the settlement to provide cash and in-kind services to a maximum of $102.8 million to develop new programs for class members and their families.

21 Importantly, Canada will be paying from a separate fund legal fees for the conduct of the various Court actions, for negotiation of the settlement agreement, for conduct of the C.E.P. claims and a contribution toward legal fees to be earned on the IAP claims to the extent of 15 percent of the awards. I will say more about this in para. 30 and 31.

22 The settlement agreement does not bind any member of the class to seek or accept the benefits provided in the agreement. It makes provision for class members to opt out of making a claim for C.E.P. and proceeding with a court claim. Para. 4.14 creates a threshold that if 5,000 persons opt out the agreement is invalidated and court approval set aside unless Canada chooses to waive compliance within a prescribed period.

c) The principles applicable to a motion for certification of a class action;

23 This motion for certification has been brought pursuant to **The Class Proceedings Act** C.C.S.M. c. C130. Section 4 provides:

Certification of class proceeding

4. The court must certify a proceeding as a class proceeding on a motion under section 2 or 3 if

(a) the pleadings disclose a cause of action;
(b) there is an identifiable class of two or more persons;
(c) the claims of the class members raise a common issue, whether or not the common issue predominates over issues affecting only individual members;
(d) a class proceeding would be the preferable procedure for the fair and efficient resolution of the common issues; and
(e) there is a person who is prepared to act as the representative plaintiff who

(i) would fairly and adequately represent the interests of the class,
(ii) has produced a plan for the class proceeding that sets out a workable method of advancing the class proceeding on behalf of the class of notifying class members of the class proceeding, and
(iii) does not have, on the common issues, an interest that conflicts with the interests of other class members.

All parties consent to the order being made. However the consent of the defendants is conditional

on the settlement being confirmed by this Court and the Courts in eight other jurisdictions. The statute provides with regard to settlements:

> **Settlement, discontinuance and abandonment**
>
> 35(1) A class proceeding may be settled, discontinued or abandoned only
>
> (a) with the approval of the court; and
> (b) on the terms the court considers appropriate.
>
> **Court approval of settlement**
>
> 35(2) A settlement may be concluded in relation to the common issues affecting a subclass only
>
> (a) with the approval of the court; and
> (b) on the terms the court considers appropriate.
>
> **Settlement not binding unless approved**
>
> 35(3) A settlement is not binding unless approved by the court.

It does not specify the matters to be considered in deciding whether to approve a settlement.

24 In my view it is clear that all of the criteria have been met for certification of the action as a class action. I wish to discuss briefly the requirement of s. 4(d) that a class proceeding be "the preferable procedure for the fair and efficient resolution of the common issues."

25 For the purpose of this section the class proceeding is the class proceeding sought by the parties including the implementation of the settlement with the C.E.P. payments (para. 13), IAP payments (para. 15), national and community based programs (paras. 17 to 20) and regime for payment of legal fees (paras. 30 and 31). That this procedure is preferable to the alternative which faces 78,000 claimants, our court systems and our community is self evident. I agree with the submissions of counsel that without rubber stamping a consent order a Court may properly be flexible and relax the standards that might be expected of a moving party in a contested motion. In the case of **Gariepy v. Shell Oil Co.** [2002] O.J. No. 4022, Nordheimer J. stated at para. 27:

> [paragraph]27 The first issue is whether this action should be certified as a class proceeding for the purposes of the proposed settlement. The requirements for certification in a settlement context are the same as they are in a litigation context and are set out in section 5 of the Class Proceedings Act, 1992. However, their application need not, in my view, be as rigorously applied in the settlement context as they should be in the litigation context, principally because the underlying concerns over the manageability of the ongoing proceeding are removed.

In my view that means that the preferable procedure requirement has been satisfied in the circumstances of this case leaving any question of manageability or administration of the carrying out of the settlement agreement as a matter to be considered along with all other aspects of the settlement in deciding whether to approve it.

d) Principles relating to approval of a settlement;

26 The minimum standards for obtaining court approval of a settlement have been described by the author in Class Actions in Canada by Ward K. Branch 2006 Canada Law Book Aurora, as follows:

> **16.30** While the Acts do not specify the test for approval, courts have held that the court must find that in all the circumstances the settlement is fair, reasonable and in the best interest of those affected by it. The settlement must be in the best interests of the class as a whole, not any particular member. Settlement approval should not lead the court to a dissection of the settlement with an eye to perfection in every aspect. Rather, the settlement must fall within a zone or range of reasonableness. In *Dabbs v. Sun Life Assurance Co. of Canada*, [1998] O.J. No. 1598, the court stated that the following factors were a useful list of criteria for assessing the reasonableness of a proposed settlement:
>
> (1) likelihood of recovery, or likelihood of success;
> (2) amount and nature of discovery evidence;
> (3) settlement terms and conditions;
> (4) recommendation and experience of counsel;
> (5) future expense and likely duration of litigation;
> (6) recommendation of neutral parties if any;
> (7) number of objectors and nature of objections;
> (8) the presence of good faith and the absence of collusion.
>
> These factors have been adopted in many other cases both inside and outside Ontario. It is not necessary that all of the enumerated factors be

> present in each case, nor is it necessary that each factor be given equal weight in the consideration of any particular settlement.

To these factors I would add that the court should also consider whether the refusal of approval or attaching of conditions to approval, puts the settlement in jeopardy of being unravelled. It should be remembered that there is no obligation on parties to resume negotiations, that sometimes parties who have reached their limit in negotiation, resile from their positions or abandon the effort. The reality is that based on the assertions made at our hearing, many unrepresented Aboriginal people want the agreement affirmed, want the process expedited and not delayed, and the fact is that expectations have been created by announcement of the settlement and by the making of interim payments referred to in para. 14.

27 While the proposed settlement may not be perfect, it certainly is within a zone of reasonableness. In my view it is fair, reasonable and in the best interest of the parties. In a companion proceeding, the motion for certification and approval in Ontario in the case of **Charles Baxter, Sr. and others v. The Attorney General of Canada** [2006] O.J. No. 4968, 00-CV-192059CP Winkler J. raises a concern about the manageability of the settlement of the action. That is certainly a matter to be considered on a motion for approval of a settlement. If, for example, a settlement were made with a party whose financial stability was in doubt the question might be more significant than in a case like this where the principal payer is the Government of Canada. I will say more about my view of this question in para. 32 when I address the question of whether the issue is one which makes the settlement less than perfect but reasonable and whether Winkler J.'s proposal should be left as a suggestion for the parties to consider without making it a condition of approval.

e) Recommendation of counsel;

28 The settlement agreement was negotiated by all parties with the benefit of experienced counsel. Counsel have not only signed the agreement but they have jointly recommended to the Court that the settlement be approved. Moreover a number of them have provided affidavits in support of the motion.

f) Position of the parties who are not represented by counsel;

29 Fourteen persons filed written objections or comments in advance of the hearing. Several hundred persons, many of them members of the class, attended the hearing. Nineteen persons made oral presentations at the hearing touching on a number of subjects. Several of them supplemented the written presentations that they had filed in advance. Of those who complained about the settlement, more often it was because it was felt that payment should be made sooner rather than later. No substantive reason was offered for rejecting the settlement. Mr. Baert, counsel for the National Consortium responded to some of the points raised, providing clarification of the terms of the settlement. For my part I found the presentations moving and persuasive evidence as to how pervasive the damage caused to the Aboriginal community by the IRS policy and as to why it is in

everyone's interest that the settlement be implemented without delay.

g) The feature of the settlement relating to payment of legal fees;

30 The judges in the companion judgments have analyzed the provisions of the settlement agreement relating to payment of legal fees. The claims to fees are large, multiples of ten million, but many years work have gone into the various proceedings by experienced counsel. The fees in question are being paid by Canada from a fund which is separate from the source of payment to the members of the class. Most of the legal bills have been reviewed by or by persons employed by Canada's representative and he has recommended payment of them. There is an issue relating to the claim for fees of one law firm but the settlement agreement sets out a reasonable formula for determination of the firm's fees. The area of concern for me is the question of the absence of express provision in the agreement for review of legal fees on IAP claims. Under the settlement agreement Canada will on the making of an award, pay to each claimant's counsel an additional 15 percent of the award on account of legal fees. It appears that many of the lawyers who will be conducting the proceedings in the IAP claims are acting on contingency agreements entered into before the settlement agreement was made. None of the agreements are before the court but it appears that prior to the making of the settlement agreement many contingency agreements were entered into under which law firms may be entitled to claim 30 per cent or more of the recovery in a court action. One firm that claims to represent several thousand claimants has undertaken not to charge any IAP claimant more than 15 percent of the recovery in addition to the amount received from Canada. That is, the firm has agreed to limit its claim to fees to 30 percent of the amount of the recovery. Even if every law firm in Canada were to agree to do the same, there is a risk that IAP claimants may be called on to pay unreasonably large amounts. On the IAP claims, liability is not in issue as the parties must have contemplated in composing the contingency agreements. There may be settlements short of hearing in some cases. It is easy to visualize circumstances in which no or relative small fee might be justified in addition to the contribution made by Canada.

31 Under section 55 of the **Legal Profession Act** S.M. 2002 c. 44, lawyers practicing in Manitoba must give clients a copy of the contingency agreement on execution of it, failing which it will be unenforceable. Further, along with a copy of the agreement they must give the client a copy of the section that articulates their right to apply for a declaration that the agreement is unfair and unreasonable. However, the evidence shows that many members of the class are illiterate and likely not aware of their rights to have their legal bills reviewed. While no evidence was led on the point one presenter did tell us that she put her name on a list provided by a law firm which she believed related to an offer of information about making an IRS claim. She later was told that she had signed a contingency agreement and when she tried to terminate the services of the law firm she was told that she could not do so. Winkler J. has made a very practical suggestion in the *Baxter* case for implementing a procedure for review of legal fees in the IAP claim. I recommend that the parties give serious consideration to implementing his suggestion. Members of the class made negative comments at the hearing before me about the amounts paid to lawyers and about the conduct of lawyers who persuaded them to sign contingency agreements. In this paragraph I have approved the

settlement as it relates to payment for work done to this time. This settlement is historic and I feel sure that once implemented, Canadians will look back with pride on the way the parties have agreed to put to rest the issues arising from the IRS legacy. An effective review of the legal fees would ensure that the IRS legacy would not be viewed as a windfall to the legal profession.

Critique of the settlement

32 In the *Baxter* case Winkler J. has identified four deficiencies in the settlement agreement. The deficiencies have been summarized by Ball J. in para. 19 of his judgment in the companion case of **Sparvier v. The Attorney General of Canada** [2006] S.J. No. 752, SKQB (see his draft) as follows:

> (a) Financial information sufficient to enable the courts to make an informed decision regarding the anticipated cost of administration of the IAP will be provided for the purposes of approval and thereafter on a periodic basis (para. 52);
> (b) An autonomous supervisor or supervisory board will oversee the administration of the IAP, reporting ultimately to the court (para. 52);
> (c) The adjudicator hearing each case under the IAP will regulate counsel fees to be charged having regard to the complexity of the case, the result achieved, the intention to provide claimants with a reasonable settlement, and the fact that an additional 15% of the compensation award will be paid as fees by Canada (para. 78); and
> (d) The parties will establish a protocol for determining the manner in which issues relating to the ongoing administration of the settlement will be submitted to the courts in each jurisdiction for determination. This will ensure that the requirement for unanimous approval of all courts of any material amendment will not unduly hinder or delay the ability of the courts to make timely decisions (para. 81).

While I agree that the settlement might be better if the four changes were made, it might still be regarded imperfect for a variety of reasons. In para. 31 of my judgment I have articulated my concerns about the desirability of making provisions for review of counsel fees on IAP claims. However, I would not make such a provision a condition of approval. Of the remaining conditions the ones that raise a red flag are (a) and (b) relating to production of financial information and supervision of the administration of the CEP and IAP. Of this, Winkler J. has made the following findings in *Baxter*:

> [38] The potential for conflict for Canada between its proposed role as administrator and its role as continuing litigant is the first issue that must be addressed. One of the goals of this settlement is to resolve all ongoing litigation related to the residential schools. The structure of the administration must be

consistent with this aim and not such as to render itself subject to claims of bias and partiality based on apparent conflicts of interest. If such perception exists, it has the potential to taint even those areas where the neutrality is more enshrined such as the adjudication process. Accordingly, the administration of the plan must be neutral and independent of any concerns that Canada, as a party to the settlement, may otherwise have. In order to satisfactorily achieve this requisite separation, the administrative function must be completely isolated from the litigation function with an autonomous supervisor or supervisory board reporting ultimately to the courts. This separation will serve to protect the interests of the class members and insulate the government from unfounded conflict of interest claims. To effectively accomplish this separation and autonomy it is not necessary to alter the administrative scheme by replacing the proposed administration or by imposing a third party administrator on the settlement. Rather, the requisite independence and neutrality can be achieved by ensuring that the person, or persons, appointed by Canada with authority over the administration of the settlement shall ultimately report to and take direction, where necessary, from the courts and not from the government. By extension, such person, or persons, once appointed by the government and approved by the courts, is not subject to removal by the government without further approval from the courts. This is consistent with the approach taken in all class action administrations and there is no reason to depart from that approach in this instance.

[39] The autonomous supervisor or supervisory board envisioned by the court will have the authority necessary to direct the administration of the plan in accordance with its terms, to communicate with the supervisory courts and to be responsible to those courts. Simply put, it cannot be the case that the "administrator", once directed by the courts to undertake a certain task, must seek the ultimate approval from Canada. The administration of the settlement will be under the direction of the courts and they will be the final authority. Otherwise, the neutrality and independence of the administrator will be suspect and the supervisory authority of the courts compromised.

[40] The foregoing are organizational issues that relate to what may be called the "executive oversight" role in the administration. There are other issues in relation to the operational framework for delivery of the benefits under the settlement, particularly with respect to the costs of administration.

[42] Absent any explanation, the current costs of the ADR program appear to be

excessively disproportionate when considered against the typical costs of administering a class action settlement. This court has never approved a settlement where the costs of administration exceed the compensation available let alone where the cost excess is a factor of three. It is no answer as was suggested in argument that since Canada, as defendant, has committed to funding the administrative costs separately from the settlement funding, the court need not be concerned with the quantum of that cost. This proposition must be rejected for two reasons. First, it ignores the court's supervisory role in class actions. Secondly, it fails to recognize how the peculiar aspects of certain terms of this settlement relating to funding can impact unfairly on the class members while at the same time leaving the courts powerless to provide a remedy. This is addressed in more detail below. Thirdly, it fails to recognize that this is not a settlement where the administration is being paid out of a fixed settlement fund. The administrative costs will be paid from the general revenues of the government. This leads to a certain precariousness in respect of the administration and leads to the prospect of the ongoing administration of the settlement becoming a political issue to the potential detriment of the class members.

[44] This combination of inadequate information and absolute veto power over expenditures is unacceptable. The court cannot approve a settlement without adequate information to ensure that the class members' interests are being protected and that it will be able to maintain an effective ongoing supervisory role. As stated in *McCarthy* [2001] O.J. No. 2474 at para. 21:

> ... a class proceeding by its very nature involves the issuance of orders or judgments that affect persons who are not before the Court. These absent class members are dependent on the Court to protect their interests. In order to do so, the Court must have all of the available information that has some bearing on the issues, whether favourable or unfavourable to the moving party.

It strikes me that an issue is being raised as to who, as between the courts and Canada, is to have ultimate control over the administration of the settlement. The settlement of this case is too important to the parties affected and is so fair and reasonable, that it is inappropriate to engage in that debate in this case. Canada has shown its good intentions in so many ways and the parties, after a lengthy and complex series of negotiations, have accepted that Canada will have the supervisory role. Issues like this one can well be left for other settings.

i) Risks of not unconditionally approving the settlement;

33 The settlement agreement provides:

16.01

Agreement is Conditional

> This Agreement will not be effective unless and until it is approved by the Courts, and if such approvals are not granted by each of the Courts on substantially the same terms and conditions save and except for the variations in membership contemplated in Sections 4.04 and 4.07 of this Agreement, this Agreement will thereupon be terminated and none of the Parties will be liable to any of the other Parties hereunder, except that the fees and disbursements of the members of the NCC will be paid in any event.

This provision largely mirrors the condition set out in the settlement agreement referred to in **Parsons v. Canadian Red Cross Society** [1999] O.J. No. 3572 at para. 127. However, one could argue that the four conditions referred to in Winkler J.'s judgment in the *Baxter* case are much more substantial than the two conditions imposed in *Parsons*. Winkler J. has stated in para. 36 of *Baxter*:

> [36] I turn now to the specific deficiencies that must be addressed in the proposed administrative scheme. In my view they are neither insurmountable nor do they require any material change to the settlement agreement itself.

In para. 85 of *Baxter* he also stated, "The changes that the court requires to the settlement are neither material nor substantial in the context of its scope and complexity." There is another view that is reasonably arguable, that the conditions are not "substantially the same as" the terms of the settlement agreement. If the alternative interpretation is adopted it will be open to Canada to treat the settlement agreement as terminated and 78000 Aboriginal claimants will be returned to their pre-settlement plight. Also there will be nothing to compel the parties to resume negotiation and if they do, there is a risk that they will resile from positions agreed to. In other words there is a risk that the settlement will unravel although it is in its present form well within a zone of reasonableness.

j) Conclusion.

34 Having reviewed the material that has been placed before this court I have reached the conclusion that the order of certification of a class action should be granted and the settlement should be approved unconditionally. An expectation has been created on the part of class members that they would receive payments and many have received interim payments. It would be unfortunate if this creative effort by all parties were brought to a halt and the whole settlement

unravelled because of the imposition of conditions which may well have been rejected in the course of negotiations of the agreement. Negotiation involves give and take on the part of negotiating parties and the negotiation concluded with a settlement which cries out for confirmation.

SCHULMAN J.

Case Name:

ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp.

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 and Arrangement involving Metcalfe & Mansfield Alternative Investments II Corp., Metcalfe & Mansfield Alternative Investments III Corp., Metcalfe & Mansfield Alternative Investments V Corp., Metcalfe & Mansfield Alternative Investments XI Corp., Metcalfe & Mansfield Alternative Investments XII Corp., 4446372 Canada Inc. and 6932819 Canada Inc., Trustees of the Conduits Listed In Schedule "A" Hereto
Between
The Investors represented on the Pan-Canadian Investors Committee for Third-Party Structured Asset-Backed Commercial Paper listed in Schedule "B" hereto, Applicants (Respondents in Appeal), and Metcalfe & Mansfield Alternative Investments II Corp., Metcalfe & Mansfield Alternative Investments III Corp., Metcalfe & Mansfield Alternative Investments V Corp., Metcalfe & Mansfield Alternative Investments XI Corp., Metcalfe & Mansfield Alternative Investments XII Corp., 6932819 Canada Inc. and 4446372 Canada Inc., Trustees of the Conduits listed in Schedule "A" hereto, Respondents (Respondents in Appeal), and Air Transat A.T. Inc., Transat Tours Canada Inc., The Jean Coutu Group (PJC) Inc., Aéroports de Montréal Inc., Aéroports de Montréal Capital Inc., Pomerleau Ontario Inc., Pomerleau Inc., Labopharm Inc., Domtar Inc., Domtar Pulp and Paper Products Inc., GIRO Inc., Vêtements de sports R.G.R. Inc., 131519 Canada Inc., Air Jazz LP, Petrifond Foundation Company Limited, Petrifond Foundation Midwest Limited, Services hypothécaires la patrimoniale Inc., TECSYS Inc., Société générale de financement du Québec, VibroSystM

Inc., Interquisa Canada L.P., Redcorp Ventures Ltd., Jura Energy Corporation, Ivanhoe Mines Ltd., WebTech Wireless Inc., Wynn Capital Corporation Inc., Hy Bloom Inc., Cardacian Mortgage Services, Inc., West Energy Ltd., Sabre Enerty Ltd., Petrolifera Petroleum Ltd., Vaquero Resources Ltd. and Standard Energy Inc., Respondents (Appellants)

[2008] O.J. No. 3164

2008 ONCA 587

45 C.B.R. (5th) 163

296 D.L.R. (4th) 135

2008 CarswellOnt 4811

168 A.C.W.S. (3d) 698

240 O.A.C. 245

47 B.L.R. (4th) 123

92 O.R. (3d) 513

Docket: C48969 (M36489)

Ontario Court of Appeal
Toronto, Ontario

J.I. Laskin, E.A. Cronk and R.A. Blair JJ.A.

Heard: June 25-26, 2008.
Judgment: August 18, 2008.

(121 paras.)

Bankruptcy and insolvency law -- Proceedings in bankruptcy and insolvency -- Practice and procedure -- General principles -- Legislation -- Interpretation -- Courts -- Jurisdiction -- Federal -- Companies' Creditors Arrangement Act -- Application by certain creditors opposed to a Plan of Compromise and Arrangement for leave to appeal sanctioning of that Plan -- Pan-Canadian Investors Committee was formed and ultimately put forward the creditor-initiated Plan of

Compromise and Arrangement that formed the subject matter of the proceedings -- Plan dealt with liquidity crisis threatening Canadian market in Asset Backed Commercial Paper -- Plan was sanctioned by court -- Leave to appeal allowed and appeal dismissed -- CCAA permitted the inclusion of third party releases in a plan of compromise or arrangement to be sanctioned by the court -- Companies' Creditors Arrangement Act, ss. 4, 6.

Application by certain creditors opposed to a Plan of Compromise and Arrangement for leave to appeal the sanctioning of that Plan. In August 2007, a liquidity crisis threatened the Canadian market in Asset Backed Commercial Paper (ABCP). The crisis was triggered by a loss of confidence amongst investors stemming from the news of widespread defaults on US sub-prime mortgages. By agreement amongst the major Canadian participants, the $32 billion Canadian market in third-party ABCP was frozen on August 13, 2007, pending an attempt to resolve the crisis through a restructuring of that market. The Pan-Canadian Investors Committee was formed and ultimately put forward the creditor-initiated Plan of Compromise and Arrangement that formed the subject matter of the proceedings. The Plan was sanctioned on June 5, 2008. The applicants raised an important point regarding the permissible scope of restructuring under the Companies' Creditors Arrangement Act: could the court sanction a Plan that called for creditors to provide releases to third parties who were themselves insolvent and not creditors of the debtor company? They also argued that if the answer to that question was yes, the application judge erred in holding that the Plan, with its particular releases (which barred some claims even in fraud), was fair and reasonable and therefore in sanctioning it under the CCAA.

HELD: Application for leave to appeal allowed and appeal dismissed. The appeal raised issues of considerable importance to restructuring proceedings under the CCAA Canada-wide. There were serious and arguable grounds of appeal and the appeal would not unduly delay the progress of the proceedings. In the circumstances, the criteria for granting leave to appeal were met. Respecting the appeal, the CCAA permitted the inclusion of third party releases in a plan of compromise or arrangement to be sanctioned by the court where the releases were reasonably connected to the proposed restructuring. The wording of the CCAA, construed in light of the purpose, objects and scheme of the Act, supported the court's jurisdiction and authority to sanction the Plan proposed in this case, including the contested third-party releases contained in it. The Plan was fair and reasonable in all the circumstances.

Statutes, Regulations and Rules Cited:

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3,

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 4, s. 6

Constitution Act, 1867, R.S.C. 1985, App. II, No. 5, s. 91(21), s. 92(13)

Appeal From:

On appeal from the sanction order of Justice Colin L. Campbell of the Superior Court of Justice, dated June 5, 2008, with reasons reported at [2008] O.J. No. 2265.

Counsel:

See Schedule "A" for the list of counsel.

The judgment of the Court was delivered by

R.A. BLAIR J.A.:--

A. INTRODUCTION

1 In August 2007 a liquidity crisis suddenly threatened the Canadian market in Asset Backed Commercial Paper ("ABCP"). The crisis was triggered by a loss of confidence amongst investors stemming from the news of widespread defaults on U.S. sub-prime mortgages. The loss of confidence placed the Canadian financial market at risk generally and was reflective of an economic volatility worldwide.

2 By agreement amongst the major Canadian participants, the $32 billion Canadian market in third-party ABCP was frozen on August 13, 2007 pending an attempt to resolve the crisis through a restructuring of that market. The Pan-Canadian Investors Committee, chaired by Purdy Crawford, C.C., Q.C., was formed and ultimately put forward the creditor-initiated Plan of Compromise and Arrangement that forms the subject-matter of these proceedings. The Plan was sanctioned by Colin L. Campbell J. on June 5, 2008.

3 Certain creditors who opposed the Plan seek leave to appeal and, if leave is granted, appeal from that decision. They raise an important point regarding the permissible scope of a restructuring under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 as amended ("CCAA"): can the court sanction a Plan that calls for creditors to provide releases to third parties who are themselves solvent and not creditors of the debtor company? They also argue that, if the answer to this question is yes, the application judge erred in holding that this Plan, with its particular releases (which bar some claims even in fraud), was fair and reasonable and therefore in sanctioning it under the CCAA.

<u>Leave to Appeal</u>

4 Because of the particular circumstances and urgency of these proceedings, the court agreed to

collapse an oral hearing for leave to appeal with the hearing of the appeal itself. At the outset of argument we encouraged counsel to combine their submissions on both matters.

5 The proposed appeal raises issues of considerable importance to restructuring proceedings under the CCAA Canada-wide. There are serious and arguable grounds of appeal and -- given the expedited time-table -- the appeal will not unduly delay the progress of the proceedings. I am satisfied that the criteria for granting leave to appeal in CCAA proceedings, set out in such cases as *Re Cineplex Odeon Corp.* (2001), 24 C.B.R. (4th) 21 (Ont. C.A.), and *Re Country Style Food Services* (2002), 158 O.A.C. 30, are met. I would grant leave to appeal.

Appeal

6 For the reasons that follow, however, I would dismiss the appeal.

B. FACTS

The Parties

7 The appellants are holders of ABCP Notes who oppose the Plan. They do so principally on the basis that it requires them to grant releases to third party financial institutions against whom they say they have claims for relief arising out of their purchase of ABCP Notes. Amongst them are an airline, a tour operator, a mining company, a wireless provider, a pharmaceuticals retailer, and several holding companies and energy companies.

8 Each of the appellants has large sums invested in ABCP -- in some cases, hundreds of millions of dollars. Nonetheless, the collective holdings of the appellants -- slightly over $1 billion -- represent only a small fraction of the more than $32 billion of ABCP involved in the restructuring.

9 The lead respondent is the Pan-Canadian Investors Committee which was responsible for the creation and negotiation of the Plan on behalf of the creditors. Other respondents include various major international financial institutions, the five largest Canadian banks, several trust companies, and some smaller holders of ABCP product. They participated in the market in a number of different ways.

The ABCP Market

10 Asset Backed Commercial Paper is a sophisticated and hitherto well-accepted financial instrument. It is primarily a form of short-term investment -- usually 30 to 90 days -- typically with a low interest yield only slightly better than that available through other short-term paper from a government or bank. It is said to be "asset backed" because the cash that is used to purchase an ABCP Note is converted into a portfolio of financial assets or other asset interests that in turn provide security for the repayment of the notes.

11 ABCP was often presented by those selling it as a safe investment, somewhat like a

guaranteed investment certificate.

12 The Canadian market for ABCP is significant and administratively complex. As of August 2007, investors had placed over $116 billion in Canadian ABCP. Investors range from individual pensioners to large institutional bodies. On the selling and distribution end, numerous players are involved, including chartered banks, investment houses and other financial institutions. Some of these players participated in multiple ways. The Plan in this proceeding relates to approximately $32 billion of non-bank sponsored ABCP the restructuring of which is considered essential to the preservation of the Canadian ABCP market.

13 As I understand it, prior to August 2007 when it was frozen, the ABCP market worked as follows.

14 Various corporations (the "Sponsors") would arrange for entities they control ("Conduits") to make ABCP Notes available to be sold to investors through "Dealers" (banks and other investment dealers). Typically, ABCP was issued by series and sometimes by classes within a series.

15 The cash from the purchase of the ABCP Notes was used to purchase assets which were held by trustees of the Conduits ("Issuer Trustees") and which stood as security for repayment of the notes. Financial institutions that sold or provided the Conduits with the assets that secured the ABCP are known as "Asset Providers". To help ensure that investors would be able to redeem their notes, "Liquidity Providers" agreed to provide funds that could be drawn upon to meet the demands of maturing ABCP Notes in certain circumstances. Most Asset Providers were also Liquidity Providers. Many of these banks and financial institutions were also holders of ABCP Notes ("Noteholders"). The Asset and Liquidity Providers held first charges on the assets.

16 When the market was working well, cash from the purchase of new ABCP Notes was also used to pay off maturing ABCP Notes; alternatively, Noteholders simply rolled their maturing notes over into new ones. As I will explain, however, there was a potential underlying predicament with this scheme.

The Liquidity Crisis

17 The types of assets and asset interests acquired to "back" the ABCP Notes are varied and complex. They were generally long-term assets such as residential mortgages, credit card receivables, auto loans, cash collateralized debt obligations and derivative investments such as credit default swaps. Their particular characteristics do not matter for the purpose of this appeal, but they shared a common feature that proved to be the Achilles heel of the ABCP market: because of their long-term nature there was an inherent timing mismatch between the cash they generated and the cash needed to repay maturing ABCP Notes.

18 When uncertainty began to spread through the ABCP marketplace in the summer of 2007, investors stopped buying the ABCP product and existing Noteholders ceased to roll over their

maturing notes. There was no cash to redeem those notes. Although calls were made on the Liquidity Providers for payment, most of the Liquidity Providers declined to fund the redemption of the notes, arguing that the conditions for liquidity funding had not been met in the circumstances. Hence the "liquidity crisis" in the ABCP market.

19 The crisis was fuelled largely by a lack of transparency in the ABCP scheme. Investors could not tell what assets were backing their notes -- partly because the ABCP Notes were often sold before or at the same time as the assets backing them were acquired; partly because of the sheer complexity of certain of the underlying assets; and partly because of assertions of confidentiality by those involved with the assets. As fears arising from the spreading U.S. sub-prime mortgage crisis mushroomed, investors became increasingly concerned that their ABCP Notes may be supported by those crumbling assets. For the reasons outlined above, however, they were unable to redeem their maturing ABCP Notes.

<u>The Montreal Protocol</u>

20 The liquidity crisis could have triggered a wholesale liquidation of the assets, at depressed prices. But it did not. During the week of August 13, 2007, the ABCP market in Canada froze -- the result of a standstill arrangement orchestrated on the heels of the crisis by numerous market participants, including Asset Providers, Liquidity Providers, Noteholders and other financial industry representatives. Under the standstill agreement -- known as the Montréal Protocol -- the parties committed to restructuring the ABCP market with a view, as much as possible, to preserving the value of the assets and of the notes.

21 The work of implementing the restructuring fell to the Pan-Canadian Investors Committee, an applicant in the proceeding and respondent in the appeal. The Committee is composed of 17 financial and investment institutions, including chartered banks, credit unions, a pension board, a Crown corporation, and a university board of governors. All 17 members are themselves Noteholders; three of them also participated in the ABCP market in other capacities as well. Between them, they hold about two thirds of the $32 billion of ABCP sought to be restructured in these proceedings.

22 Mr. Crawford was named the Committee's chair. He thus had a unique vantage point on the work of the Committee and the restructuring process as a whole. His lengthy affidavit strongly informed the application judge's understanding of the factual context, and our own. He was not cross-examined and his evidence is unchallenged.

23 Beginning in September 2007, the Committee worked to craft a plan that would preserve the value of the notes and assets, satisfy the various stakeholders to the extent possible, and restore confidence in an important segment of the Canadian financial marketplace. In March 2008, it and the other applicants sought CCAA protection for the ABCP debtors and the approval of a Plan that had been pre-negotiated with some, but not all, of those affected by the misfortunes in the Canadian ABCP market.

The Plan

a) Plan Overview

24 Although the ABCP market involves many different players and kinds of assets, each with their own challenges, the committee opted for a single plan. In Mr. Crawford's words, "all of the ABCP suffers from common problems that are best addressed by a common solution." The Plan the Committee developed is highly complex and involves many parties. In its essence, the Plan would convert the Noteholders' paper -- which has been frozen and therefore effectively worthless for many months -- into new, long-term notes that would trade freely, but with a discounted face value. The hope is that a strong secondary market for the notes will emerge in the long run.

25 The Plan aims to improve transparency by providing investors with detailed information about the assets supporting their ABCP Notes. It also addresses the timing mismatch between the notes and the assets by adjusting the maturity provisions and interest rates on the new notes. Further, the Plan adjusts some of the underlying credit default swap contracts by increasing the thresholds for default triggering events; in this way, the likelihood of a forced liquidation flowing from the credit default swap holder's prior security is reduced and, in turn, the risk for ABCP investors is decreased.

26 Under the Plan, the vast majority of the assets underlying ABCP would be pooled into two master asset vehicles (MAV1 and MAV2). The pooling is designed to increase the collateral available and thus make the notes more secure.

27 The Plan does not apply to investors holding less than $1 million of notes. However, certain Dealers have agreed to buy the ABCP of those of their customers holding less than the $1-million threshold, and to extend financial assistance to these customers. Principal among these Dealers are National Bank and Canaccord, two of the respondent financial institutions the appellants most object to releasing. The application judge found that these developments appeared to be designed to secure votes in favour of the Plan by various Noteholders, and were apparently successful in doing so. If the Plan is approved, they also provide considerable relief to the many small investors who find themselves unwittingly caught in the ABCP collapse.

b) The Releases

28 This appeal focuses on one specific aspect of the Plan: the comprehensive series of releases of third parties provided for in Article 10.

29 The Plan calls for the release of Canadian banks, Dealers, Noteholders, Asset Providers, Issuer Trustees, Liquidity Providers, and other market participants -- in Mr. Crawford's words, "virtually all participants in the Canadian ABCP market" -- from any liability associated with ABCP, with the exception of certain narrow claims relating to fraud. For instance, under the Plan as approved,

creditors will have to give up their claims against the Dealers who sold them their ABCP Notes, including challenges to the way the Dealers characterized the ABCP and provided (or did not provide) information about the ABCP. The claims against the proposed defendants are mainly in tort: negligence, misrepresentation, negligent misrepresentation, failure to act prudently as a dealer/advisor, acting in conflict of interest, and in a few cases fraud or potential fraud. There are also allegations of breach of fiduciary duty and claims for other equitable relief.

30 The application judge found that, in general, the claims for damages include the face value of the Notes, plus interest and additional penalties and damages.

31 The releases, in effect, are part of a *quid pro quo*. Generally speaking, they are designed to compensate various participants in the market for the contributions they would make to the restructuring. Those contributions under the Plan include the requirements that:

a) Asset Providers assume an increased risk in their credit default swap contracts, disclose certain proprietary information in relation to the assets, and provide below-cost financing for margin funding facilities that are designed to make the notes more secure;
b) Sponsors -- who in addition have cooperated with the Investors' Committee throughout the process, including by sharing certain proprietary information -- give up their existing contracts;
c) The Canadian banks provide below-cost financing for the margin funding facility and,
d) Other parties make other contributions under the Plan.

32 According to Mr. Crawford's affidavit, the releases are part of the Plan "because certain key participants, whose participation is vital to the restructuring, have made comprehensive releases a condition for their participation."

The CCAA Proceedings to Date

33 On March 17, 2008 the applicants sought and obtained an Initial Order under the CCAA staying any proceedings relating to the ABCP crisis and providing for a meeting of the Noteholders to vote on the proposed Plan. The meeting was held on April 25th. The vote was overwhelmingly in support of the Plan -- 96% of the Noteholders voted in favour. At the instance of certain Noteholders, and as requested by the application judge (who has supervised the proceedings from the outset), the Monitor broke down the voting results according to those Noteholders who had worked on or with the Investors' Committee to develop the Plan and those Noteholders who had not. Re-calculated on this basis the results remained firmly in favour of the proposed Plan -- 99% of those connected with the development of the Plan voted positively, as did 80% of those Noteholders who had not been involved in its formulation.

34 The vote thus provided the Plan with the "double majority" approval -- a majority of creditors

representing two-thirds in value of the claims -- required under s. 6 of the CCAA.

35 Following the successful vote, the applicants sought court approval of the Plan under s. 6. Hearings were held on May 12 and 13. On May 16, the application judge issued a brief endorsement in which he concluded that he did not have sufficient facts to decide whether all the releases proposed in the Plan were authorized by the CCAA. While the application judge was prepared to approve the releases of negligence claims, he was not prepared at that point to sanction the release of fraud claims. Noting the urgency of the situation and the serious consequences that would result from the Plan's failure, the application judge nevertheless directed the parties back to the bargaining table to try to work out a claims process for addressing legitimate claims of fraud.

36 The result of this renegotiation was a "fraud carve-out" -- an amendment to the Plan excluding certain fraud claims from the Plan's releases. The carve-out did not encompass all possible claims of fraud, however. It was limited in three key respects. First, it applied only to claims against ABCP Dealers. Secondly, it applied only to cases involving an express fraudulent misrepresentation made with the intention to induce purchase and in circumstances where the person making the representation knew it to be false. Thirdly, the carve-out limited available damages to the value of the notes, minus any funds distributed as part of the Plan. The appellants argue vigorously that such a limited release respecting fraud claims is unacceptable and should not have been sanctioned by the application judge.

37 A second sanction hearing -- this time involving the amended Plan (with the fraud carve-out) -- was held on June 3, 2008. Two days later, Campbell J. released his reasons for decision, approving and sanctioning the Plan on the basis both that he had jurisdiction to sanction a Plan calling for third-party releases and that the Plan including the third-party releases in question here was fair and reasonable.

38 The appellants attack both of these determinations.

C. LAW AND ANALYSIS

39 There are two principal questions for determination on this appeal:

1) As a matter of law, may a CCAA plan contain a release of claims against anyone other than the debtor company or its directors?
2) If the answer to that question is yes, did the application judge err in the exercise of his discretion to sanction the Plan as fair and reasonable given the nature of the releases called for under it?

(1) Legal Authority for the Releases

40 The standard of review on this first issue -- whether, as a matter of law, a CCAA plan may

contain third-party releases -- is correctness.

41 The appellants submit that a court has no jurisdiction or legal authority under the CCAA to sanction a plan that imposes an obligation on creditors to give releases to third parties other than the directors of the debtor company.[1] The requirement that objecting creditors release claims against third parties is illegal, they contend, because:

a) on a proper interpretation, the CCAA does not permit such releases;
b) the court is not entitled to "fill in the gaps" in the CCAA or rely upon its inherent jurisdiction to create such authority because to do so would be contrary to the principle that Parliament did not intend to interfere with private property rights or rights of action in the absence of clear statutory language to that effect;
c) the releases constitute an unconstitutional confiscation of private property that is within the exclusive domain of the provinces under s. 92 of the *Constitution Act*, 1867;
d) the releases are invalid under Quebec rules of public order; and because
e) the prevailing jurisprudence supports these conclusions.

42 I would not give effect to any of these submissions.

<u>Interpretation, "Gap Filling" and Inherent Jurisdiction</u>

43 On a proper interpretation, in my view, the CCAA permits the inclusion of third party releases in a plan of compromise or arrangement to be sanctioned by the court where those releases are reasonably connected to the proposed restructuring. I am led to this conclusion by a combination of (a) the open-ended, flexible character of the CCAA itself, (b) the broad nature of the term "compromise or arrangement" as used in the Act, and (c) the express statutory effect of the "double-majority" vote and court sanction which render the plan binding on <u>all</u> creditors, including those unwilling to accept certain portions of it. The first of these signals a flexible approach to the application of the Act in new and evolving situations, an active judicial role in its application and interpretation, and a liberal approach to that interpretation. The second provides the entrée to negotiations between the parties affected in the restructuring and furnishes them with the ability to apply the broad scope of their ingenuity in fashioning the proposal. The latter afford necessary protection to unwilling creditors who may be deprived of certain of their civil and property rights as a result of the process.

44 The CCAA is skeletal in nature. It does not contain a comprehensive code that lays out all that is permitted or barred. Judges must therefore play a role in fleshing out the details of the statutory scheme. The scope of the Act and the powers of the court under it are not limitless. It is beyond controversy, however, that the CCAA is remedial legislation to be liberally construed in accordance with the modern purposive approach to statutory interpretation. It is designed to be a flexible instrument and it is that very flexibility which gives the Act its efficacy: *Canadian Red Cross*

Society (Re) (1998), 5 C.B.R. (4th) 299 (Ont. Gen. Div.). As Farley J. noted in *Re Dylex Ltd.* (1995), 31 C.B.R. (3d) 106 at 111 (Ont. Gen. Div.), "[t]he history of CCAA law has been an evolution of judicial interpretation."

45 Much has been said, however, about the "evolution of judicial interpretation" and there is some controversy over both the source and scope of that authority. Is the source of the court's authority statutory, discerned solely through application of the principles of statutory interpretation, for example? Or does it rest in the court's ability to "fill in the gaps" in legislation? Or in the court's inherent jurisdiction?

46 These issues have recently been canvassed by the Honourable Georgina R. Jackson and Dr. Janis Sarra in their publication "Selecting the Judicial Tool to get the Job Done: An Examination of Statutory Interpretation, Discretionary Power and Inherent Jurisdiction in Insolvency Matters,"[2] and there was considerable argument on these issues before the application judge and before us. While I generally agree with the authors' suggestion that the courts should adopt a hierarchical approach in their resort to these interpretive tools -- statutory interpretation, gap-filling, discretion and inherent jurisdiction -- it is not necessary in my view to go beyond the general principles of statutory interpretation to resolve the issues on this appeal. Because I am satisfied that it is implicit in the language of the CCAA itself that the court has authority to sanction plans incorporating third-party releases that are reasonably related to the proposed restructuring, there is no "gap-filling" to be done and no need to fall back on inherent jurisdiction. In this respect, I take a somewhat different approach than the application judge did.

47 The Supreme Court of Canada has affirmed generally -- and in the insolvency context particularly -- that remedial statutes are to be interpreted liberally and in accordance with Professor Driedger's modern principle of statutory interpretation. Driedger advocated that "the words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament": *Re Rizzo & Rizzo Shoes Ltd.*, [1998] 1 S.C.R. 27 at para. 21, quoting E.A. Driedger, *Construction of Statutes*, 2nd ed. (Toronto: Butterworths, 1983); *Bell Expressvu Ltd. Partnership v. R.*, [2002] 2 S.C.R. 559 at para. 26.

48 More broadly, I believe that the proper approach to the judicial interpretation and application of statutes -- particularly those like the CCAA that are skeletal in nature -- is succinctly and accurately summarized by Jackson and Sarra in their recent article, *supra*, at p. 56:

> The exercise of a statutory authority requires the statute to be construed. The plain meaning or textualist approach has given way to a search for the object and goals of the statute and the intentionalist approach. This latter approach makes use of the purposive approach and the mischief rule, including its codification under interpretation statutes that every enactment is deemed remedial, and is to be given such fair, large and liberal construction and interpretation as best

> ensures the attainment of its objects. This latter approach advocates reading the statute as a whole and being mindful of Driedger's "one principle", that the words of the Act are to be read in their entire context, in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament. It is important that courts first interpret the statute before them and exercise their authority pursuant to the statute, before reaching for other tools in the judicial toolbox. Statutory interpretation using the principles articulated above leaves room for gap-filling in the common law provinces and a consideration of purpose in *Québec* as a manifestation of the judge's overall task of statutory interpretation. Finally, the jurisprudence in relation to statutory interpretation demonstrates the fluidity inherent in the judge's task in seeking the objects of the statute and the intention of the legislature.

49 I adopt these principles.

50 The remedial purpose of the CCAA -- as its title affirms -- is to facilitate compromises or arrangements between an insolvent debtor company and its creditors. In *Chef Ready Foods Ltd. v. Hongkong Bank of Canada* (1990), 4 C.B.R. (3d) 311 at 318 (B.C.C.A.), Gibbs J.A. summarized very concisely the purpose, object and scheme of the Act:

> Almost inevitably, liquidation destroyed the shareholders' investment, yielded little by way of recovery to the creditors, and exacerbated the social evil of devastating levels of unemployment. The government of the day sought, through the C.C.A.A., to create a regime whereby the principals of the company and the creditors could be brought together under the supervision of the court to attempt a reorganization or compromise or arrangement under which the company could continue in business.

51 The CCAA was enacted in 1933 and was necessary -- as the then Secretary of State noted in introducing the Bill on First Reading -- "because of the prevailing commercial and industrial depression" and the need to alleviate the effects of business bankruptcies in that context: see the statement of the Hon. C.H. Cahan, Secretary of State, *House of Commons Debates (Hansard)* (April 20, 1933) at 4091. One of the greatest effects of that Depression was what Gibbs J.A. described as "the social evil of devastating levels of unemployment". Since then, courts have recognized that the Act has a broader dimension than simply the direct relations between the debtor company and its creditors and that this broader public dimension must be weighed in the balance together with the interests of those most directly affected: see, for example, *Elan Corp. v. Comiskey (Trustee of)* (1990), 1 O.R. (3d) 289 (C.A.), *per* Doherty J.A. in dissent; *Re Skydome Corp.* (1998), 16 C.B.R. (4th) 125 (Ont. Gen. Div.); *Re Anvil Range Mining Corp.* (1998), 3 C.B.R. (4th) 93 (Ont. Gen. Div.).

52 In this respect, I agree with the following statement of Doherty J.A. in *Elan, supra,* at pp.

306-307:

> ... [T]he Act was designed to serve a "broad constituency of investors, creditors and employees".[3] Because of that "broad constituency" the court must, when considering applications brought under the Act, *have regard not only to the individuals and organizations directly affected by the application, but also to the wider public interest.* [Emphasis added.]

Application of the Principles of Interpretation

53 An interpretation of the CCAA that recognizes its broader socio-economic purposes and objects is apt in this case. As the application judge pointed out, the restructuring underpins the financial viability of the Canadian ABCP market itself.

54 The appellants argue that the application judge erred in taking this approach and in treating the Plan and the proceedings as an attempt to restructure a financial market (the ABCP market) rather than simply the affairs between the debtor corporations who caused the ABCP Notes to be issued and their creditors. The Act is designed, they say, only to effect reorganizations between a corporate debtor and its creditors and not to attempt to restructure entire marketplaces.

55 This perspective is flawed in at least two respects, however, in my opinion. First, it reflects a view of the purpose and objects of the CCAA that is too narrow. Secondly, it overlooks the reality of the ABCP marketplace and the context of the restructuring in question here. It may be true that, in their capacity as ABCP *Dealers*, the releasee financial institutions are "third-parties" to the restructuring in the sense that they are not creditors of the debtor corporations. However, in their capacities as *Asset Providers* and *Liquidity Providers*, they are not only creditors but they are prior secured creditors to the Noteholders. Furthermore -- as the application judge found -- in these latter capacities they are making significant contributions to the restructuring by "foregoing immediate rights to assets and ... providing real and tangible input for the preservation and enhancement of the Notes" (para. 76). In this context, therefore, the application judge's remark at para. 50 that the restructuring "involves the commitment and participation of all parties" in the ABCP market makes sense, as do his earlier comments at paras. 48-49:

> Given the nature of the ABCP market and all of its participants, it is more appropriate to consider all Noteholders as claimants and the object of the Plan to restore liquidity to the assets being the Notes themselves. The restoration of the liquidity of the market necessitates the participation (including more tangible contribution by many) of all Noteholders.
>
> In these circumstances, *it is unduly technical to classify the Issuer Trustees as debtors and the claims of the Noteholders as between themselves and others as*

> *being those of third party creditors*, although I recognize that the restructuring structure of the CCAA requires the corporations as the vehicles for restructuring. [Emphasis added.]

56 The application judge did observe that "[t]he insolvency is of the ABCP market itself, the restructuring is that of the market for such paper ..." (para. 50). He did so, however, to point out the uniqueness of the Plan before him and its industry-wide significance and not to suggest that he need have no regard to the provisions of the CCAA permitting a restructuring as between debtor and creditors. His focus was on *the effect* of the restructuring, a perfectly permissible perspective, given the broad purpose and objects of the Act. This is apparent from his later references. For example, in balancing the arguments against approving releases that might include aspects of fraud, he responded that "what is at issue is a liquidity crisis that affects the ABCP market in Canada" (para. 125). In addition, in his reasoning on the fair-and-reasonable issue, he stated at para. 142: "Apart from the Plan itself, there is a need to restore confidence in the financial system in Canada and this Plan is a legitimate use of the CCAA to accomplish that goal."

57 I agree. I see no error on the part of the application judge in approaching the fairness assessment or the interpretation issue with these considerations in mind. They provide the context in which the purpose, objects and scheme of the CCAA are to be considered.

The Statutory Wording

58 Keeping in mind the interpretive principles outlined above, I turn now to a consideration of the provisions of the CCAA. Where in the words of the statute is the court clothed with authority to approve a plan incorporating a requirement for third-party releases? As summarized earlier, the answer to that question, in my view, is to be found in:

a) the skeletal nature of the CCAA;
b) Parliament's reliance upon the broad notions of "compromise" and "arrangement" to establish the framework within which the parties may work to put forward a restructuring plan; and in
c) the creation of the statutory mechanism binding all creditors in classes to the compromise or arrangement once it has surpassed the high "double majority" voting threshold and obtained court sanction as "fair and reasonable".

Therein lies the expression of Parliament's intention to permit the parties to negotiate and vote on, and the court to sanction, third-party releases relating to a restructuring.

59 Sections 4 and 6 of the CCAA state:

> 4. Where a compromise or an arrangement is proposed between a debtor company and its unsecured creditors or any class of them, the court may, on the application in a summary way of the company, of any such creditor or of the trustee in

bankruptcy or liquidator of the company, order a meeting of the creditors or class of creditors, and, if the court so determines, of the shareholders of the company, to be summoned in such manner as the court directs.

6. Where a majority in number representing two-thirds in value of the creditors, or class of creditors, as the case may be, present and voting either in person or by proxy at the meeting or meetings thereof respectively held pursuant to sections 4 and 5, or either of those sections, agree to any compromise or arrangement either as proposed or as altered or modified at the meeting or meetings, the compromise or arrangement may be sanctioned by the court, and if so sanctioned is binding

(*a*) on all the creditors or the class of creditors, as the case may be, and on any trustee for any such class of creditors, whether secured or unsecured, as the case may be, and on the company; and

(*b*) in the case of a company that has made an authorized assignment or against which a bankruptcy order has been made under the *Bankruptcy and Insolvency Act* or is in the course of being wound up under the *Winding-up and Restructuring Act*, on the trustee in bankruptcy or liquidator and contributories of the company.

Compromise or Arrangement

60 While there may be little practical distinction between "compromise" and "arrangement" in many respects, the two are not necessarily the same. "Arrangement" is broader than "compromise" and would appear to include any scheme for reorganizing the affairs of the debtor: Houlden and Morawetz, *Bankruptcy and Insolvency Law of Canada*, loose-leaf, 3rd ed., vol. 4 (Toronto: Thomson Carswell) at 10A-12.2, N para. 10. It has been said to be "a very wide and indefinite [word]": *Re Refund of Dues under Timber Regulations*, [1935] A.C. 184 at 197 (P.C.), affirming S.C.C. [1933] S.C.R. 616. See also, *Re Guardian Assur. Co.*, [1917] 1 Ch. 431 at 448, 450; *Re T&N Ltd. and Others (No. 3)*, [2007] 1 All E.R. 851 (Ch.).

61 The CCAA is a sketch, an outline, a supporting framework for the resolution of corporate insolvencies in the public interest. Parliament wisely avoided attempting to anticipate the myriad of business deals that could evolve from the fertile and creative minds of negotiators restructuring their financial affairs. It left the shape and details of those deals to be worked out within the framework of the comprehensive and flexible concepts of a "compromise" and "arrangement." I see no reason why a release in favour of a third party, negotiated as part of a package between a debtor and creditor and reasonably relating to the proposed restructuring cannot fall within that framework.

62 A proposal under the *Bankruptcy and Insolvency Act*, R.S., 1985, c. B-3 (the "BIA") is a

contract: *Employers' Liability Assurance Corp. Ltd. v. Ideal Petroleum* (1959) Ltd. [1978] 1 S.C.R. 230 at 239; *Society of Composers, Authors & Music Publishers of Canada v. Armitage* (2000), 50 O.R. (3d) 688 at para. 11 (C.A.). In my view, a compromise or arrangement under the CCAA is directly analogous to a proposal for these purposes, and therefore is to be treated as a contract between the debtor and its creditors. Consequently, parties are entitled to put anything into such a plan that could lawfully be incorporated into any contract. See *Re Air Canada* (2004), 2 C.B.R. (5th) 4 at para. 6 (Ont. S.C.J.); *Olympia & York Developments Ltd. v. Royal Trust Co.* (1993), 12 O.R. (3d) 500 at 518 (Gen. Div.).

63 There is nothing to prevent a debtor and a creditor from including in a contract between them a term providing that the creditor release a third party. The term is binding as between the debtor and creditor. In the CCAA context, therefore, a plan of compromise or arrangement may propose that creditors agree to compromise claims against the debtor and to release third parties, just as any debtor and creditor might agree to such a term in a contract between them. Once the statutory mechanism regarding voter approval and court sanctioning has been complied with, the plan -- including the provision for releases -- becomes binding on all creditors (including the dissenting minority).

64 *Re T&N Ltd. and Others, supra,* is instructive in this regard. It is a rare example of a court focussing on and examining the meaning and breadth of the term "arrangement". T&N and its associated companies were engaged in the manufacture, distribution and sale of asbestos-containing products. They became the subject of many claims by former employees, who had been exposed to asbestos dust in the course of their employment, and their dependents. The T&N companies applied for protection under s. 425 of the U.K. *Companies Act 1985*, a provision virtually identical to the scheme of the CCAA -- including the concepts of compromise or arrangement.[4]

65 T&N carried employers' liability insurance. However, the employers' liability insurers (the "EL insurers") denied coverage. This issue was litigated and ultimately resolved through the establishment of a multi-million pound fund against which the employees and their dependants (the "EL claimants") would assert their claims. In return, T&N's former employees and dependants (the "EL claimants") agreed to forego any further claims against the EL insurers. This settlement was incorporated into the plan of compromise and arrangement between the T&N companies and the EL claimants that was voted on and put forward for court sanction.

66 Certain creditors argued that the court could not sanction the plan because it did not constitute a "compromise or arrangement" between T&N and the EL claimants since it did not purport to affect rights as between them but only the EL claimants' rights against the EL insurers. The Court rejected this argument. Richards J. adopted previous jurisprudence -- cited earlier in these reasons -- to the effect that the word "arrangement" has a very broad meaning and that, while both a compromise and an arrangement involve some "give and take", an arrangement need not involve a compromise or be confined to a case of dispute or difficulty (paras. 46-51). He referred to what would be the equivalent of a solvent arrangement under Canadian corporate legislation as an

example.[5] Finally, he pointed out that the compromised rights of the EL claimants against the EL insurers were not unconnected with the EL claimants' rights against the T&N companies; the scheme of arrangement involving the EL insurers was "an integral part of a single proposal affecting all the parties" (para. 52). He concluded his reasoning with these observations (para. 53):

> In my judgment it is not a necessary element of an arrangement for the purposes of s. 425 of the 1985 Act that it should alter the rights existing between the company and the creditors or members with whom it is made. No doubt in most cases it will alter those rights. But, provided that the context and content of the scheme are such as properly to constitute an arrangement between the company and the members or creditors concerned, it will fall within s. 425. It is ... neither necessary nor desirable to attempt a definition of arrangement. The legislature has not done so. To insist on an alteration of rights, or a termination of rights as in the case of schemes to effect takeovers or mergers, is to impose a restriction which is neither warranted by the statutory language nor justified by the courts' approach over many years to give the term its widest meaning. *Nor is an arrangement necessarily outside the section, because its effect is to alter the rights of creditors against another party or because such alteration could be achieved by a scheme of arrangement with that party.* [Emphasis added.]

67 I find Richard J.'s analysis helpful and persuasive. In effect, the claimants in *T&N* were being asked to release their claims against the EL insurers in exchange for a call on the fund. Here, the appellants are being required to release their claims against certain financial third parties in exchange for what is anticipated to be an improved position for all ABCP Noteholders, stemming from the contributions the financial third parties are making to the ABCP restructuring. The situations are quite comparable.

The Binding Mechanism

68 Parliament's reliance on the expansive terms "compromise" or "arrangement" does not stand alone, however. Effective insolvency restructurings would not be possible without a statutory mechanism to bind an unwilling minority of creditors. Unanimity is frequently impossible in such situations. But the minority must be protected too. Parliament's solution to this quandary was to permit a wide range of proposals to be negotiated and put forward (the compromise or arrangement) and to bind all creditors by class to the terms of the plan, but to do so only where the proposal can gain the support of the requisite "double majority" of votes[6] and obtain the sanction of the court on the basis that it is fair and reasonable. In this way, the scheme of the CCAA supports the intention of Parliament to encourage a wide variety of solutions to corporate insolvencies without unjustifiably overriding the rights of dissenting creditors.

The Required Nexus

69 In keeping with this scheme and purpose, I do not suggest that any and all releases between

creditors of the debtor company seeking to restructure and third parties may be made the subject of a compromise or arrangement between the debtor and its creditors. Nor do I think the fact that the releases may be "necessary" in the sense that the third parties or the debtor may refuse to proceed without them, of itself, advances the argument in favour of finding jurisdiction (although it may well be relevant in terms of the fairness and reasonableness analysis).

70 The release of the claim in question must be justified as part of the compromise or arrangement between the debtor and its creditors. In short, there must be a reasonable connection between the third party claim being compromised in the plan and the restructuring achieved by the plan to warrant inclusion of the third party release in the plan. This nexus exists here, in my view.

71 In the course of his reasons, the application judge made the following findings, all of which are amply supported on the record:

a) The parties to be released are necessary and essential to the restructuring of the debtor;
b) *The claims to be released are rationally related to the purpose of the Plan and necessary for it*;
c) The Plan cannot succeed without the releases;
d) *The parties who are to have claims against them released are contributing in a tangible and realistic way to the Plan*; and
e) The Plan will benefit not only the debtor companies but creditor Noteholders generally.

72 Here, then -- as was the case in *T&N* -- there is a close connection between the claims being released and the restructuring proposal. The tort claims arise out of the sale and distribution of the ABCP Notes and their collapse in value, just as do the contractual claims of the creditors against the debtor companies. The purpose of the restructuring is to stabilize and shore up the value of those notes in the long run. The third parties being released are making separate contributions to enable those results to materialize. Those contributions are identified earlier, at para. 31 of these reasons. The application judge found that the claims being released are not independent of or unrelated to the claims that the Noteholders have against the debtor companies; they are closely connected to the value of the ABCP Notes and are required for the Plan to succeed. At paras. 76-77 he said:

> [76] I do not consider that the Plan in this case involves a change in relationship among creditors "that does not directly involve the Company." Those who support the Plan and are to be released are "directly involved in the Company" in the sense that many are foregoing immediate rights to assets and are providing real and tangible input for the preservation and enhancement of the Notes. It would be unduly restrictive to suggest that the moving parties' claims against released parties do not involve the Company, since the claims are directly related to the value of the Notes. The value of the Notes is in this case the value of the

> Company.
>
> [77] This Plan, as it deals with releases, doesn't change the relationship of the creditors apart from involving the Company and its Notes.

73 I am satisfied that the wording of the CCAA -- construed in light of the purpose, objects and scheme of the Act and in accordance with the modern principles of statutory interpretation -- supports the court's jurisdiction and authority to sanction the Plan proposed here, including the contested third-party releases contained in it.

The Jurisprudence

74 Third party releases have become a frequent feature in Canadian restructurings since the decision of the Alberta Court of Queen's Bench in *Re Canadian Airlines Corp.* (2000), 265 A.R. 201, leave to appeal refused by *Resurgence Asset Management LLC v. Canadian Airlines Corp.* (2000), 266 A.R. 131 (C.A.), and [2001] S.C.C.A. No. 60, (2001) 293 A.R. 351 (S.C.C.). In *Re Muscle Tech Research and Development Inc.* (2006), 25 C.B.R (5th) 231 (Ont. S.C.J.) Justice Ground remarked (para. 8):

> [It] is not uncommon in CCAA proceedings, in the context of a plan of compromise and arrangement, to compromise claims against the Applicants and other parties against whom such claims or related claims are made.

75 We were referred to at least a dozen court-approved CCAA plans from across the country that included broad third-party releases. With the exception of *Re Canadian Airlines*, however, the releases in those restructurings -- including *Muscle Tech* -- were not opposed. The appellants argue that those cases are wrongly decided, because the court simply does not have the authority to approve such releases.

76 In *Re Canadian Airlines* the releases in question were opposed, however. Paperny J. (as she then was) concluded the court had jurisdiction to approve them and her decision is said to be the well-spring of the trend towards third-party releases referred to above. Based on the foregoing analysis, I agree with her conclusion although for reasons that differ from those cited by her.

77 Justice Paperny began her analysis of the release issue with the observation at para. 87 that "[p]rior to 1997, the CCAA did not provide for compromises of claims against anyone other than the petitioning company." It will be apparent from the analysis in these reasons that I do not accept that premise, notwithstanding the decision of the Quebec Court of Appeal in *Michaud v. Steinberg,*[7] of which her comment may have been reflective. Paperny J.'s reference to 1997 was a reference to the amendments of that year adding s. 5.1 to the CCAA, which provides for limited releases in favour of directors. Given the limited scope of s. 5.1, Justice Paperny was thus faced with the argument -- dealt with later in these reasons -- that Parliament must not have intended to extend the

authority to approve third-party releases beyond the scope of this section. She chose to address this contention by concluding that, although the amendments "[did] not authorize a release of claims against third parties other than directors, [they did] not prohibit such releases either" (para. 92).

78 Respectfully, I would not adopt the interpretive principle that the CCAA permits releases because it does not expressly prohibit them. Rather, as I explain in these reasons, I believe the open-ended CCAA permits third-party releases that are reasonably related to the restructuring at issue because they are encompassed in the comprehensive terms "compromise" and "arrangement" and because of the double-voting majority and court sanctioning statutory mechanism that makes them binding on unwilling creditors.

79 The appellants rely on a number of authorities, which they submit support the proposition that the CCAA may not be used to compromise claims as between anyone other than the debtor company and its creditors. Principal amongst these are *Michaud v. Steinberg, supra*; *NBD Bank, Canada v. Dofasco Inc.*, (1999), 46 O.R. (3d) 514 (C.A.); *Pacific Coastal Airlines Ltd. v. Air Canada* (2001), 19 B.L.R. (3d) 286 (B.C.S.C.); and *Re Stelco Inc.* (2005), 78 O.R. (3d) 241 (C.A.) ("*Stelco I*"). I do not think these cases assist the appellants, however. With the exception of *Steinberg*, they do not involve third party claims that were reasonably connected to the restructuring. As I shall explain, it is my opinion that *Steinberg* does not express a correct view of the law, and I decline to follow it.

80 In *Pacific Coastal Airlines*, Tysoe J. made the following comment at para. 24:

> [The purpose of the CCAA proceeding] is not to deal with disputes between a creditor of a company and a third party, even if the company was also involved in the subject matter of the dispute. While issues between the debtor company and non-creditors are sometimes dealt with in CCAA proceedings, it is not a proper use of a CCAA proceeding to determine disputes between parties other than the debtor company.

81 This statement must be understood in its context, however. Pacific Coastal Airlines had been a regional carrier for Canadian Airlines prior to the CCAA reorganization of the latter in 2000. In the action in question it was seeking to assert separate tort claims against Air Canada for contractual interference and inducing breach of contract in relation to certain rights it had to the use of Canadian's flight designator code prior to the CCAA proceeding. Air Canada sought to have the action dismissed on grounds of *res judicata* or issue estoppel because of the CCAA proceeding. Tysoe J. rejected the argument.

82 The facts in *Pacific Coastal* are not analogous to the circumstances of this case, however. There is no suggestion that a resolution of Pacific Coastal's separate tort claim against Air Canada was in any way connected to the Canadian Airlines restructuring, even though Canadian -- at a contractual level -- may have had some involvement with the particular dispute. Here, however, the disputes that are the subject-matter of the impugned releases are not simply "disputes between

parties other than the debtor company". They are closely connected to the disputes being resolved between the debtor companies and their creditors and to the restructuring itself.

83 Nor is the decision of this Court in the *NBD Bank* case dispositive. It arose out of the financial collapse of Algoma Steel, a wholly-owned subsidiary of Dofasco. The Bank had advanced funds to Algoma allegedly on the strength of misrepresentations by Algoma's Vice-President, James Melville. The plan of compromise and arrangement that was sanctioned by Farley J. in the Algoma CCAA restructuring contained a clause releasing Algoma from all claims creditors "may have had against Algoma or its directors, officers, employees and advisors." Mr. Melville was found liable for negligent misrepresentation in a subsequent action by the Bank. On appeal, he argued that since the Bank was barred from suing Algoma for misrepresentation by its officers, permitting it to pursue the same cause of action against him personally would subvert the CCAA process -- in short, he was personally protected by the CCAA release.

84 Rosenberg J.A., writing for this Court, rejected this argument. The appellants here rely particularly upon his following observations at paras. 53-54:

> 53 In my view, the appellant has not demonstrated that allowing the respondent to pursue its claim against him would undermine or subvert the purposes of the Act. As this court noted in *Elan Corp. v. Comiskey* (1990), 1 O.R. (3d) 289 at 297, the *CCAA* is remedial legislation "intended to provide a structured environment for the negotiation of compromises between a debtor company and its creditors for the benefit of both". It is a means of avoiding a liquidation that may yield little for the creditors, especially unsecured creditors like the respondent, and the debtor company shareholders. However, the appellant has not shown that allowing a creditor to continue an action against an officer for negligent misrepresentation would erode the effectiveness of the Act.
>
> 54 In fact, to refuse on policy grounds to impose liability on an officer of the corporation for negligent misrepresentation would contradict the policy of Parliament as demonstrated in recent amendments to the *CCAA* and the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3. Those Acts now contemplate that an arrangement or proposal may include a term for compromise of certain types of claims against directors of the company except claims that "are based on allegations of misrepresentations made by directors". L.W. Houlden and C.H. Morawetz, the editors of *The 2000 Annotated Bankruptcy and Insolvency Act* (Toronto: Carswell, 1999) at p. 192 are of the view that the policy behind the provision is to encourage directors of an insolvent corporation to remain in office so that the affairs of the corporation can be reorganized. I can see no similar policy interest in barring an action against an officer of the company who, prior to the insolvency, has misrepresented the financial affairs of

> the corporation to its creditors. It may be necessary to permit the compromise of claims against the debtor corporation, otherwise it may not be possible to successfully reorganize the corporation. The same considerations do not apply to individual officers. Rather, it would seem to me that it would be contrary to good policy to immunize officers from the consequences of their negligent statements which might otherwise be made in anticipation of being forgiven under a subsequent corporate proposal or arrangement. [Footnote omitted.]

85 Once again, this statement must be assessed in context. Whether Justice Farley had the authority in the earlier Algoma CCAA proceedings to sanction a plan that included third party releases was not under consideration at all. What the Court was determining in *NBD Bank* was whether the release extended by its terms to protect a third party. In fact, on its face, it does not appear to do so. Justice Rosenberg concluded only that not allowing Mr. Melville to rely upon the release did not subvert the purpose of the CCAA. As the application judge here observed, "there is little factual similarity in *NBD* to the facts now before the Court" (para. 71). Contrary to the facts of this case, in *NBD Bank* the creditors had not agreed to grant a release to officers; they had not voted on such a release and the court had not assessed the fairness and reasonableness of such a release as a term of a complex arrangement involving significant contributions by the beneficiaries of the release -- as is the situation here. Thus, *NBD Bank* is of little assistance in determining whether the court has authority to sanction a plan that calls for third party releases.

86 The appellants also rely upon the decision of this Court in *Stelco I*. There, the Court was dealing with the scope of the CCAA in connection with a dispute over what were called the "Turnover Payments". Under an inter-creditor agreement one group of creditors had subordinated their rights to another group and agreed to hold in trust and "turn over" any proceeds received from Stelco until the senior group was paid in full. On a disputed classification motion, the Subordinated Debt Holders argued that they should be in a separate class from the Senior Debt Holders. Farley J. refused to make such an order in the court below, stating:

> [Sections] 4, 5 and 6 [of the CCAA] talk of compromises or arrangements between a company and its creditors. There is no mention of this extending by statute to encompass a change of relationship among the creditors vis-à-vis the creditors themselves *and not directly involving the company.* [Citations omitted; emphasis added.]

See *Re Stelco Inc.* (2005), 15 C.B.R. (5th) 297 (Ont. S.C.J.) at para. 7.

87 This Court upheld that decision. The legal relationship between each group of creditors and Stelco was the same, albeit there were inter-creditor differences, and creditors were to be classified in accordance with their legal rights. In addition, the need for timely classification and voting decisions in the CCAA process militated against enmeshing the classification process in the

vagaries of inter-corporate disputes. In short, the issues before the Court were quite different from those raised on this appeal.

88 Indeed, the Stelco plan, as sanctioned, included third party releases (albeit uncontested ones). This Court subsequently dealt with the same inter-creditor agreement on an appeal where the Subordinated Debt Holders argued that the inter-creditor subordination provisions were beyond the reach of the CCAA and therefore that they were entitled to a separate civil action to determine their rights under the agreement: *Re Stelco Inc.*, (2006), 21 C.B.R. (5th) 157 (Ont. C.A.) ("*Stelco II*"). The Court rejected that argument and held that where the creditors' rights amongst themselves were sufficiently related to the debtor and its plan, they were properly brought within the scope of the CCAA plan. The Court said (para. 11):

> In [*Stelco I*] -- the classification case -- the court observed that it is not a proper use of a CCAA proceeding to determine disputes between parties other than the debtor company ... *[H]owever, the present case is not simply an inter-creditor dispute that does not involve the debtor company; it is a dispute that is inextricably connected to the restructuring process*. [Emphasis added.]

89 The approach I would take to the disposition of this appeal is consistent with that view. As I have noted, the third party releases here are very closely connected to the ABCP restructuring process.

90 Some of the appellants -- particularly those represented by Mr. Woods -- rely heavily upon the decision of the Quebec Court of Appeal in *Michaud v. Steinberg, supra.* They say that it is determinative of the release issue. In *Steinberg*, the Court held that the CCAA, as worded at the time, did not permit the release of directors of the debtor corporation and that third-party releases were not within the purview of the Act. Deschamps J.A. (as she then was) said (paras. 42, 54 and 58 -- English translation):

> [42] Even if one can understand the extreme pressure weighing on the creditors and the respondent at the time of the sanctioning, a plan of arrangement is not the appropriate forum to settle disputes other than the claims that are the subject of the arrangement. In other words, one cannot, under the pretext of an absence of formal directives in the Act, transform an arrangement into a potpourri.
>
> ...
>
> [54] The Act offers the respondent a way to arrive at a compromise with is creditors. It does not go so far as to offer an umbrella to all the persons within its orbit by permitting them to shelter themselves from any recourse.
>
> ...

> [58] The [CCAA] and the case law clearly do not permit extending the application of an arrangement to persons other than the respondent and its creditors and, consequently, the plan should not have been sanctioned as is [that is, including the releases of the directors].

91 Justices Vallerand and Delisle, in separate judgments, agreed. Justice Vallerand summarized his view of the consequences of extending the scope of the CCAA to third party releases in this fashion (para. 7):

> In short, the Act will have become the Companies' *and Their Officers and Employees* Creditors Arrangement Act -- an awful mess -- and likely not attain its purpose, which is to enable the company to survive in the face of *its* creditors and through their will, and not in the face of the creditors of its officers. This is why I feel, just like my colleague, that such a clause is contrary to the Act's mode of operation, contrary to its purposes and, for this reason, is to be banned.

92 Justice Delisle, on the other hand, appears to have rejected the releases because of their broad nature -- they released directors from all claims, including those that were altogether unrelated to their corporate duties with the debtor company -- rather than because of a lack of authority to sanction under the Act. Indeed, he seems to have recognized the wide range of circumstances that could be included within the term "compromise or arrangement". He is the only one who addressed that term. At para. 90 he said:

> The CCAA is drafted in general terms. It does not specify, among other things, what must be understood by "compromise or arrangement". However, it may be inferred from the purpose of this [A]ct that these terms *encompass all that should enable the person who has recourse to it to fully dispose of his debts*, both those that exist on the date when he has recourse to the statute and *those contingent on the insolvency in which he finds himself* ... [Emphasis added.]

93 The decision of the Court did not reflect a view that the terms of a compromise or arrangement should "encompass all that should enable the person who has recourse to [the Act] to dispose of his debts ... and those contingent on the insolvency in which he finds himself," however. On occasion such an outlook might embrace third parties other than the debtor and its creditors in order to make the arrangement work. Nor would it be surprising that, in such circumstances, the third parties might seek the protection of releases, or that the debtor might do so on their behalf. Thus, the perspective adopted by the majority in *Steinberg*, in my view, is too narrow, having regard to the language, purpose and objects of the CCAA and the intention of Parliament. They made no attempt to consider and explain why a compromise or arrangement could not include third-party releases. In addition, the decision appears to have been based, at least partly, on a rejection of the use of contract-law concepts in analysing the Act -- an approach inconsistent with the jurisprudence referred to above.

94 Finally, the majority in *Steinberg* seems to have proceeded on the basis that the CCAA cannot interfere with civil or property rights under Quebec law. Mr. Woods advanced this argument before this Court in his factum, but did not press it in oral argument. Indeed, he conceded that if the Act encompasses the authority to sanction a plan containing third-party releases -- as I have concluded it does -- the provisions of the CCAA, as valid federal insolvency legislation, are paramount over provincial legislation. I shall return to the constitutional issues raised by the appellants later in these reasons.

95 Accordingly, to the extent *Steinberg* stands for the proposition that the court does not have authority under the CCAA to sanction a plan that incorporates third-party releases, I do not believe it to be a correct statement of the law and I respectfully decline to follow it. The modern approach to interpretation of the Act in accordance with its nature and purpose militates against a narrow interpretation and towards one that facilitates and encourages compromises and arrangements. Had the majority in *Steinberg* considered the broad nature of the terms "compromise" and "arrangement" and the jurisprudence I have referred to above, they might well have come to a different conclusion.

The 1997 Amendments

96 *Steinberg* led to amendments to the CCAA, however. In 1997, s. 5.1 was added, dealing specifically with releases pertaining to directors of the debtor company. It states:

> 5.1 (1) A compromise or arrangement made in respect of a debtor company may include in its terms provision for the compromise of claims against directors of the company that arose before the commencement of proceedings under this Act and that relate to the obligations of the company where the directors are by law liable in their capacity as directors for the payment of such obligations.
>
> Exception
>
> (2) A provision for the compromise of claims against directors may not include claims that
>
> (*a*) relate to contractual rights of one or more creditors; or
>
> (*b*) are based on allegations of misrepresentations made by directors to creditors or of wrongful or oppressive conduct by directors.
>
> Powers of court

(3) The court may declare that a claim against directors shall not be compromised if it is satisfied that the compromise would not be fair and reasonable in the circumstances.

Resignation or removal of directors

(4) Where all of the directors have resigned or have been removed by the shareholders without replacement, any person who manages or supervises the management of the business and affairs of the debtor company shall be deemed to be a director for the purposes of this section.

1997, c. 12, s. 122.

97 Perhaps the appellants' strongest argument is that these amendments confirm a prior lack of authority in the court to sanction a plan including third party releases. If the power existed, why would Parliament feel it necessary to add an amendment specifically permitting such releases (subject to the exceptions indicated) in favour of directors? *Expressio unius est exclusio alterius*, is the Latin maxim sometimes relied on to articulate the principle of interpretation implied in that question: to express or include one thing implies the exclusion of the other.

98 The maxim is not helpful in these circumstances, however. The reality is that there *may* be another explanation why Parliament acted as it did. As one commentator has noted:[8]

> Far from being a rule, [the maxim *expressio unius*] is not even lexicographically accurate, because it is simply not true, generally, that the mere express conferral of a right or privilege in one kind of situation implies the denial of the equivalent right or privilege in other kinds. Sometimes it does and sometimes its does not, and whether it does or does not depends on the particular circumstances of context. Without contextual support, therefore there is not even a mild presumption here. Accordingly, the maxim is at best a description, after the fact, of what the court has discovered from context.

99 As I have said, the 1997 amendments to the CCAA providing for releases in favour of directors of debtor companies in limited circumstances were a response to the decision of the Quebec Court of Appeal in *Steinberg*. A similar amendment was made with respect to proposals in the BIA at the same time. The rationale behind these amendments was to encourage directors of an insolvent company to remain in office during a restructuring, rather than resign. The assumption was that by remaining in office the directors would provide some stability while the affairs of the

company were being reorganized: see Houlden and Morawetz, vol. 1, *supra*, at 2-144, Es.11A; *Le Royal Penfield Inc. (Syndic de)*, [2003] R.J.Q. 2157 at paras. 44-46 (C.S.).

100 Parliament thus had a particular focus and a particular purpose in enacting the 1997 amendments to the CCAA and the BIA. While there is some merit in the appellants' argument on this point, at the end of the day I do not accept that Parliament intended to signal by its enactment of s. 5.1 that it was depriving the court of authority to sanction plans of compromise or arrangement in all circumstances where they incorporate third party releases in favour of anyone other than the debtor's directors. For the reasons articulated above, I am satisfied that the court does have the authority to do so. Whether it sanctions the plan is a matter for the fairness hearing.

The Deprivation of Proprietary Rights

101 Mr. Shapray very effectively led the appellants' argument that legislation must not be construed so as to interfere with or prejudice established contractual or proprietary rights -- including the right to bring an action -- in the absence of a clear indication of legislative intention to that effect: *Halsbury's Laws of England*, 4th ed. reissue, vol. 44 (1) (London: Butterworths, 1995) at paras. 1438, 1464 and 1467; Driedger, 2nd ed., *supra,* at 183; Ruth Sullivan, *Sullivan and Driedger on the Construction of Statutes*, 4th ed., (Markham: Butterworths, 2002) at 399. I accept the importance of this principle. For the reasons I have explained, however, I am satisfied that Parliament's intention to clothe the court with authority to consider and sanction a plan that contains third party releases is expressed with sufficient clarity in the "compromise or arrangement" language of the CCAA coupled with the statutory voting and sanctioning mechanism making the provisions of the plan binding on all creditors. This is not a situation of impermissible "gap-filling" in the case of legislation severely affecting property rights; it is a question of finding meaning in the language of the Act itself. I would therefore not give effect to the appellants' submissions in this regard.

The Division of Powers and Paramountcy

102 Mr. Woods and Mr. Sternberg submit that extending the reach of the CCAA process to the compromise of claims as between solvent creditors of the debtor company and solvent third parties to the proceeding is constitutionally impermissible. They say that under the guise of the federal insolvency power pursuant to s. 91(21) of the *Constitution Act, 1867*, this approach would improperly affect the rights of civil claimants to assert their causes of action, a provincial matter falling within s. 92(13), and contravene the rules of public order pursuant to the *Civil Code of Quebec*.

103 I do not accept these submissions. It has long been established that the CCAA is valid federal legislation under the federal insolvency power: *Reference re: Companies' Creditors Arrangement Act (Canada)*, [1934] S.C.R. 659. As the Supreme Court confirmed in that case (p. 661), citing Viscount Cave L.C. in *Royal Bank of Canada v. Larue* [1928] A.C. 187, "the exclusive legislative authority to deal with all matters within the domain of bankruptcy and insolvency is vested in

Parliament." Chief Justice Duff elaborated:

> Matters normally constituting part of a bankruptcy scheme but not in their essence matters of bankruptcy and insolvency may, of course, from another point of view and in another aspect be dealt with by a provincial legislature; but, when treated as matters pertaining to bankruptcy and insolvency, they clearly fall within the legislative authority of the Dominion.

104 That is exactly the case here. The power to sanction a plan of compromise or arrangement that contains third-party releases of the type opposed by the appellants is embedded in the wording of the CCAA. The fact that this may interfere with a claimant's right to pursue a civil action -- normally a matter of provincial concern -- or trump Quebec rules of public order is constitutionally immaterial. The CCAA is a valid exercise of federal power. Provided the matter in question falls within the legislation directly or as necessarily incidental to the exercise of that power, the CCAA governs. To the extent that its provisions are inconsistent with provincial legislation, the federal legislation is paramount. Mr. Woods properly conceded this during argument.

Conclusion With Respect to Legal Authority

105 For all of the foregoing reasons, then, I conclude that the application judge had the jurisdiction and legal authority to sanction the Plan as put forward.

(2) The Plan is "Fair and Reasonable"

106 The second major attack on the application judge's decision is that he erred in finding that the Plan is "fair and reasonable" and in sanctioning it on that basis. This attack is centred on the nature of the third-party releases contemplated and, in particular, on the fact that they will permit the release of some claims based in fraud.

107 Whether a plan of compromise or arrangement is fair and reasonable is a matter of mixed fact and law, and one on which the application judge exercises a large measure of discretion. The standard of review on this issue is therefore one of deference. In the absence of a demonstrable error an appellate court will not interfere: see *Re Ravelston Corp. Ltd.* (2007), 31 C.B.R. (5th) 233 (Ont. C.A.).

108 I would not interfere with the application judge's decision in this regard. While the notion of releases in favour of third parties -- including leading Canadian financial institutions -- that extend to claims of fraud is distasteful, there is no legal impediment to the inclusion of a release for claims based in fraud in a plan of compromise or arrangement. The application judge had been living with and supervising the ABCP restructuring from its outset. He was intimately attuned to its dynamics. In the end he concluded that the benefits of the Plan to the creditors as a whole, and to the debtor companies, outweighed the negative aspects of compelling the unwilling appellants to execute the releases as finally put forward.

109 The application judge was concerned about the inclusion of fraud in the contemplated releases and at the May hearing adjourned the final disposition of the sanctioning hearing in an effort to encourage the parties to negotiate a resolution. The result was the "fraud carve-out" referred to earlier in these reasons.

110 The appellants argue that the fraud carve-out is inadequate because of its narrow scope. It (i) applies only to ABCP Dealers, (ii) limits the type of damages that may be claimed (no punitive damages, for example), (iii) defines "fraud" narrowly, excluding many rights that would be protected by common law, equity and the Quebec concept of public order, and (iv) limits claims to representations made directly to Noteholders. The appellants submit it is contrary to public policy to sanction a plan containing such a limited restriction on the type of fraud claims that may be pursued against the third parties.

111 The law does not condone fraud. It is the most serious kind of civil claim. There is therefore some force to the appellants' submission. On the other hand, as noted, there is no legal impediment to granting the release of an antecedent claim in fraud, provided the claim is in the contemplation of the parties to the release at the time it is given: *Fotinis Restaurant Corp. v. White Spot Ltd.* (1998), 38 B.L.R. (2d) 251 at paras. 9 and 18 (B.C.S.C.). There may be disputes about the scope or extent of what is released, but parties are entitled to settle allegations of fraud in civil proceedings -- the claims here all being untested allegations of fraud -- and to include releases of such claims as part of that settlement.

112 The application judge was alive to the merits of the appellants' submissions. He was satisfied in the end, however, that the need "to avoid the potential cascade of litigation that ... would result if a broader 'carve out' were to be allowed" (para. 113) outweighed the negative aspects of approving releases with the narrower carve-out provision. Implementation of the Plan, in his view, would work to the overall greater benefit of the Noteholders as a whole. I can find no error in principle in the exercise of his discretion in arriving at this decision. It was his call to make.

113 At para. 71 above I recited a number of factual findings the application judge made in concluding that approval of the Plan was within his jurisdiction under the CCAA and that it was fair and reasonable. For convenience, I reiterate them here -- with two additional findings -- because they provide an important foundation for his analysis concerning the fairness and reasonableness of the Plan. The application judge found that:

a) The parties to be released are necessary and essential to the restructuring of the debtor;
b) The claims to be released are rationally related to the purpose of the Plan and necessary for it;
c) The Plan cannot succeed without the releases;
d) The parties who are to have claims against them released are contributing in a tangible and realistic way to the Plan;

e) The Plan will benefit not only the debtor companies but creditor Noteholders generally;

f) The voting creditors who have approved the Plan did so with knowledge of the nature and effect of the releases; and that,

g) The releases are fair and reasonable and not overly broad or offensive to public policy.

114 These findings are all supported on the record. Contrary to the submission of some of the appellants, they do not constitute a new and hitherto untried "test" for the sanctioning of a plan under the CCAA. They simply represent findings of fact and inferences on the part of the application judge that underpin his conclusions on jurisdiction and fairness.

115 The appellants all contend that the obligation to release the third parties from claims in fraud, tort, breach of fiduciary duty, etc. is confiscatory and amounts to a requirement that they -- as individual creditors -- make the equivalent of a greater financial contribution to the Plan. In his usual lively fashion, Mr. Sternberg asked us the same rhetorical question he posed to the application judge. As he put it, how could the court countenance the compromise of what in the future might turn out to be fraud perpetrated at the highest levels of Canadian and foreign banks? Several appellants complain that the proposed Plan is unfair to them because they will make very little additional recovery if the Plan goes forward, but will be required to forfeit a cause of action against third-party financial institutions that may yield them significant recovery. Others protest that they are being treated unequally because they are ineligible for relief programs that Liquidity Providers such as Canaccord have made available to other smaller investors.

116 All of these arguments are persuasive to varying degrees when considered in isolation. The application judge did not have that luxury, however. He was required to consider the circumstances of the restructuring as a whole, including the reality that many of the financial institutions were not only acting as Dealers or brokers of the ABCP Notes (with the impugned releases relating to the financial institutions in these capacities, for the most part) but also as Asset and Liquidity Providers (with the financial institutions making significant contributions to the restructuring in these capacities).

117 In insolvency restructuring proceedings almost everyone loses something. To the extent that creditors are required to compromise their claims, it can always be proclaimed that their rights are being unfairly confiscated and that they are being called upon to make the equivalent of a further financial contribution to the compromise or arrangement. Judges have observed on a number of occasions that CCAA proceedings involve "a balancing of prejudices," inasmuch as everyone is adversely affected in some fashion.

118 Here, the debtor corporations being restructured represent the issuers of the more than $32 billion in non-bank sponsored ABCP Notes. The proposed compromise and arrangement affects that entire segment of the ABCP market and the financial markets as a whole. In that respect, the

application judge was correct in adverting to the importance of the restructuring to the resolution of the ABCP liquidity crisis and to the need to restore confidence in the financial system in Canada. He was required to consider and balance the interests of all Noteholders, not just the interests of the appellants, whose notes represent only about 3% of that total. That is what he did.

119 The application judge noted at para. 126 that the Plan represented "a reasonable balance between benefit to all Noteholders and enhanced recovery for those who can make out specific claims in fraud" within the fraud carve-out provisions of the releases. He also recognized at para. 134 that:

> No Plan of this size and complexity could be expected to satisfy all affected by it. The size of the majority who have approved it is testament to its overall fairness. No plan to address a crisis of this magnitude can work perfect equity among all stakeholders.

120 In my view we ought not to interfere with his decision that the Plan is fair and reasonable in all the circumstances.

D. DISPOSITION

121 For the foregoing reasons, I would grant leave to appeal from the decision of Justice Campbell, but dismiss the appeal.

R.A. BLAIR J.A.
J.I. LASKIN J.A.:-- I agree.
E.A. CRONK J.A.:-- I agree.

* * * * *

SCHEDULE "A" - CONDUITS

Apollo Trust

Apsley Trust

Aria Trust

Aurora Trust

Comet Trust

Encore Trust

Gemini Trust

Ironstone Trust

MMAI-I Trust

Newshore Canadian Trust

Opus Trust

Planet Trust

Rocket Trust

Selkirk Funding Trust

Silverstone Trust

Slate Trust

Structured Asset Trust

Structured Investment Trust III

Symphony Trust

Whitehall Trust

* * * * *

SCHEDULE "B" - APPLICANTS

ATB Financial

Caisse de Dépôt et Placement du Québec

Canaccord Capital Corporation

Canada Post Corporation

Credit Union Central of Alberta Limited

Credit Union Central of British Columbia

Credit Union Central of Canada

Credit Union Central of Ontario

Credit Union Central of Saskatchewan

Desjardins Group

Magna International Inc.

National Bank Financial Inc./National Bank of Canada

NAV Canada

Northwater Capital Management Inc.

Public Sector Pension Investment Board

The Governors of the University of Alberta

* * * * *

SCHEDULE "A" - COUNSEL

1) Benjamin Zarnett and Frederick L. Myers for the Pan-Canadian Investors Committee.
2) Aubrey E. Kauffman and Stuart Brotman for 4446372 Canada Inc. and 6932819 Canada Inc.
3) Peter F.C. Howard and Samaneh Hosseini for Bank of America N.A.; Citibank N.A.; Citibank Canada, in its capacity as Credit Derivative Swap Counterparty and not in any other capacity; Deutsche Bank AG; HSBC Bank Canada; HSBC Bank USA, National Association; Merrill Lynch International; Merill Lynch Capital Services, Inc.; Swiss Re Financial Products Corporation; and UBS AG.
4) Kenneth T. Rosenberg, Lily Harmer and Max Starnino for Jura Energy Corporation and Redcorp Ventures Ltd.
5) Craig J. Hill and Sam P. Rappos for the Monitors (ABCP Appeals).
6) Jeffrey C. Carhart and Joseph Marin for Ad Hoc Committee and Pricewaterhouse Coopers Inc., in its capacity as Financial Advisor.
7) Mario J. Forte for Caisse de Dépôt et Placement du Québec.
8) John B. Laskin for National Bank Financial Inc. and National Bank of Canada.
9) Thomas McRae and Arthur O. Jacques for Ad Hoc Retail Creditors Committee (Brian Hunter, et al).
10) Howard Shapray, Q.C. and Stephen Fitterman for Ivanhoe Mines Ltd.
11) Kevin P. McElcheran and Heather L. Meredith for Canadian Banks, BMO, CIBC RBC, Bank of Nova Scotia and T.D. Bank.

12) Jeffrey S. Leon for CIBC Mellon Trust Company, Computershare Trust Company of Canada and BNY Trust Company of Canada, as Indenture Trustees.
13) Usman Sheikh for Coventree Capital Inc.
14) Allan Sternberg and Sam R. Sasso for Brookfield Asset Management and Partners Ltd. and Hy Bloom Inc. and Cardacian Mortgage Services Inc.
15) Neil C. Saxe for Dominion Bond Rating Service.
16) James A. Woods, Sebastien Richemont and Marie-Anne Paquette for Air Transat A.T. Inc., Transat Tours Canada Inc., The Jean Coutu Group (PJC) Inc., Aéroports de Montréal, Aéroports de Montréal Capital Inc., Pomerleau Ontario Inc., Pomerleau Inc., Labopharm Inc., Agence Métropolitaine de Transport (AMT), Giro Inc., Vêtements de sports RGR Inc., 131519 Canada Inc., Tecsys Inc., New Gold Inc. and Jazz Air LP.
17) Scott A. Turner for Webtech Wireless Inc., Wynn Capital Corporation Inc., West Energy Ltd., Sabre Energy Ltd., Petrolifera Petroleum Ltd., Vaquero Resources Ltd., and Standard Energy Ltd.
18) R. Graham Phoenix for Metcalfe & Mansfield Alternative Investments II Corp., Metcalfe & Mansfield Alternative Investments III Corp., Metcalfe & Mansfield Alternative Investments V Corp., Metcalfe & Mansfield Alternative Investments XI Corp., Metcalfe & Mansfield Alternative Investments XII Corp., Quanto Financial Corporation and Metcalfe & Mansfield Capital Corp.

1 Section 5.1 of the CCAA specifically authorizes the granting of releases to directors in certain circumstances.

2 Justice Georgina R. Jackson and Dr. Janis P. Sarra, "Selecting the Judicial Tool to get the Job Done: An Examination of Statutory Interpretation, Discretionary Power and Inherent Jurisdiction in Insolvency Matters" in Sarra, ed., *Annual Review of Insolvency Law, 2007* (Vancouver: Thomson Carswell, 2007).

3 Citing Gibbs J.A. in *Chef Ready Foods, supra,* at pp. 319-320.

4 The Legislative Debates at the time the CCAA was introduced in Parliament in April 1933 make it clear that the CCAA is patterned after the predecessor provisions of s. 425 of the *Companies Act 1985* (U.K.): see *House of Commons Debates (Hansard), supra.*

5 See *Canada Business Corporations Act,* R.S.C. 1985, c. C-44, s. 192; *Ontario Business Corporations Act,* R.S.O. 1990, c. B.16, s. 182.

6 A majority in number representing two-thirds in value of the creditors (s. 6).

7 *Steinberg* was originally reported in French: [1993] R.J.Q. 1684 (C.A.). All paragraph references to *Steinberg* in this judgment are from the unofficial English translation available at 1993 CarswellQue 2055.

8 Reed Dickerson, *The Interpretation and Application of Statutes* (1975) at pp. 234-235, cited in Bryan A. Garner, ed., Black's Law Dictionary, 8th ed. (West Group, St. Paul, Minn., 2004) at 621.

Case Name:

Healy v. Gregory

Between
Glenn Healy, Paul Kelly, Ian Penny and Jamal Mayers, Applicants, and
Jim Gregory, Craig Harnett, Colin Campbell and Bill Daly, Respondents

[2009] O.J. No. 2562

75 C.C.P.B. 178

2009 CarswellOnt 3523

Court File No. CV-08-003623270000

Ontario Superior Court of Justice

P.M. Perell J.

Heard: June 9-10, 2009.
Judgment: June 18, 2009.

(111 paras.)

Pensions and benefits law -- Private pension plans -- Pension benefits -- Commuted value -- Death benefits -- Application by Healy and three other members of the Board of Trustees of NHL Players' Pension Plan for opinion, advice, and direction of court about pre-retirement death benefit in Pension Plan allowed -- Pension-based methodology was to be used to calculate pre-retirement death benefit -- Consistent use of words "commuted value" in 1966 Pension Plan and its restatements connected them to pension-based methodology.

Contracts -- Interpretation -- General principles -- Ordinary meaning -- Context -- Application by Healy and three other members of the Board of Trustees of NHL Players' Pension Plan for opinion, advice, and direction of court about pre-retirement death benefit in Pension Plan allowed -- Pension-based methodology was to be used to calculate pre-retirement death benefit -- Consistent use of words "commuted value" in 1966 Pension Plan and its restatements connected them to pension-based methodology.

Application by Healy and three other members of the Board of Trustees of the National Hockey League Players' Pension Plan for the opinion, advice, and direction of the court about a pre-retirement death benefit in the Pension Plan. The Board of Trustees was the Trustee and Administrator of the Pension Plan, which was first introduced in 1947. The Pension Plan was a defined contribution pension plan with some aspects of a defined benefit plan. The general scheme of the Pension Plan was that normal pension age was 45 for players and 60 or 65 for non-players depending on the category of employment. The pension was payable in monthly installments for the lifetime of a member and, in any event, 120 installments were to be paid. A person could take an early pension, in which case the amount of the pension was reduced. A participant could defer taking his pension. There was an advantage in postponing the pension because deferral substantially increased the value of the retirement pension when it was received. If a member died after the commencement of his pension benefits, the remainder of the 120 monthly payments were to be paid to the member's beneficiary. The pre-retirement death benefit in dispute was a benefit to be paid to the beneficiary of a member of the Pension Plan if the member died before he began receiving his pension. The death benefit was not available after pension benefits were received. The original pre-retirement death benefit was set out in s. 19 of the 1947 Regulations. Under s. 19, the beneficiary of an active player who died would receive a benefit calculated as the greater of two methodologies, and the beneficiary of a retired player who died before receiving his pension would receive a benefit based on a single methodology. Section 18 of the 1947 Regulations required a member's pension entitlement to be secured by an annuity purchased by the trustees of the Pension Plan and held in trust to be assigned to the member at retirement or, in the event of death, to his estate or beneficiary. In 1952, the Pension Plan's pre-retirement death benefits and the other benefits provided by the Pension Plan were funded by a series of group annuity contracts purchased from Manulife. The requirement that contracts be purchased to secure members' benefits was a feature that continued into the 1966 Pension Plan and its Restatements. The 1966 Pension Plan was restated four times between 1966 and 1987, and the precise benefit in question was the pre-retirement death benefit that was available (a) for former players of NHL clubs for services between April 30, 1952 and July 1, 1986; and (b) for non-player employees of NHL clubs for services between 1961 and July 1, 1994. Effective July 1, 1986, players' benefits ceased to be funded under the group Manulife contract and contributions were instead paid into separate earmarked investment accounts established for players. Benefits for non-player participants continued to be funded under the Manulife contract until July 1, 1994. At issue was the calculation in respect of pre-retirement death benefits in respect of players who had service under the Pension Plan before July 1, 1986 and non-players who had service under the Pension Plan before July 1, 1994. The Applicants submitted that under s. 19 of the 1947 Regulations, the two methodologies for active players were a pension-based methodology and a contribution-based methodology and the single methodology for former players was a pension-based methodology. The Respondents, the four other members of the Board of Trustees, argued that the two methodologies under the 1947 Regulations were both contribution-based methodologies. The Applicants argued that the pre-retirement death benefit was to be calculated using a pension-based methodology, which was a calculation that reflected a present value calculation of a stream of future payments. The respondents argued that the

pre-retirement death benefit did not and never did provide a pension-based methodology for the pre-retirement death benefit. They submitted that calculation of the pre-retirement death benefit involved a contribution-based methodology where premium payments were refunded plus interest.

HELD: Application allowed. A pension-based methodology was to be used to calculate the pre-retirement death benefit. The consistent use of the words "commuted value" in the 1966 Pension Plan and its restatements connected them to a pension-based methodology. Although the phrase "the commuted value of any contracts" in the 1966 Pension Plan replaced the phrase "paid-up pension at normal pension age" in the 1947 Regulations, there was no change of meaning. Both phrases entailed the same pension-based methodology. There was no evidence that the intent of the draftsperson was to specify a pre-retirement death benefit and then diminish it. To have given effect to the Respondents' argument that the contribution-based methodology of the Manulife contracts substantively determined the rights of the members of the 1966 Pension Plan was to accept an opaque interpretation of the Pension Plan that hid, negated, removed, or overturned the language of the pre-retirement death benefit. The interpretative tide had to flow the other way and the language of the pre-retirement death benefit was to define what should have been provided by the Manulife annuity contract. An interpretation of the pre-retirement death benefit that involved a pension-based methodology was not inherently problematic or illegal. Any bad consequences, such as the Manulife contracts being an inadequate resource to satisfy the pre-retirement death benefit obligations, the Pension Plan being under-resourced or the Pension Plan losing its status as a defined contribution pension plan, did not emerge from the language of the 1966 Pension Plan. Instead, they arose because the Trustees did not purchase contracts that accorded with the language of the 1966 Pension Plan and its restatements. Aversion to the consequences of a pension-based methodology was not a reason for interpreting the pre-retirement death benefit otherwise than in accordance with the normal principles of interpretation.

Statutes, Regulations and Rules Cited:

Ontario Rules of Civil Procedure, Rule 14.05(3)(a)

Counsel:

James K. McDonald and Dona L. Campbell, for the Applicants.

Neil Finklestein and J.A. Prestage, for the Respondents.

REASONS FOR DECISION

P.M. PERELL J.:--

Introduction and Overview

1 This Application under rule 14.05(3)(a) of the *Rules of Civil Procedure* is for the opinion, advice, and direction of the Court about a pre-retirement death benefit in the National Hockey League Players' Pension Plan. More precisely, the Pension Plan is the 1966 Pension Plan that was restated four times between 1966 and 1987, and the precise benefit in question is the pre-retirement death benefit that is available: (a) for former players of NHL clubs for services between April 30, 1952 and July 1, 1986; and (b) for non-player employees of NHL clubs for services between 1961 and July 1, 1994.

2 There is a dispute about how the pre-retirement death benefit should be calculated.

3 The Applicants are Glenn Healy, Paul Kelly, Ian Penny, and Jamal Mayers. They are four of the eight members of the Board of Trustees that is the trustee and administrator of the Pension Plan. They were all appointed to the Board by the National Hockey League Players' Association, and their position on this Application is that the pre-retirement death benefit should be calculated using a "pension-based" methodology, which they say is a calculation that reflects a present value calculation of a stream of future payments.

4 The Respondents are Jim Gregory, Craig Harnett, Colin Campbell, and Bill Daly, who are the other four members of the Board of Trustees. The Respondents were all appointed by the NHL, and with the exception of Mr. Campbell, their position is that the pre-retirement death benefit does not and never did provide a pension-based methodology for the pre-retirement death benefit. They submit that calculation of the pre-retirement death benefit involves a contribution-based methodology where premium payments are refunded plus interest.

5 Although technically a party, Mr. Campbell takes no position because he has a conflict of interest being a member of the Pension Plan.

6 The factum of the Applicants provides an illustration of the significance of the outcome of the Application. This illustration arose when a plan member, through his advisor, inquired about the pre-retirement death benefit. The result of this inquiry was that, if the view of the Respondents is correct, then the pre-retirement death benefit would be $214,300, while, if the view of the Applicants is correct, then the benefit would be $668,659. The explanation for this difference is that there is a much higher interest rate applied under the pension-based methodology than used in the contribution-based methodology.

7 During argument, I was told that the outcome of the Application might affect the calculation of pre-retirement death benefits that have already been paid using a contribution-based methodology. (The Application Record indicates that payments for at least 53 deceased members might be affected.)

8 I was also told that whatever the outcome, it would affect the retirement planning of members

of the plan. As of November 7, 2008, there are 1,115 persons who have not yet begun to receive their pension. If a pension-based methodology is not available for the pre-retirement death benefit, then a plan member would have to make a decision between: (a) starting his pension, which would maximize his survivor's benefit on his death but reduce his potential pension during his lifetime; or (b) deferring the pension, which would maximize the pension but yield a substantially smaller pre-retirement death benefit for his survivor should he die before receiving any pension.

9 In advancing their several competing arguments and counterarguments about how the pre-retirement death benefit in the Pension Plan should be calculated, both sides refer to the surrounding circumstances and the history of the language used in the Pension Plan documents before the 1966 Pension Plan; namely, the language used in a plan that originated in 1947, and both sides referred to the surrounding circumstances and the history of the language of the 1966 Pension Plan and its four Restatements. The use to be made of the extrinsic evidence was a matter of dispute.

10 Both sides also referred to the history of a series of group annuity contracts purchased from the Manufacturers Life Insurance Company. The significance of the Manulife contracts to the determination of the method of calculation of the pre-retirement death benefit in the 1966 Pension Plan and its Restatements is a critical matter in the dispute between the parties. The Respondents' position is that the 1966 Pension Plan and the Manulife contracts are interconnected and must be interpreted accordingly, with the result that the pre-retirement death benefit is limited by the terms of the Manulife contracts, which did not use a pension-based methodology to calculate the pre-retirement death benefit. The Respondents request an order declaring that the pre-retirement death benefit is the amount payable on the death of a member under the terms of the Manulife contracts held by the Trustees in respect of the member.

11 The Applicants, however, submit that the language of the Pension Plan calls for a pension-based methodology and that the inconsistent language of the Manulife contracts does not govern or dominate the interpretation of the pre-retirement death benefit.

12 In advancing their arguments, both sides refer to communications to the members about Pension Plan entitlements, and both sides refer to the practical consequences of the possible outcome of this Application about the manner of calculation of the pre-retirement death benefit. One consequence of a decision that the pre-retirement death benefit should use a pension-based methodology is that the pre-retirement death benefit is under-funded. A suggested possible consequence of a decision that the Manulife contracts govern the methodology of calculation of the pre-retirement death benefit is that having entered into such an agreement would be a breach of trust by the trustees of the Pension Plan.

13 The use to be made of the communications and the use to be made of the practical consequences of the competing interpretations in interpreting the Pension Plan's treatment of the Pre-retirement death benefit is another matter of dispute between the parties.

14 To provide the advice that the parties are seeking, it will be necessary for me to recount the history of the pre-retirement death benefit, to consider the various matters of dispute, and to come to conclusions about the numerous arguments advanced by the parties. I foreshadow to say that although I do not agree with all of the Applicants' arguments, I agree with their interpretation of the Pension Plan as having a pension-based methodology for the calculation of the pre-retirement death benefit. The result is that for the reasons that follow, the Application should be granted.

The History of the Pre-Retirement Death Benefit and of the Manulife Annuity Contracts

15 A pension plan for NHL players was first introduced in 1947. The trustee and administrator of the plan was originally the National Hockey League Pension Society ("the Society"). The Society, which was replaced by the Board of Trustees in 1999, continues to act as an administrative agent for the Board. The Board of Trustees is now the Trustee and the Administrator of the Pension Plan

16 The Pension Plan is a defined contribution pension plan with some aspects of a defined benefit plan. See *Bathgate v. National Hockey League Pension Society* (1992), 11 O.R. (3d) 449 (Gen. Div.), aff'd (1994), 16 O.R. (3d) 761 (C.A.). The current plan is registered in the Province of Ontario under the *Pension Benefits Act*, R.S.O. 1990, c. P.8. The plan is also subject to U.S. and Canadian tax laws, as well as, U.S. laws such as the U.S. *Employee Retirement Income Security Act of 1974* and the *Retirement Equity Act.*

17 The general scheme of the Pension Plan is that normal pension age is 45 for players and 60 or 65 for non-players depending on the category of employment. The pension is payable in monthly installments for the lifetime of a member and, in any event, 120 installments shall be paid. A person may take an early pension, in which case the amount of the pension is reduced. A participant may defer taking his pension and apparently 50% of participants do so. There is an advantage in postponing the pension because deferral substantially increases the value of the retirement pension when it is received. If a member dies after the commencement of his pension benefits, the remainder of the 120 monthly payments shall be paid to the member's beneficiary.

18 The pre-retirement death benefit that is in dispute in this Application is a benefit to be paid to the beneficiary of a member of the Pension Plan if the member dies before he begins receiving his pension. The death benefit is not available after pension benefits are received. The Pension Plan has always provided a pre-retirement death benefit.

19 The original pre-retirement death benefit was set out in s. 19 of the "1947 Regulations," which constituted the original pension plan. Under s. 19, the beneficiary of an active player who died would receive a benefit calculated as the greater of two methodologies and the beneficiary of a retired player who died before receiving his pension would receive a benefit based on a single methodology.

20 The Applicants submit that under s. 19, the two methodologies for active players were a pension-based methodology and a contribution-based methodology and the single methodology for

former players was a pension-based methodology. In contrast, the Respondents argue that the two methodologies under the 1947 Regulations are both contribution-based methodologies. For present purposes, so as to not beg any questions that I have to decide, I will not characterize the methodologies in s. 19, and rather I will, with my emphasis added, simply set out s. 19 of the 1947 Regulations, which stated:

> 19 (a) If a Participant dies while he is a Player, his estate - or beneficiary if one has been nominated by him - shall be entitled to receive **an amount of money equal to the commuted value of the Paid-up Pension at Normal Pension Age as calculated by the Actuary to which the Participant would have been entitled at the date of his death, or a sum of money equal to his contributions made under the Plan together with interest thereon** as credited by the Society, whichever is greater.
>
> (b) If a Participant dies after he has ceased to be a Player but before his Pension commences, his estate - or beneficiary if one has been nominated by him - shall be entitled to receive **an amount of money equal to the commuted value of the Paid-up Pension at Normal Pension Age as calculated by the Actuary to which the Participant would have been entitled at the date of his death**.

21 Section 18 of the 1947 Regulations required a member's pension entitlement to be secured by an annuity purchased by the trustees of the Pension Plan and held in trust to be assigned to the member at retirement or, in the event of death, to his estate or beneficiary. Until 1952, individual annuity contracts were purchased for players, but beginning in 1952, the Pension Plan's pre-retirement death benefits and the other benefits provided by the Pension Plan were funded by a series of group annuity contracts purchased from Manulife. The requirement that contracts be purchased to secure members' benefits is a feature that continued into the 1966 Pension Plan and its Restatements.

22 In *Bathgate v. National Hockey League Pension Society, supra,* the Court ruled that: "the group annuity contract was more administratively convenient to the Society than the purchase of individual annuities. But no change was made to the Regulation to distinguish between the purchase of individual annuity contracts and the purchase of this ongoing group annuity contract."

23 Section 23 of the 1947 Regulations stipulated that participants in the Pension Plan would receive a Certificate of Participation. Section 23 stated, with my emphasis added:

> 23. A Player will receive by becoming a Participant, a certificate of his inclusion in the Plan. The certificate, however, shall not set forth a Participant's rights and privileges, **all of which are subject to these Regulations as well as to the terms and conditions of any Contract entered into between the Society and any Insurance Company** or Annuities Branch, Department of Labour,

> Dominion of Canada, for the benefit of the Participant. When a Participant's pension commences or he attains Normal Pension Age, whichever event is the first to occur, he shall be entitled to receive from the Society the contract the Society has purchased from an Insurance Company or Annuities Branch, Department of Labour, Dominion of Canada, securing the benefits to which he is or may be entitled. **Such contract shall define his rights thereunder**.

24 Manulife annuity contract GA 550 was issued on July 3, 1952 with effect from April 13, 1952. This contract provided, with my emphasis added, the following pre-retirement death benefit:

> 8. Death Benefit In the event of the death of a member before annuity payments commence, any Normal Annuities and Special Annuity purchased in respect to such member shall be automatically cancelled, and there shall be paid to the beneficiary designated by the member by written request filed at the Head Office of the Company, **an amount equal to the total premiums which have been received by the Company in respect of such member, together with interest thereon** at the rate of 2 1/2% per annum compounded annually, interest being computed separately on each premium from the beginning of the contract year in which the premium was paid to the first day of the month in which death occurs.
>
> . . . .

25 Section 1 of contract GA 550 included a definition of "Normal Annuity" and "Special Annuity." A "Normal Annuity" was defined as "that portion of the total annuity which is purchased for a member during any contract year in respect of his years of service subsequent to October 1, 1947. A "Special Annuity" was defined as "that portion of the total annuity which is purchased for a member in respect to his years of service prior to October 1, 1947 ... "

26 The premiums paid to Manulife under contract GA 550 came from five sources: (1) member contributions, which in the case of hockey players became non-compulsory after 1969 when players were no longer required to contribute; (2) voluntary member contributions; (3) employer contributions; (4) re-allocation of non-vested contribution forfeitures; and (5) special experience rate credits from Manulife allocated to members.

27 A few weeks before Manulife annuity contract GA 550 was issued, the Society's Directors at a meeting on June 17, 1952 voted to amend the 1947 Regulations as follows, with my emphasis added:

> When a contract has been purchased by the Society to secure for any participant all or any portion of the benefits to which he is entitled under these Regulations, **the rights and benefits of such participant shall thereafter be determined in accordance with such Annuity Contract to the extent of the amount of current service benefits provided for in that contract** and, notwithstanding that, the participant may have been either an active player or a retired player who

> has not yet commenced to receive his pension at the date of his death.

28 When the Plan was republished in 1958, the June 17, 1952 amendment was not included as expressed above; rather, between 1958 and 1966 the Plan contained the following wording:

> The obligation of the Society to a Participant, his estate or his beneficiary shall be completely fulfilled and discharged by and to the extent of the purchase of Annuity Contracts on his behalf under the Plan.

29 To the current day, the only Pension Plan assets held by the trustees in respect of the pre-retirement death benefits that are the subject matter of this Application are the series of Manulife group annuity contracts. These Manulife contracts provide insufficient funds if a pension-based methodology is used to calculate the pre-retirement death benefit.

30 In or about 1965, the then trustees of the Pension Plan; that is, the Society, began to take steps to qualify the Pension Plan for recognition under U.S. tax law, and in 1967, the 1947 Regulations were replaced by a new plan, which was effective as of May 1, 1966. This is the 1966 Pension Plan that is at the focal point of the Application now before the Court.

31 The Respondents submit that the 1966 Pension Plan and its Restatements, like the 1947 Regulations, do not provide for a pension-based methodology for the pre-retirement death benefit. This, of course, is disputed by the Applicants.

32 At a January 25, 1966 meeting of the Society's Board of Directors, the President, Mr. Clarence Campbell, stated that the new plan would contain substantially the same provisions as the 1947 Regulations, and the following year, at the January 17, 1977 meeting, Mr. Campbell stated that the "provisions for Players' benefits under the Trust Plan are identical to those of the original Plan."

33 Whatever, the President of the Society may have said or meant, the language of the 1966 Pension Plan that replaced s. 19 of the 1947 Regulations, namely sections 3.25 and 3.26, is not identical to s. 19. The change in language is the nub of the current dispute between the parties. Also relevant to the dispute are sections 1.11 and 3.29. These sections, with my emphasis added, stated:

> 1.11 "Participant" means a Player, Protected Player, Accommodation Service Player, Staff Employee or Trainer who is entitled to receive benefits under the Club Pension Plan

> 3.25 If a person dies while a Participant [which is to say while a non-retired player or employee], his beneficiary shall be entitled to receive the insurance benefit and the greater of: (a) **the commuted value of any contracts purchased for such Participant, or** (b) **the Participant's contributions under the Club Pension Plan, together with interest thereon** as credited by the Trustee.

> 3.26 If a former Participant dies prior to the commencement of the payment of his pension benefit, the Trustee shall pay to the former Participant's beneficiary an amount of money equal to **the commuted value of any contracts purchased for such former Participant.**

> 3.29 In lieu of making payment of an amount of money equal to the **commuted value of any contract,** as provided for in s. 3.25 and s. 3.26, the Trustee may, if it so desires make such payment in installments for a period certain or for the lifetime of the beneficiary, provided, however, that such **installment payments shall be the actuarial equivalent of such commuted value.**

34 Pausing here, four points should be kept in mind for the analysis of the parties' competing arguments that will follow later:

* First, the language of the plan has changed from **"the commuted value of the Paid-up Pension"** in the 1947 Regulations to **"the commuted value of any contracts purchased"** in the 1966 Pension Plan.
* Second, as one of their arguments, the Respondents submit that that no version of the Pension Plan provides for a pension-based calculation for the pre-retirement death benefit.
* Third, in what I take to be a mutually exclusive alternative argument, the Respondents submit that the change in language found in the 1966 Pension Plan was indeed a substantive change made to indicate that there was now only a contribution-based methodology and no pension-based methodology.
* Fourth, the Society continued the practice of securing group annuity contracts with Manulife and not individual annuity contracts. The Court in *Bathgate v. National Hockey League Pension Society, supra,* at p. 478 made the following observation about this practice: " ... like the original Plan, [the 1966 Pension Plan] provided that the Society would purchase individual annuity contracts for players at the end of each season on a basis proportional to the number of games in a hockey season with which a player was credited. For cost considerations and reasons of administrative efficiency, the Pension Society continued with Group Annuity Contract GA 550 and the entitlement of each player to rights under the Plan was monitored."

35 The group annuity contract that was connected to the 1966 Pension Plan was the already existing Manulife contract GA 550.

36 The 1966 Pension Plan and all later Restatements of it required the Trustees of the Plan to purchase annually a "contract" in respect of a participant's entitlement. A contract was defined in the 1966 Pension Plan as "an annuity contract purchased from an insurance company and/or Annuities Branch, Department of Labour, Dominion of Canada." The definition of contract was similar in subsequent iterations of the Pension Plan. Manulife contract GA 550 and its successor contracts are within the 1966 Pension Plan's definition of contract.

37 The 1966 Pension Plan and its subsequent iterations contained the following provision, s, 6.04, which echoes features found in the 1947 Regulations about such matters as the Certificate of Participation. Section 6.04, with my emphasis added states:

> 6.04 For each year that a Participant is entitled to credit for service, he shall receive a Certificate of Participation showing the amount of such service awarded and the pension entitled corresponding thereto. **The Club Pension Plan contains the terms and conditions and rights and responsibilities of the Participants. It shall not be necessary that the Certificate of Participation set out the Participant's rights and privileges or the terms and conditions of any contract entered into between the Trustee and the insurance company** or Annuities Branch, Department of Labour, Government of Canada, for the benefit of the Participant. When a Participant's pension commences or he attains Normal Pension Age, whichever event is the first to occur, he shall be entitled to receive from the Trustee the contracts that Trustee has purchased from an insurance company or the Annuities Branch, Department of Labour, Government of Canada, securing the benefits to which he is entitled. **Such contracts shall define his rights thereunder. The Trustee shall supply to each Participant a description of the Club Pension Plan setting out in particular**: (a) eligibility for participation; (b) participation; (c) pension and other benefit formulae; (d) Normal Pension Age; (e) financial arrangements to ensure full funding of pension benefits, other benefits and rights of refund; (f) vesting provisions; (g) voluntary contributions; (h) early retirement provisions; (i) deferred retirement provisions; (j) **death benefits**; (k) management of the Club Retirement Fund; and (l) such other information as the Trustee may deem pertinent to a proper explanation of the Club Pension Plan.

38 In 1972, the 1966 Pension Plan was restated (the "First Restatement") and the pre-retirement death benefit provision was revised by extending the two methodologies treatment of "Participants" to both "Participants" and "Former Participants." The First Restatement, with my emphasis added, stated:

> 3.39 If a person dies while a Participant, his beneficiary shall be entitled to receive the insurance benefit, if any, and the greater of: (a) **the commuted value of any contracts purchased for such Participant, or** (b) **the Participant's**

> **contributions and all other contributions, together with interest thereon**, as credited by the Trustee.
>
> 3.40 If a Former Participant dies prior to distribution of any benefit to which he was entitled, pursuant to 3.39, the Trustee shall pay to the Former Participant's beneficiary an amount of money equal to the greater of : (a) **the commuted value of any contracts purchased for such Former Participant, or** (b) **the Former Participant's contributions and all other contributions, together with interest thereon**, as credited by the Trustee.

39 Between 1972 and 1975, the Society prepared a Handbook to describe the First Restatement, which described the pre-retirement death benefit as follows, with my emphasis added:

> If a person, who is vested in the Plan, dies before his retirement, his beneficiary shall be entitled to receive **the commuted value of any contract purchased for the Participant.** If a Participant dies after he has ceased to be a Player, Development Club Player, Team Executive, Staff Employee or Trainer, but before the commencement of the payment of his pension benefit the Trustee shall pay to his beneficiary **an amount of money equal to the commuted value of the paid up pension as calculated by the Trustee's actuary to which the Participant would have been entitled at the date of his death.**

40 The 1966 Pension Plan was restated in 1977 (the "Second Restatement") with no material change to the pre-retirement death benefit provision.

41 A Summary Plan Description was provided to participants in respect of the Second Restatement. It advised participants, with my emphasis added, that if a "person dies while a participant, or if a former participant dies prior to receipt of any benefit to which he is entitled, his designated beneficiary will receive **the greater of the commuted value of any annuity contracts purchased for such participant or the participant's own contributions and all other contributions, together with interest thereon.**"

42 The 1966 Pension Plan was restated in 1986 (the "Third Restatement") and made effective to July 1, 1983. The Third Restatement revised the pre-retirement death benefit to comply with the United States' *Retirement Equity Act*, which required pension plans to provide a "qualified preretirement survivor annuity" to a participant's spouse. The Third Restatement introduced a definition of preretirement survivor annuity that tracked the language of the American statute, with my emphasis added, as follows:

> 1.32 Preretirement Survivor Annuity means **a monthly annuity** for the life of a Participant's surviving spouse, **the actuarial equivalent of which is one-half of the Participant's account balance** in the Club Pension Plan on the date of

> death.

43 The Third Restatement did away with the former two methodologies approach in the description of the pre-retirement death benefit, and it had a new double methodology for the calculation of the benefit that depended upon the preretirement survivor annuity and whether there was a surviving Spouse. The new provision, with my emphasis added, stated:

> 5.01 If a Participant or Former Participant dies before the commencement of distribution of any benefit and leaves a surviving Spouse, **such surviving Spouse shall receive a Preretirement Survivor Annuity** (unless a Preretirement Survivor Annuity has been waived, as provided in 7.01, **or if the deceased does not leave a surviving spouse, the full commuted value of any Contracts purchased for the deceased** shall be distributed to the Beneficiary last selected by the deceased.

44 A Summary Plan Description was provided to explain the Third Restatement. It stated, with my emphasis added:

> The participant's surviving spouse will be entitled to receive a preretirement survivor annuity from the Plan. However, no preretirement survivor annuity will be payable to the surviving spouse if the participant and his spouse waive the preretirement survivor annuity prior to the participant's death.
>
> In addition to the preretirement survivor annuity payable to the surviving spouse, **a death benefit equal to one-half of the commuted value of the annuity contracts purchased for the participant will be distributed to his designated beneficiary. If the participant and his spouse waived the preretirement survivor annuity prior to his death, or if the participant does not have a surviving spouse, the total commuted value of the annuity contracts purchased for the participant will be distributed** to his designated beneficiary.

45 The 1966 Pension Plan was restated in 1987 (the "Fourth Restatement"). The Fourth Restatement amended the definition of Preretirement Survivor Annuity to differentiate between Canadian and U.S. residents. The new provision for the pre-retirement pension benefit, with my emphasis added, stated:

> 5.01 If a Participant or Former Participant dies before the commencement of a distribution of any benefit and leaves a surviving Spouse, **such surviving Spouse shall receive a Preretirement Survivor Annuity** (unless a Preretirement Survivor Annuity has been waived, as provided in s. 7.01), **and the balance of the commuted value of any Contracts** purchased for the deceased shall be distributed to the Beneficiary last selected by the deceased. If a Preretirement

> Survivor Annuity has been waived, as provided in s. 7.01, **or** if the deceased does not leave a surviving Spouse, **the full commuted value of any contracts** purchased for the deceased shall be distributed to the Beneficiary last selected by the deceased.

46 A Summary Plan Description was provided to explain the Fourth Restatement. It stated, with my emphasis added:

> The participant's surviving spouse will be entitled to receive a Preretirement Survivor Annuity from the Plan. No Preretirement Survivor Annuity will be payable to the surviving spouse, however, if the participant and his spouse waived the Preretirement Survivor Annuity prior to his death or, if in the case of a participant who is a Canadian resident, the participant is living separate and apart from his spouse on the date of his death.
>
> If the participant is a U.S. resident, in addition to the Preretirement Survivor Annuity payable to the surviving spouse, **a death benefit equal to one-half of the value of the participant's Plan benefits will be distributed to the participant's designated beneficiary**. If the participant is a Canadian resident living separate and apart from his spouse on the date of his death, or if the participant and his spouse waived the Preretirement Survivor Annuity prior to his death, or if the participant does not have a surviving spouse, the **total value of his Plan benefits will be distributed to his designated beneficiary**.

47 As already noted above, Participants in the 1947 Regulations and the 1966 Pension Plan received an annual "Certificate of Participation". Until 1967, the Certificate did not address the pre-retirement death benefit. From 1967 to 1988, the Certificates referred Participants to the Handbook for information about the pre-retirement benefit. In 1988 and in subsequent years, the Certificate indicated that the pre-retirement death benefit was equal to all contributions plus interest.

48 The first Manulife group contract, GA 550 was the operative contract for the 1966 Pension Plan and for the First Restatement and the Second Restatement. The provisions in Contract GA 550 for pre-retirement death benefits remained unchanged throughout the duration of that contract (1952-1983), save that the interest rate changed from time to time. Although Contract GA 550 provides for one methodology to calculate the pre-retirement pension benefit, as already noted, the 1966 Pension Plan used two methodologies until the Third Restatement, when new methodologies were introduced.

49 In 1985, contract GA 550 was replaced effective June 30, 1983 by three new contracts. Two of the contracts, namely, GA 20900 (Canadian dollar contract) and GA 20902 (U.S. dollar contract) covered services under the Pension Plan to June 30, 1983. The third contract, GA 20901, covered services after June 30, 1983. The Manulife contracts continued to use only one methodology to

calculate the pre-retirement death benefit. The pre-retirement death benefit provision in Manulife contract GA 20900 was as follows, with my emphasis added:

> DEATH BENEFIT. In the event of the death of a participant before annuity payments commence, all annuities purchased hereunder to which such participant would otherwise be entitled shall be automatically cancelled and a Death Benefit shall be paid to the beneficiary upon the written direction of the Trustee. Such Death Benefit **shall be an amount as shown under the column titled "DEATH BEN" in Appendix X for such participant, together with interest thereon** at the rate of 5% per annum ... .

50 As appears, in Manulife contract GA 20900, instead of expressing a methodology, the pre-retirement death benefit is actually calculated. The calculation found in Appendix A was not a pension-based calculation but rather was based on premiums paid; it is a contributions-based methodology.

51 Manulife Contract GA 20902 is similar to Manulife contract GA 20900. It contains a schedule that calculates the pre-retirement death benefit. Today, there are no longer potential pre-retirement death benefit beneficiaries under GA 20902, so practically speaking, it is significant only as part of the history of the 1966 Pension Plan and as part of the interpretative problems to be solved.

52 Contract GA 20901 provided benefits for service after June 30, 1983. More particularly, Contract GA 20901 covered service for players from June 30, 1983 to June 30 1986 and for non-players from June 30, 1983 to June 30, 1994. Using language similar to that of contract GA 550, it provided for pre-retirement death benefits, with my emphasis added, as follows:

> DEATH BENEFIT. In the event of the death of a participant before annuity payments commence, all annuities purchased hereunder for such participant shall be automatically cancelled, and a Death Benefit shall be paid to the beneficiary upon the written direction of the Trustee. Such Death Benefit **shall be an amount equal to all premiums which have been received by the Company for such participant, together with interest** thereon at the rate of 5% per annum, compounded annually, computed from the beginning of the contract year in which such premium was due in respect of any contributions made on a lump sum basis) to the first day of the calendar month in which death occurs.

53 Effective July 1, 1986, players' benefits ceased to be funded under the group Manulife contract and contributions were instead paid into separate earmarked investment accounts established for players. Benefits for non-player Participants continued to be funded under the Manulife contract until July 1, 1994. Thus, at issue in this Application now before the court is the calculation in respect of pre-retirement death benefits in respect of players who had service under the Pension Plan before July 1, 1986 and non-players who had service under the Pension Plan before July 1, 1994.

54 Up until this Application, the records indicate that pre-retirement death benefits have been calculated and paid in accordance with the formula set out in the Manulife contracts, which is also to say that they were not calculated with reference to the present value of the pension benefits that the deceased member would have received as at the date of his death. The Respondents' submit, but the Applicants strongly deny, that if the payments were made in a greater amount, then the Pension Plan would be disqualified as a defined contribution pension plan under U.S. tax law, with resulting adverse tax consequences for both participants and contributing employers.

55 To conclude this account of the history of the pre-retirement death benefits and the Manulife annuity contracts and before proceeding to the analysis, it will prove helpful to make two observations.

56 The first observation is to note that at the very centre of the dispute between the parties about the interpretation of the pre-retirement death benefit are the references in the 1947 Regulations, the 1966 Pension Plan, and the Restatements to a "commuted value." Thus, in s. 19 of the 1947 Regulation, the reference is to: **"the commuted value of the Paid-up Pension at Normal Pension Age as calculated by the Actuary to which the Participant would have been entitled at the date of his death.** In the 1966 Pension Plan, the reference changed to: **the commuted value of any contracts purchased for such former Participant**." In the First and Second Restatements, this reference is continued. In the Third and Fourth Restatements, the reference changed to: **"commuted value of any Contracts purchased for the deceased."**

57 The second observation is to note that the language of "commuted value" is used in other parts and with respect to other provisions of the 1947 Regulations and other provisions in the 1966 Pension Plan and its Restatements. Thus, the 1966 Pension Plan and the First Restatement dealt with the settlement of small pensions by payment of a lump sum and, in this regard, referred to: **"the commuted value of his pension**." The comparable provision in the Second and Third Restatements was: **"the present value of [a member's] accrued pension benefit."**

Analysis: Interpretative Principles

58 The parties made many arguments, but the one thing the parties did not argue about was the principles for courts to apply when asked to interpret contracts and trust instruments. I was referred to the advice of Justice L'Heureux-Dubé in *Manulife Bank of Canada v. Conlin*, [1996] 3 S.C.R. 415 who stated at para. 41:

> [T]he "modern contextual approach" for statutory interpretation with appropriate adaptations, is equally applicable to contractual interpretation. Statutory interpretation and contractual interpretation are but two species of the general category of judicial interpretation. In the instant case, the methodological reference provided by R. Sullivan in *Drieger on the Construction of Statutes* (3rd ed. 1994) at p. 131, applies equally to contractual interpretation:

> There is only one rule in modern interpretation, namely, courts are obliged to determine the meaning of [that which is to be judicially determined] in its total context, having regard to [its] purpose ...., the consequences of proposed interpretations, the presumptions and special rules of interpretation, as well as admissible external aids. In other words, the courts must consider and take into account all relevant and admissible indicators of ... meaning

59 I was referred to the advice of Justice Doherty in *Glimmer Resources Inc. v. Exall Resources Ltd.*, [1999] O.J. No. 1357 (C.A.), who stated at paras. 16 and 17:

> 16. When interpreting the provisions of a written contract, the court must look first at the language used in that contract. If the language reveals no ambiguity, there is no need to go outside of the agreement for assistance in the interpretive exercise. As Iacobucci J. recently said in *Eli Lilly and Co. v. Novopharm Ltd.* (1998), 161 D.L.R. (4th) 1 at 27:
>
> > The contractual intent of the parties is to be determined by reference to the words they used in drafting the document, possibly read in light of the surrounding circumstances which were prevalent at the time. Evidence of one party's subjective intention has no independent place in this determination.
> >
> > Indeed, it is unnecessary to consider any extrinsic evidence at all when the document is clear and unambiguous on its face ...
> >
> > When there is no ambiguity of the wording of the document the notion in *Consolidated-Bathurst* [[1980] 1 S.C.R. 888] that the interpretation which produces a "fair result" or a "sensible commercial result" should be adopted is not determinative. Admittedly, it would be absurd to adopt an interpretation which is clearly inconsistent with the commercial interests of the parties if the goal is to ascertain their true contractual intent. <u>However, to interpret a plainly worded document in accordance with the true contractual intent of the parties is not difficult, if it is presumed that the parties intended the legal consequences of their words.</u> [Emphasis added.]
>
> 17. That is not to say that each word in an agreement must be placed under the interpretative microscope in isolation and given a meaning without regard to the entire document and the nature of the relationship created by the agreement.

> Context can elucidate and assist in revealing the plain meaning of words used in a contract. One part of an agreement may enlighten as to the meaning to be given to words used in another part of the agreement. Similarly, the relationship created by the agreement and its overall purpose as indicated in the agreement may assist in giving meaning to particular words or phrases within the agreement. Context in this sense does not, however, refer to extrinsic evidence of the conduct of the parties or expert evidence as to the meaning of words used in the agreement.

60 In *British Columbia Hydro and Power Authority v. BG Checo International Ltd.*, (1993), 99 D.L.R. (4th) 577 (S.C.C.), a case about contract interpretation but which recites the general principles of interpretation, La Forest and McLachlin, JJ. stated at pp. 581-2:

> It is a cardinal rule of the construction of contracts that the various parts of the contract are to be interpreted in the context of the intentions of the parties as evident from the contract as a whole. Where there are apparent inconsistencies between different terms of a contract, the court should attempt to find an interpretation which can reasonably give meaning to each of the terms in question. Only if an interpretation giving reasonable consistency to the terms in question cannot be found will the court rule one clause or the other ineffective. In this process, the terms will, if reasonably possible, be reconciled by construing one term as a qualification of the other term. A frequent result of this kind of analysis will be that general terms of a contract will be seen to be qualified by specific terms -- or, to put it another way, where there is apparent conflict between a general term and a specific term, the terms may be reconciled by taking the parties to have intended the scope of the general term to not extend to the subject-matter of the specific term.

61 Although, with a few narrow exceptions for situations of ambiguity, evidence of negotiations and of the parties' subjective intent is not admissible, in interpreting a document, the court may have regard to the surrounding circumstances; that is, the factual background and the purpose of the document: *Prenn v. Simmonds*, [1971] 3 All E.R. 237 (H.L.); *Reardon Smith Line v. Hansen-Tangen*, [1976] 3 All E.R. 570 (H.L.); *Canada Square Corp. v. VS Services Ltd.* (1981), 34 O.R. (2d) 250 (C.A.). The admissibility of evidence of surrounding circumstances does not depend upon a finding that the document is ambiguous: *Ahluwalia v. Richmond Cabs Ltd.*, [1996] 1 W.W.R. 656 (B.C.C.A.); *ACLI Ltd. v. Cominco Ltée* (1985), 61 B.C.L.R. 177 (B.C.C.A.).

The Structure of the Competing Arguments

62 Of course, agreement about the principles of contract interpretation does not entail agreement about the outcome of the application of the principles, and here the debate of the parties was vigorous.

63 The superstructure of the Applicants' primary argument was that the language of the 1966

Pension Plan and its several Restatements governed, and under the 1996 Pension Plan, and its predecessor, the 1947 Regulations, there was clear and unambiguous language stipulating a pension-based methodology. An aspect of the Applicants' primary argument was that the operation or language of the Manulife contracts cannot and does not alter the meaning of the 1966 Pension Plan and its Restatements.

64 The superstructure of the Applicants' secondary and tertiary arguments was that if there is any ambiguity in the interpretation of the 1966 Pension Plan and the Restatements, then a resort to extrinsic aids and to consequences reveals that the intention of the parties was that the Pension Plan must use a pension-based methodology for the calculation of the pre-retirement death benefit.

65 The superstructure of the Respondents' competing primary argument was two-branched. The first branch was the submission that the language of the 1947 Regulations, the 1966 Pension Plan, and its several Restatements never provided a pension-based methodology but rather always stipulated a contribution-based methodology. The second branch of the primary argument was the mutually exclusive argument that the 1966 Pension Plan was a substantive change that made it clear that there was now only a contribution-based methodology. The Respondents submit that the words "commuted value of any contracts" do not require reference to a present value calculation and can reasonably be understood to refer to any lump sum payment under the Manulife annuity contracts. The return of premiums provision in the Manulife contract is thus a "commuted value of the contract."

66 An aspect of both branches of the Respondents' primary argument is that the Pension Plan must be read and interpreted along with the Manulife Contract. Thus, the Respondents submit that since the Pension Plan contains terms that limit entitlements to the amounts payable under the purchased annuity contracts, it follows that "commuted value of any contracts" means the lump sum payment made available under the Manulife contracts. The Respondents further submit that when a present value calculation is called for, the plan language is specific, and this design of the Pension Plan precludes "commuted value of the contract" meaning a present value and pension-based methodology.

67 The superstructure of the Respondents' secondary and tertiary arguments was that if there is any ambiguity in the interpretation of the 1966 Pension Plan and the Restatements, then a resort to extrinsic aids and to consequences reveals that the intention of the parties was that the Pension Plan use a contribution-based methodology for the calculation of the pre-retirement death benefit; that contribution-based methodology was the return of premiums calculation found in the Manulife contracts.

Analysis: The Meaning of "Commute" and "The Commuted value of any contracts"

68 My own analysis may begin with the meaning of the word "commute." In this regard, the Respondents provided excerpts of the definition of "commute" from several dictionaries, as follows:

* ... 2 To change an obligation etc. into something lighter or more agreeable ... 4 To change one kind of payment or obligation into or for another (*Shorter Oxford English Dictionary* (3rd ed.), 1968)
* ... change one kind of payment or obligation for (another) - replace (an annuity or other series of payments) with a single payment (*Concise Oxford English Dictionary* (10th ed.), revised 2002)
* ... 3 change (one kind of payment) for another; make a payment to change (an obligation etc.) for another ... 4 a, exchange; interchange (two things), b change (to another thing) (*Oxford Canadian Dictionary*, 2002)
* ... 2 to exchange for another or for something else; give and take reciprocally; interchange ... 4 to change (one kind of payment) into another, as by substitution ... 6 to make substitution. 7, to serve as a substitute (*The Random House Dictionary of the English Language* (2nd ed., unabridged 1987)

69 Accepting these definitions as helpful to resolving the problems of the case at bar, five analytical points may be made about the competing interpretations of the 1966 Pension Plan and its Restatements:

* First, to "commute" something is to end that thing and to substitute a different thing, and in the case of the 1966 Pension Plan and its Restatements, the thing that is ended is the annuity purchased to secure the pension benefits of the Participant. The Applicants and the Respondents do not dispute the first point.
* Second, for a Participant or a Former Participant, the thing that is being substituted or exchanged for the annuity is a lump sum payment of money. The Applicants and the Respondents do not dispute the second point.
* Third, under the language of the pre-retirement death benefit clause of the 1966 Pension Plan and its First and Second Restatements, the amount of the substituted lump sum payment is: (a) the commuted value of the [Manulife] contracts purchased for the Participant; or (b) the participant's contributions and all other contributions plus interest. The Applicants and the Respondents cannot dispute the third point because it is merely to recite what the 1966 Pension Plan and its Restatements say.
* Fourth, the Manulife contracts are contracts for an annuity, which is to say a stream of payments, and a stream of payments has a value that can be calculated by a present value calculation. A present value calculation of the annuity payments as the substituted payment for the cancelled annuities is the interpretation of the pre-retirement death benefit being advanced by the Applicants. For their part, the Respondents acknowledge in their factum that when used in reference to a stream of payments, the term "commuted value" is capable of meaning the present value of the stream of payments;

however, the Respondents submit that the issue in the case at bar is not the calculation of the commuted value of the annuity but the meaning of the phrase "commuted value of any contracts."

* Fifth, under the language of the Manulife contracts - but not the language of the pre-retirement death benefit section of the 1966 Pension Plan and its Restatements - the substitute for the annuity payments is "an amount equal to the total premiums which have been received by the Company in respect of such member together with interest thereon." The Respondents submit that the amount equal to the Manulife premiums plus interest is the substitute payment for the annuity and that this payment satisfies the meaning of the phrase "commuted value of any contracts purchased for the Participant."

70 From these five analytical points, it may be seen that the precise difference between the parties about the substitute for the cancelled annuity contract is that the Respondents would substitute what it cost to purchase the contract for an annuity (the premiums, a contribution-based methodology) and the Applicants would substitute the value of the annuity purchased by the contract (a pension-based methodology). Speaking metaphorically, the Respondents would substitute the cost of the box (contribution-based methodology) and the Respondents would substitute the value of what is in the box (pension-based methodology). For the reasons that follow, my opinion is that the pension-based methodology is what is intended by the 1966 Pension Plan and its Restatements.

71 A problem for the Respondents' interpretation is that it makes the "greater than" choice that is available in the 1966 Pension Plan for a Participant and that is available in the First and Second Restatements for both Participants and Former Participants meaningless, which would offend the normative principles of document interpretation.

72 Using s. 3.39 of the First Restatement to make this point, s. 3.39 gives a beneficiary of a Participant who dies the choice of the greater of: "(a) the commuted value of any contracts purchased for such Participant" or (b) the Participant's contributions and all other contributions, together with interest thereon. The Respondents' interpretation of clause (a) is that "the commuted value of any contracts purchased for such Participant" is equal to: "the total premiums which have been received by [Manulife] in respect of such member together with interest thereon." That interpretation, however, is also the meaning of clause (b) in section 3.39, with the result that one or the other of clauses (a) and (b) of section 3.39 is meaningless.

73 A related problem for Respondents' interpretation is that their effort to constrain the meaning of the words "commuted value" to a contribution-based methodology by its modification by the prepositional phrase "of any contracts purchased for such Participant" strains rather than constrains the meaning of the words "commuted value," which in the context of a contracts for an annuity would more typically denote and connote a methodology that requires a present value calculation and the assistance of an actuary.

74 As the Applicants note in their list of definitions of "commuted value," *Black's Law Dictionary* defines "commuted value" to mean "the value of future payments when discounted to present value." The *Dictionary of Canadian Law* defines "commuted value" as follows: "In relation to benefits that a person has at present or future entitlement to receive, the actuarial value of those benefits determined, as of the time in question, on the appropriate basis of actuarial assumptions and methods that are adequate and appropriate and in accordance with generally accepted actuarial principles." See also *Opoku v. Pal*, [1999] O.J. No. 1777 (S.C.J.), aff'd [2000] O.J. No. 1700 (C.A.); *Rebecca K.Chown Income Charitable Fund v. Commissioner of Internal Revenue* (1992), 98 T.C. No. 25 (Westlaw), aff'd 8 F. (3d) 571 (7th Circuit 1993); *Pension Benefits Act* R.S.O. 1990, c. P.8, s. 1(1) and Reg. 909, s. 19(1.2), R.R.O. 1990. The definitions and the case law suggest that if a draftsperson uses the word "commuted value," then he or she means something more substantial than a premium refund plus interest.

75 Another related problem for the Respondents' interpretation is that while it is true that the substitution of "the total premiums which have been received by [Manulife] in respect of such member together with interest thereon" for the cancelled annuity payments is to change or exchange one kind of payment for another and thus to fall within a definition of a "commuted value," nevertheless, in the context of a pension plan obligation to purchase an annuity for the participants, this usage of the words "commuted value" is over-inclusive and captures a substitute payment that, in my opinion, was not intended by the draftsperson. Put somewhat differently, the draftsperson of the 1966 Pension Plan and its Restatements intended "commuted value" to mean something more than a refund plus interest and the draftsperson connected the words "commuted value" with a present value calculation of some sort.

76 That the draftsperson intended something more than a contribution-based methodology for the words "commuted value of the contracts" is supported by having regard to s. 3.29 of the 1966 Pension Plan, which for convenience I set out again below:

> 3.29 In lieu of making payment of an amount of money equal to the **commuted value of any contract,** as provided for in s. 3.25 and s. 3.26, the Trustee may, if it so desires make such payment in installments for a period certain or for the lifetime of the beneficiary, provided, however, that such **installment payments shall be the actuarial equivalent of such commuted value**.

77 Section 3.29 provides for what might be described as a second or derivative commuting of the "commuted value of any contract." This second substitute payment of installment payments for the "commuted value of any contracts" is subject to the precondition that the installments "be the actuarial equivalent of such commuted value." An actuarial equivalent for the derivate substitute payment suggests a present value calculation and this, is turn, suggests that the root substitution also involves a present value or pension-based methodology.

78 The interpretation of the words "commuted value for the contract" as involving something

more than a contribution-based methodology is also supported by the usage of "commuted value" in other parts of the 1966 Pension Plan and the Restatements, where commuted value is connected with a pension-based methodology. As already noted in the concluding observations of the previous part of these Reasons for Decision, the 1966 Pension Plan and the First Restatement dealt with the settlement of small pensions by payment of a lump sum and in this regard referred to: **"the commuted value of his pension."** The comparable provision in the Second and Third Restatements was: **"the present value of [a member's] accrued pension benefit."** In these provisions, there is the connection of "commuted value" with a pension-based methodology and in my opinion the "commuted value of any contracts" should be treated in a consistent fashion.

79 With respect, although the Respondents purport to rely on a principle of interpretation, which they describe as the presumption of consistent expression, they misapply the principle. The presumption of consistent language entails that: (a) a draftsperson will use language consistently; (b) a draftperson's use of different words indicates an intention to refer to different things; (c) a draftsperson will not use different words to refer to the same thing; and (d) different words should not be interpreted to mean the same thing. See: *Prestcold (Central) Ltd. v. Minister of Labour*, [1969] 1 W.L.R. 89 (C.A.) at p. 97; *Jarvis (John) Ltd. v. Rockdale Housing Association Ltd.*, [1986] 3 Const. L.J. 24 (C.A.) at p. 30. K. Lewison, *Interpretation of Contracts* (London: Sweet & Maxwell, 1989) at para. 6.02.

80 From these principles, the Respondent makes the following argument set out in para. 46 of their factum:

> 46. When the [Pension] Plan meant to refer to the present or commuted value of the benefits it did so in clear language and not by using the phrase "commuted value of any contracts." Applying the presumption of consistent expression, it should be assumed that if the draftsman had intended in respect of pre-retirement death benefits to refer to the commuted value or present value of the retirement benefits payable, he would have said so as he did in the Plan provisions relating to the settlement of small pension entitlements. In those provisions the Plan clearly refers to the commuted value or the present value of the "pension benefit" not the "contract." The fact that the draftsman chose different terminology indicates that he intended the pre-retirement death benefit to be determined in a different way and without reference to future pension benefits.

81 With respect, in my opinion, the Respondents are looking through the wrong end of the interpretive binoculars. The consistent use of the words "commuted value" in the 1966 Pension Plan and its restatements is to connect them to a pension-based methodology.

82 Yet another problem with the Respondents' interpretation, which eschews any pension-based methodology, is that this interpretation does not fit with the language of the Third and Fourth Statements that introduced a "preretirement survivor annuity," which has to be calculated and

carved out of the pre-retirement death benefit. In other words, these Restatements require a pension-based methodology to be paid to a surviving spouse and the amount of the "preretirement survivor annuity" would be an actuarial calculation and something quite different from a refund of Manulife premiums plus interest. The beneficiary of the pre-retirement death benefit then receives "the balance of the commuted value of any Contracts purchased for the deceased." It does not make sense that determining the "balance of the commuted value" should involve starting a contribution-based methodology when the already calculated "commuted value" involves a pension-based methodology.

83 The numerous problems confronting the Respondents' interpretation support the Applicants' arguments about how the pre-retirement death benefit should be interpreted. Pausing here, the above considerations are enough to lead me to the provisional conclusion that the Applicants' interpretation of the pre-retirement death benefit in the 1966 Pension Plan is the correct interpretation. My conclusion is provisional, however, because I still must consider what I take to be the Respondents' strongest arguments. I turn now to those arguments advanced by the Respondents.

The Respondents' Arguments Premised on Whether the Language and Meaning of the Pre-retirement Death Benefit Changed

84 The Respondents rely on the principle of interpretation that in placing a document in its context of surrounding circumstances for the purpose of interpreting the document, a court may consider predecessor agreements, and from predecessor documents a court may decide that when the wording of a document differs from its predecessors, the change in wording indicates a change of meaning: *Punjab National Bank v. De Boinville*, [1992] 1 W.L.R. 1138 at p. 1149; *HIH Casualty and General Insurance Company v. New Hampshire Insurance Co.*, [2001] 2 Lloyds 161 (C.A.) at para. 83.

85 From this principle, the Respondents argue that the change in the pre-retirement death benefit from "the commuted value of the Paid up Pension at Normal Pension Age" in the 1947 Regulations to "commuted value of any contracts" indicates an intention to make a substantive change and shows that the pre-retirement death benefit no longer referred to a pension-based methodology. In other words, conceding for the purpose of the argument that the 1947 Regulations involved a pension-based methodology, the Respondents then submit that the change in language in the 1966 Pension Plan indicates that the new plan was not to have a pension-based methodology for the pre-retirement death benefit.

86 I do not agree with the Respondents' argument. Rather, I agree with the submission of the Applicants that although the phrase "the commuted value of any contracts" in the 1966 Pension Plan replaced the phrase "paid-up pension at normal pension age," in the 1947 Regulation, there was no change of meaning. I come to this conclusion largely for the reasons already expressed above that show that the meaning of the phrase "the commuted value of any contracts" is effectively the same

as saying "paid-up pension at normal pension age." Both phrases entail the same pension-based methodology.

87 This brings me to the other branch of the Respondents' primary argument. As I noted earlier, it was a branch of the Respondents' primary argument that the phrase "paid up pension at normal pension age" in the 1947 Regulations does not involve a pension-based methodology. In other words, it was the Respondents' alternative submission that the 1947 Regulations never provided for anything other than contribution-based methodologies. Presumably, the Respondents made this argument because if it succeeded, then *a fortiori* their argument that "the commuted value of any contracts purchased for such Participant" involves a contribution-based methodology must also succeed.

88 During argument, the Respondents explained that keeping in mind that there were five sources for contributions, it followed that the reference in s. 19(a) of the 1947 Regulations to "the commuted value of the Paid-up Pension at Normal Pension Age as calculated by the Actuary" was a reference to a sum equal to all five sources of contribution for the benefit of the Participant plus interest, which is a contribution-based methodology. Further they explained that the reference in s. 19(a) to "a sum of money equal to **his contributions** made under the Plan together with interest" (my emphasis added) was a reference to a sum equal to two sources of contribution, namely, compulsory contributions by plan members and voluntary contributions by plan members, again a contribution-based methodology.

89 I find the Respondents' arguments to make the point that the 1947 Regulations did not include a pension-based methodology to be very strained and farfetched. For instance with respect to s. 19 of the 1947 Regulations, there should be no need for the involvement of an actuary to make the proposed contribution-based calculations but an actuary's involvement is specified by s. 19(a). Conversely, calling for the employment of an actuary makes sense if a pension-based methodology was directed by s. 19(a), which I conclude is the correct interpretation of the pre-retirement death benefit. Further, that the draftsperson of s. 19(s) intended both a pension-based methodology and a contribution-based methodology is supported by comparing and contrasting the use of the words "an amount of money equal to" in the first branch of s. 19(a) with the use of the words "sum of money equal to" in the second branch. The words "an amount of money equal to" are consistent with a pension-based methodology to be determined by an actuary while the words "sum of money equal to" are consistent with a contribution-based methodology where arithmetical expertise in multiplying sums by specified interest rates would be sufficient.

Respondents' Arguments Based on the Role of the Manulife Contracts

90 More worthy are the Respondents' arguments about the influence of the references to the contracts purchased for the Participants (the Manulife contracts) that are found in the 1947 Regulations and the 1966 Pension Plan and its Restatements. I turn now to those arguments.

91 The Respondents rely on the principles of interpretation that the words of a document must be

construed cohesively and harmoniously and that individual provisions must be construed in the context of the whole document and along with the other provisions of the document: *McClelland & Stewart Ltd. v. Mutual Life Assurance Co. of Canada*, [1981] 2 S.C.R. 6; *Hillis Oil & Sales Ltd. v. Wynn's Canada Ltd.* [1986] 1 S.C.R. 57; *Glimmer Resources Inc. v. Exall Resources Ltd.*, [1999] O.J. No. 1357 (C.A.); *Manitoba Hydro Electric v. John Inglis Co.* (1999), 181 D.L.R. (4th) 470 (Man. C.A.); *Canada Deposit Insurance Corp. (CDIC) v. Canadian Commercial Bank*, [1991] 4 W.W.R. 418 (Alta. C.A.).

92 From these principles, the Respondents argue that the words "commuted value of any contract" that define the pre-retirement death benefit when read in the context of the provisions of the 1966 Pension Plan and its Restatements that stipulate that "when a contract is purchased ... the rights and benefits of such participant shall thereafter be determined in accordance with such Annuity Contract," only yield the interpretation that the words "the commuted value of any contracts" means the lump sum death benefit paid under such contracts.

93 An immediate problem with this argument by the Respondents is that if it is correct, the result is a serious inconsistency or conflict within both the 1947 Regulations and also the 1966 Pension Plan and its Restatements. On one hand, the pension plans as prescribed in the plan documents provide both a pension-based and a contribution-based methodology for the pre-retirement death benefit but, on the other hand, the Manulife contracts provides only the singular methodology of a contribution-based methodology of the return of premiums of interest. Further, the Third and Fourth Restatements of the 1966 Pension Plan require a preretirement survivor annuity which is not to be found in the Manulife annuity contracts.

94 The conflict, however, can be avoided or resolved in three ways. First it can be avoided if the words "such Annuity Contract" is interpreted to mean "the prescribed Annuity Contract or "an Annuity Contract purchased in accordance with this Pension Plan and Trust." Such an interpretation gives rather than negates the meaning of the language of the Pension Plan and does not set a trap for members of the Pension Plan who would not realize from reading the Pension Plan that the conferral of benefits had been negated by the manner of their conferral or that a provision designed to secure the benefits of the pension plan had the result of reducing and eliminating the benefits set out in the language of the Pension Plan.

95 Second, the conflict can be avoided by interpreting the words "the rights and benefits of such participant shall thereafter be determined in accordance with such Annuity Contract" as essentially being an administrative or procedural provision rather than a substantive one. The plan member would be left to understand that his entitlements would be prescribed by the 1966 Pension Plan and the implementation of the receipt of the benefits would be as set out in the Manulife contracts.

96 Third, the conflict can be resolved by conceding that it exists and then resolving the conflict in favour of the language of the pre-retirement death benefit as it is set out in the 1966 Pension Plan.

97 The Respondents' argument has gravitas only because the Manulife contracts were already in

existence when the 1966 Pension Plan was signed and this contextual fact gives more weight to the language that "the rights and benefits of such participant shall thereafter be determined in accordance with such Annuity Contract." However, it may be that unlike the situation for the pre-retirement death benefit, for the other pension benefits provided by the Manulife annuity contract, there is no conflict between what was specified and what was delivered. Whether or not that is the case and the explanation for the drafting, it is my opinion that the intent of the draftsperson was not to specify a pre-retirement death benefit and then diminish it.

98 To give effect to the Respondents' argument that the contribution-based methodology of the Manulife contracts substantively determines the rights of the members of the 1966 Pension Plan is to accept an opaque interpretation of the Pension Plan that hides, negates, removes, or overturns the language of the pre-retirement death benefit.

99 Indeed, if the Respondents' argument is correct it becomes futile to interpret what the words of the pre-retirement death benefit might mean because whatever they might mean the Participants' benefits are determined by the meaning of the Manulife contracts. In my opinion, the interpretative tide should flow the other way and the language of the pre-retirement death benefit should define what should have been provided by the Manulife annuity contract. I, therefore, reject the Respondents' arguments based on the role of the Manulife contracts.

The Respondents' In Terrorem Arguments

100 The Respondents made several arguments to the effect that if the pre-retirement death benefits were interpreted to require a pension-based methodology, the consequences would be bad for the Pension Plan and for the members of the plan. Thus, it was submitted that if the 1966 Pension Plan was interpreted to require a pension-based methodology, the Manulife contracts would be an inadequate resource to satisfy the pre-retirement death benefit obligations, the Pension Plan would be under-resourced, the Trustees would not have carried out their duties, the Pension Plan would lose its status as a defined contribution pension plan, there would be adverse tax consequences, the Pension Plan would be non-compliant with regulatory requirements.

101 I regard these *in terrorem arguments* as not justifying interpreting the pre-retirement death benefit other than in accordance with its meaning as I have found it to be. All of these bad consequences do not emerge from the language of the 1966 Pension Plan but rather they arise because the Trustees did not purchase contracts that accorded with the language of the 1966 Pension Plan and its Restatements. Put somewhat differently, an interpretation of the pre-retirement death benefit that involves a pension-based methodology is not inherently problematic or illegal.

102 As an answer to the Respondents' *in terrorem* arguments, the Applicants responded with evidence to suggest that the problems did not exist or if they existed, they could be solved, but it is not necessary for me to make any finding in this regard. My point is that in the case at bar, aversion to the consequences of a pension-based methodology is not a reason for interpreting the pre-retirement death benefit otherwise than in accordance with the normal principles of

interpretation.

103 In advancing their *in terrorem* arguments, the Respondents quoted the following passage from J. McCamus, *Law of Contracts* (Irwin Law, 2005) at p. 729 where Professor McCamus states:

> [W]here an agreement admits of two possible constructions, one of which renders the agreement lawful and the other of which renders it unlawful, courts will give reference to the former interpretation.

104 To similar effect, the Respondents relied on *Ventas Inc. v. Sunrise Senior Living Real Estate Investment Trust* (2007), 85 O.R. (3d) 254 (C.A.) at para. 57; *Calgary (City) v. International Assn. of Fire Fighters, Local 255* (2008), 65 C.C.P.B. 165 (Alta. C.A.); and *Fausset v. Carpenter*, [1831] 2 Dow & Cl 232 (H.L.). I do not dispute the interpretative principle, however, I do not view the pre-retirement death benefit as admitting of two possible interpretations, and I do not view the interpretation with a pension-based methodology as one that would render the pre-retirement death benefit inherently unlawful.

105 Therefore, I reject the Respondents' *in terrorem* arguments.

Other Arguments

106 Having considered and rejected the Respondents' strongest arguments, I am satisfied that my provisional conclusion was correct, and I therefore grant the Application.

107 In reaching my decision, I find no ambiguity in the language of the pre-retirement death benefit and the 1966 Pension Plan and its Restatements that would justify resort to extrinsic sources as an aid to interpretation. I, therefore, did not rely on the extrinsic sources such as the Handbook, the representations of the President of the Society, or the Certificates of Participation, conduct of the parties, etc. that were advanced as interpretative tools by both sides. In these circumstances, I will not say anything further about the merits of the competing arguments and counterarguments.

Conclusion

108 For the above reasons, I grant the Application and advice the Trustees that a pension-based methodology should be used to calculate the pre-retirement death benefit.

109 If the parties cannot agree about the matter of costs, they may make submissions in writing beginning with the Applicants within 20 days of the release of these Reasons for Decision followed by the Respondents within a further 20 days.

110 Finally, I am grateful to counsel for their well prepared and very well presented arguments, which were of considerable assistance to me.

111 Order accordingly.

P.M. PERELL J.

cp/e/qllxr/qlpxm/qlsxs/qlaxw/qlaxr

Indexed as:

Canadian Red Cross Society (Re)

**IN THE MATTER OF the Companies' Creditors Arrangement Act, R.S.C. 1985 c. C-36
AND IN THE MATTER OF a Plan of Compromise or Arrangement of the Canadian Red Cross Society/La Société Canadienne De La Croix-Rouge
AND IN THE MATTER OF the Canadian Red Cross Society/ La Société Canadienne De La Croix-Rouge**

[1998] O.J. No. 3306

72 O.T.C. 99

5 C.B.R. (4th) 299

1998 CarswellOnt 3346

81 A.C.W.S. (3d) 932

1998 CanLII 14907

Commercial List File No. 98-CL-002970

Ontario Court of Justice (General Division)

Blair J.

August 19, 1998.

(28 pp.)

[Ed. note: Supplementary reasons released August 19, 1998. See [1998] O.J. No. 3307. Further supplementary reasons also released August 19, 1998. See [1998] O.J. No. 3513.]

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Marlene Thomas and John Spencer, for the Attorney General of Canada.
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Pamela Huff and Bonnie Tough, for the 1986-1990 Haemophiliac Hepatitis C Claimants.
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Bruce Lemer, for the B.C. 1986-90 Class Action.
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BLAIR J. (endorsement):--

Background and Genesis of the Proceedings

1 The Canadian Red Cross Society/La Société Canadienne de la Croix Rouge has sought and obtained the insolvency protection and supervision of the Court under the Companies' Creditors Arrangement Act ("CCAA'). It has done so with a view to putting forward a Plan to compromise its obligations to creditors and also as part of a national process in which responsibility for the Canadian blood supply is to be transferred from the Red Cross to two new agencies which are to form a new national blood authority to take control of the Canadian Blood Program.

2 The Red Cross finds itself in this predicament primarily as a result of some $8 billion of tort claims being asserted against it (and others, including governments and hospitals) by a large number of people who have suffered tragic harm from diseases contacted as a result of a blood contamination problem that has haunted the Canadian blood system since at least the early 1980's. Following upon the revelations forthcoming from the wide-ranging and seminal Krever Commission Inquiry on the Blood System in Canada, and the concern about the safety of that system - and indeed alarm - in the general population as a result of those revelations, the federal,

provincial and territorial governments decided to transfer responsibility for the Canadian Blood Supply to a new national authority. This new national authority consists of two agencies, the Canadian Blood Service and Héma-Québec.

The Motions

3 The primary matters for consideration in these Reasons deal with a Motion by the Red Cross for approval of the sale and transfer of its blood supply assets and operations to the two agencies and a cross-Motion on behalf of one of the Groups of Transfusion Claimants for an order dismissing that Motion and directing the holding of a meeting of creditors to consider a counter-proposal which would see the Red Cross continue to operate the blood system for a period of time and attempt to generate sufficient revenues on a fee-for-blood-service basis to create a compensation fund for victims.

4 There are other Motions as well, dealing with such things as the appointment of additional Representative Counsel and their funding, and with certain procedural matters pertaining generally to the CCAA proceedings. I will return to these less central motions at the end of these Reasons.

Operation of the Canadian Blood System and Evolution of the Acquisition Agreement

5 Transfer of responsibility for the operation of the Canadian blood supply system to a new authority will mark the first time that responsibility for a nationally co-ordinated blood system has not been in the hands of the Canadian Red Cross. Its first blood donor clinic was held in January, 1940 - when a national approach to the provision of a blood supply was first developed. Since 1977, the Red Cross has operated the Blood Program furnishing the Canadian health system with a variety of blood and blood products, with funding from the provincial and territorial governments. In 1981, the Canadian Blood Committee, composed of representatives of the governments, was created to oversee the Blood Program on behalf of the Governments. In 1991 this Committee was replaced by the Canadian Blood Agency - whose members are the Ministers of Health for the provinces and territories - as funder and co-ordinator of the Blood Program. The Canadian Blood Agency, together with the federal government's regulatory agency known as BBR (The Bureau of Biologics and Radiopharmaceuticals) and the Red Cross, are the principal components of the organizational structure of the current Blood Supply System.

6 In the contemplated new regime, The Canadian Blood Service has been designated as the vehicle by which the Governments in Canada will deliver to Canadians (in all provinces and territories except Quebec) a new fully integrated and accountable Blood Supply System. Quebec has established Héma-Québec as its own blood service within its own health care system, but subject to federal standards and regulations. The two agencies have agreed to work together, and are working in a co-ordinated fashion, to ensure all Canadians have access to safe, secure and adequate supplies of blood, blood products and their alternatives. The scheduled date for the transfer of the Canadian blood supply operations from the Red Cross to the new agencies was originally September 1, 1998. Following the adjournment of these proceedings on July 31st to today's date, the

closing has been postponed. It is presently contemplated to take place shortly after September 18, 1998 if the transaction is approved by the Court.

7 The assets owned and controlled by the Red Cross are important to the continued viability of the blood supply operations, and to the seamless transfer of those operations in the interests of public health and safety. They also have value. In fact, they are the source of the principal value in the Red Cross's assets which might be available to satisfy the claims of creditors. Their sale was therefore seen by those involved in attempting to structure a resolution to all of these political, social and personal problems, as providing the main opportunity to develop a pool of funds to go towards satisfying the Red Cross's obligations regarding the claims of what are generally referred to in these proceedings as the "Transfusion Claimants". It appears, though, that the Transfusion Claimants did not have much, if any, involvement in the structuring of the proposed resolution.

8 Everyone recognizes, I think, that the projected pool of funds will not be sufficient to satisfy such claims in full, but it is thought - by the Red Cross and the Governments, in any event - that the proceeds of sale from the transfer of the Society's blood supply assets represent the best hope of maximizing the return on the Society's assets and thus of maximizing the funds available from it to meet its obligations to the Transfusion Claimants.

9 This umbrella approach - namely, that the blood supply operations must be transferred to a new authority, but that the proceeds generated from that transfer should provide the pool of funds from which the Transfusion Claimants can, and should, be satisfied, so that the Red Cross may avoid bankruptcy and continue its other humanitarian operations - is what led to the marriage of these CCAA proceedings and the transfer of responsibility for the Blood System. The Acquisition Agreement which has been carefully and hotly negotiated over the past 9 months, and the sale from the Red Cross to the new agencies is - at the insistence of the Governments - subject to the approval of the Court, and they are as well conditional upon the Red Cross making an application to restructure pursuant to the CCAA.

10 The Initial Order was made in these proceedings under the CCAA on July 20th.

The Sale and Transfer Transaction

11 The Acquisition Agreement provides for the transfer of the operation of the Blood Program from the Red Cross to the Canadian Blood Service and Héma-Québec, together with employees, donor and patient records and assets relating to the operation of the Program on September 1, 1998. Court approval of the Agreement, together with certain orders to ensure the transfer of clear title to the Purchasers, are conditions of closing.

12 The sale is expected to generate about $169 million in all, before various deductions. That sum is comprised of a purchase price for the blood supply assets of $132.9 million plus an estimated $36 million to be paid for inventory. Significant portions of these funds are to be held in escrow pending the resolution of different issues; but, in the end, after payment of the balance of the

outstanding indebtedness to the T-D Bank (which has advanced a secured line of credit to fund the transfer and re-structuring) and the payment of certain creditors, it is anticipated that a pool of funds amounting to between $70 million and $100 million may be available to be applied against the Transfusion Claims.

13 In substance, the new agencies are to acquire all fixed assets, inventory, equipment, contracts and leases associated with the Red Cross Blood Program, including intellectual property, information systems, data, software, licences, operating procedures and the very important donor and patient records. There is no doubt that the sale represents the transfer of the bulk of the significant and valuable assets of the Red Cross.

14 A vesting order is sought as part of the relief to be granted. Such an order, if made, will have the effect of extinguishing realty encumbrances against and security interest in those assets. I am satisfied for these purposes that appropriate notification has been given to registered encumbrancers and other security interest holders to permit such an order to be made. I am also satisfied, for purposes of notification warranting a vesting order, that adequate notification of a direct and public nature has been given to all of those who may have a claim against the assets. The CCAA proceedings themselves, and the general nature of the Plan to be advanced by the Red Cross - including the prior sale of the blood supply assets - has received wide coverage in the media. Specific notification has been published in principal newspapers across the country. A document room containing relevant information regarding the proposed transaction, and relevant financial information, was set up in Toronto and most, if not all, claimants have taken advantage of access to that room. Richter & Partners were appointed by the Court to provide independent financial advice to the Transfusion Claimants, and they have done so. Accordingly, I am satisfied in terms of notification and service that the proper foundation for the granting of the Order sought has been laid.

15 What is proposed, to satisfy the need to protect encumbrancers and holders of personal security interests is,

a) that generally speaking, prior registered interests and encumbrances against the Red Cross's lands and buildings will not be affected - i.e., the transfer and sale will take place subject to those interests, or they will be paid off on closing; and,

b) that registered personal property interests will either be assumed by the Purchasers or paid off from the proceeds of closing in accordance with their legal entitlement.

Whether the Purchase Price is Fair and Reasonable

16 The central question for determination on this Motion is whether the proposed Purchase Price for the Red Cross's blood supply related assets is fair and reasonable in the circumstances, and a price that is as close to the maximum as is reasonably likely to be obtained for such assets. If the

answer to this question is "Yes", then there can be little quarrel - it seems to me - with the conversion of those assets into cash and their replacement with that cash as the asset source available to satisfy the claims of creditors, including the Transfusion Claimants. It matters not to creditors and Claimants whether the source of their recovery is a pool of cash or a pool of real/personal/intangible assets. Indeed, it may well be advantageous to have the assets already crystallised into a cash fund, readily available and earning interest. What is important is that the value of that recovery pool is as high as possible.

17 On behalf of the 1986-1990 Québec Hepatitis C Claimants Mr. Lavigne and Mr. Bennett argue, however, that the purchase price is not high enough. Mr. Lavigne has put forward a counter-proposal which he submits will enhance the value of the Red Cross's blood supply assets by giving greater play to the value of its exclusive licence to be the national supplier of blood, and which will accordingly result in a much greater return for Claimants. This proposal has been referred to as the "Lavigne Proposal" or the "No-Fault Plan of Arrangement". I shall return to it shortly; but first I propose to deal with the submissions of the Red Cross and of those who support its Motion for approval, that the proposed price is fair and reasonable. Those parties include the Governments, the proposed Purchasers - the Canadian Blood Service and Héma-Québec - and several (but not all) of the other Transfusion Claimant Groups.

18 As I have indicated, the gross purchase price under the Acquisition Agreement is $132.9 million, plus an additional amount to be paid for inventory on closing which will generate a total purchase price of approximately $169 million. Out of that amount, the Bank indebtedness is to be paid and the claims of certain other creditors defrayed. It is estimated that a fund of between $70 million and $100 million will be available to constitute the trust fund to be set aside to satisfy Transfusion Claims.

19 This price is based upon a Valuation prepared jointly by Deloitte & Touche (financial advisor to the Governments) and Ernst & Young (financial advisor to the Red Cross and the present Monitor appointed under the Initial CCAA Order). These two financial advisors retained and relied upon independent appraisal experts to appraise the realty (Royal LePage), the machinery and equipment and intangible assets (American Appraisal Canada Inc.) and the laboratories (Pellemon Inc.). The experience, expertise and qualifications of these various experts to conduct such appraisals cannot be questioned. At the same time, it must be acknowledged that neither Deloitte & Touche nor Ernst & Young are completely "independent" in this exercise, given the source of their retainers. It was at least partly for this reason that the Court was open to the suggestion that Richter & Partners be appointed to advise the 1986-1990 Ontario Class Action Claimants (and through them to provide independent advice and information to the other groups of Transfusion Claimants). The evidence and submissions indicate that Richter & Partners have met with the Monitor and with representatives of Deloitte & Touche, and that all enquiries have been responded to.

20 Richter & Partners were appointed at the instance of the 1986-1990 Ontario Hepatitis C Claimants Richter & Partners, with a mandate to share their information and recommendations with

the other Groups of Transfusion Claimants. Mr. Pitch advises on behalf of that Group that as a result of their due diligence enquiries his clients are prepared to agree to the approval of the Acquisition Agreement, and, indeed urge that it be approved quickly. A significant number of the other Transfusion Claimant groups but by no means all - have taken similar positions, although subject in some cases to certain caveats, none of which pertain to the adequacy of the purchase price. On behalf of the 1986-1990 Hemophiliac Claimants, for instance, Ms. Huff does not oppose the transfer approval, although she raises certain concerns about certain terms of the Acquisition Agreement which may impinge upon the amount of monies that will be available to Claimants on closing, and she would like to see these issues addressed in any Order, if approval is granted. Mr. Lemer, on behalf of the British Columbia 1986-1990 Hepatitis C Class Action Claimants, takes the same position as Ms. Huff, but advises that his clients' further due diligence has satisfied them that the price is fair and reasonable. While Mr. Kaufman, on behalf of Pre 86/Post 90 Hepatitis C Claimants, advances a number of jurisdictional arguments against approval, his clients do not otherwise oppose the transfer (but they would like certain caveats applied) and they do not question the price which has been negotiated for the Red Cross's blood supply assets. Mr. Kainer for the Service Employees Union (which represents approximately 1,000 Red Cross employees) also supports the Red Cross Motion, as does, very eloquently, Ms. Donna Ring who is counsel for Ms. Janet Conners and other secondarily infected spouses and children with HIV.

21 Thus, there is broad support amongst a large segment of the Transfusion Claimants for approval of the sale and transfer of the blood supply assets as proposed.

22 Some of these supporting Claimants, at least, have relied upon the due diligence information received through Richter & Partners, in assessing their rights and determining what position to take. This independent source of due diligence therefore provides some comfort as to the adequacy of the purchase price. It does not necessarily carry the day, however, if the Lavigne Proposal offers a solution that may reasonably practically generate a higher value for the blood supply assets in particular and the Red Cross assets in general. I turn to that Proposal now.

The Lavigne Proposal

23 Mr. Lavigne is Representative Counsel for the 1986-1990 Québec Hepatitis C Claimants. His cross-motion asks for various types of relief, including for the purposes of the main Motion,

a) an order dismissing the Red Cross motion for court approval of the sale of the blood supply assets;
b) an order directing the Monitor to review the feasibility of the Lavigne Proposal's plan of arrangement (the "No-Fault Plan of Arrangement") which has now been filed with the Court of behalf of his group of "creditors"; and,
c) an order scheduling a meeting of creditors within 6 weeks of the end of this month for the purpose of voting on the No-Fault Plan of Arrangement.

24 This cross-motion is supported by a group of British Columbia Pre 86/Post 90 Hepatitis C Claimants who are formally represented at the moment by Mr. Kaufman but for whom Mr. Klein now seeks to be appointed Representative Counsel. It is also supported by Mr. Lauzon who seeks to be appointed Representative Counsel for a group of Québec Pre 86/Post 90 Hepatitis C Claimants. I shall return to these "Representation" Motions at the end of these Reasons. Suffice it to say at this stage that counsel strongly endorsed the Lavigne Proposal.

25 The Lavigne Proposal can be summarized in essence in the following four principals, namely:

1. Court approval of a no-fault plan of compensation for all Transfusion Claimants, known or unknown;
2. Immediate termination by the Court of the Master Agreement presently governing the relationship between the Red Cross and the Canadian Blood Agency, and the funding of the former, which Agreement requires a one year notice period for termination;
3. Payment in full of the claims of all creditors of the Red Cross; and,
4. No disruption of the Canadian Blood Supply.

26 The key assumptions and premises underlying these notions are,

* that the Red Cross has a form of monopoly in the sense that it is the only blood supplier licensed by Government in Canada to supply blood to hospitals;
* that, accordingly, this license has "value", which has not been recognized in the Valuation prepared by Deloitte & Touche and by Ernst & Young, and which can be exploited and enhanced by the Red Cross continuing to operate the Blood Supply and charging hospitals directly on a fully funded cost recovery basis for its blood services;
* that Government will not remove this monopoly from the Red Cross for fear of disrupting the Blood Supply in Canada;
* that the Red Cross would be able to charge hospitals sufficient amounts not only to cover its costs of operation (without any public funding such as that now coming from the Canadian Blood Agency under the Master Agreement), but also to pay all of its creditors and to establish a fund which would allow for compensation over time to all of the Transfusion Claimants; and, finally,
* that the no-fault proposal is simply an introduction of the Krever Commission recommendations for a scheme of no-fault compensation for all transfusion claimants, for the funding of the blood supply program through direct cost recovery from hospitals, and for the inclusion of a component for a compensation fund in the fee for service delivery charge.

27 In his careful argument in support of his proposal Mr. Lavigne was more inclined to couch his rationale for the No-Fault Plan in political terms rather than in terms of the potential value created by the Red Cross monopoly licence and arising from the prospect of utilizing that monopoly licence to raise revenue on a fee-for-blood-service basis, thus leading - arguably - to an enhanced "value" of the blood supply operations and assets. He seemed to me to be suggesting, in essence, that because there are significant Transfusion Claims outstanding against the Red Cross, Government as the indirect purchaser of the assets should recognize this and incorporate into the purchase price an element reflecting the value of those claims. It was submitted that because the Red Cross has (or, at least, will have had) a monopoly licence regarding the supply of blood products in Canada, and because it could charge a fee-for-blood-service to hospitals for those services and products, and because other regimes M other countries employ such a fee for service system and build in an insurance or compensation element for claims, and because the Red Cross might be able to recover such an element in the regime he proposes for it, then the purchase price must reflect the value of those outstanding claims in some fashion. I am not able to understand, in market terms, however, why the value of a debtor's assets is necessarily reflective in any way of the value of the claims against those assets. In fact, it is the stuff of the everyday insolvency world that exactly the opposite is the case. In my view, the argument is more appropriately put - for the purposes of the commercial and restructuring considerations which are what govern the Court's decisions in these types of CCAA proceedings - on the basis of the potential increase in value from the revenue generating capacity of the monopoly licence itself. In fairness, that is the way in which Mr. Lavigne's Proposal is developed and justified in the written materials filed.

28 After careful consideration of it, however, I have concluded that the Lavigne Proposal cannot withstand scrutiny, in the context of these present proceedings.

29 Farley Cohen - a forensic a principal in the expert forensic investigative and accounting firm of Linquist Avery Macdonald Baskerville Company - has testified that in his opinion the Red Cross operating licence "provides the potential opportunity and ability for the Red Cross to satisfy its current and future liabilities as discussed below". Mr. Cohen then proceeds in his affidavit to set out the basis and underlying assumptions for that opinion in the following paragraphs, which I quote in their entirety:

> 1. In my opinion, if the Red Cross can continue as a sole and exclusive operator of the Blood Supply Program and can amend its funding arrangements to provide for full cost recovery, including the cost of proven claims of Transfusion Claimants, and whereby the Red Cross would charge hospitals directly for the Blood Safety Program, then there is a substantial value to the Red Cross to satisfy all the claims against it.
> 2. In my opinion, such value to the Red Cross is not reflected in the Joint Valuation Report.
> 3. My opinion is based on the following assumptions: (i) the Federal Government, while having the power to issue additional licences to other

> Blood System operators, would not do so in the interest of public safety; (ii) the Red Cross can terminate the current funding arrangement pursuant to the terms of the Master Agreement; and (iii) the cost of blood charged to the hospitals would not be cost-prohibitive compared to alternative blood suppliers. (highlighting in original)

30 On his cross-examination, Mr. Cohen acknowledged that he did not know whether his assumptions could come true or not. That difficulty, it seems to me, is an indicia of the central weakness in the Lavigne Proposal. The reality of the present situation is that all 13 Governments in Canada have determined unequivocally that the Red Cross will no longer be responsible for or involved in the operation of the national blood supply in this country. That is the evidentiary bedrock underlying these proceedings. If that is the case, there is simply no realistic likelihood that any of the assumptions made by Mr. Cohen will occur. His opinion is only as sound as the assumptions on which it is based.

31 Like all counsel - even those for the Transfusion Claimants who do not support his position - I commend Mr. Lavigne for his ingenuity and for his sincerity and perseverence in pursing his clients' general goals in relation to the blood supply program. However, after giving it careful consideration as I have said, I have come to the conclusion that the Lavigne Proposal - whatever commendation it my deserve in other contexts - does not offer a workable or practical alternative solution in the context of these CCAA proceedings. I question whether it can even be said to constitute a "Plan of Compromise and Arrangement" within the meaning of the CCAA, because it is not something which either the debtor (the Red Cross) or the creditors (the Transfusion Claimants amongst them) have control over to make happen. It is, in reality, a political and social solution which must be effected by Governments. It is not something which can be imposed by the Court in the context of a restructuring. Without deciding that issue, however, I am satisfied that the Proposal is not one which in the circumstances warrants the Court in exercising its discretion under sections 4 and 5 of the CCAA to call a meeting of creditors to vote on it.

32 Mr. Justice Krever recommended that the Red Cross not continue in the operation of the Blood Supply System and, while he did recommend the introduction of a no-fault scheme to compensate all blood victims, it was not a scheme that would be centred around the continued involvement of the Red Cross. It was a government established statutory no-fault scheme. He said (Final Report, Vol. 3, p. 1045):

> The provinces and territories of Canada should devise statutory no-fault schemes that compensate all blood-injured persons promptly and adequately, so they do not suffer impoverishment or illness without treatment. I therefore recommend that, without delay, the provinces and territories devise statutory no-fault schemes for compensating persons who suffer serious adverse consequences as a result of the administration of blood components or blood products.

33 Governments - which are required to make difficult choices - have chosen, for their own particular reasons, not to go down this particular socio-political road. While this may continue to be a very live issue in the social and political arena, it is not one which, as I have said, is a solution that can be imposed by the Court in proceedings such as these.

34 I am satisfied, as well, that the Lavigne Proposal ought not to impede the present process on the basis that it is unworkable and impractical, in the present circumstances, and given the determined political decision to transfer the blood supply from the Red Cross to the new agencies, might possibly result in a disruption of the supply and raise concerns for the safety of the public if that were the case. The reasons why this is so, from an evidentiary perspective, are well articulated in the affidavit of the Secretary General of the Canadian Red Cross, Pierre Duplessis, in his affidavit sworn on August 17, 1998. I accept that evidence and the reasons articulated therein. In substance Dr. Duplessis states that the assumptions underlying the Lavigne Proposal are "unrealistic, impractical and unachievable for the Red Cross in the current environment" because,

a) the political and factual reality is that Governments have clearly decided - following the recommendation of Mr. Justice Krever - that the Red Cross will not continue to be involved in the National Blood Program, and at least with respect to Quebec have indicated that they are prepared to resort to their powers of expropriation if necessary to effect a transfer;
b) the delays and confusion which would result from a postponement to test the Lavigne Proposal could have detrimental effects on the blood system itself and on employees, hospitals, and other health care providers involved in it;
c) the Master Agreement between the Red Cross and the Canadian Blood Agency, under which the Society currently obtains its funding, cannot be cancelled except on one year's notice, and even if it could there would be great risks in denuding the Red Cross of all of its existing funding in exchange for the prospect of replacing that funding with fee for service revenues; and,
d) it is very unlikely that over 900 hospitals across Canada - which have hitherto not paid for their blood supply, which have no budgets contemplating that they will do so, and which are underfunded in event will be able to pay sufficient sums to enable the Red Cross not only to cover its operating costs and to pay current bills, but also to repay the present Bank indebtedness of approximately $35 million in full, and to repay existing unsecured creditors in full, and to generate a compensation fund that will pay existing Transfusion Claimants (it is suggested) in full for their $8 billion in claims.

35 Dr. Duplessis summarizes the risks inherent in further delays in the following passages from paragraph 17 of his affidavit sworn on August 17, 1998:

The Lavigne Proposal that the purchase price could be renegotiated to a higher price because of Red Cross' ability to operate on the terms the Lavigne Proposal envisions is not realistic, because Red Cross does not have the ability to operate on those terms. Accordingly, there is no reason to expect that CBS and H-Q would pay a higher amount than they have already agreed to pay under the Acquisition Agreement. Indeed, there is a serious risk that delays or attempts to renegotiate would result in lower amounts being paid. Delaying approval of the Acquisition Agreement to permit an experiment with the Lavigne Proposal exposes Red Cross and its stakeholders, including all Transfusion Claimants, to the following risks:

(a) continued losses in operating the National Blood Program which will reduce the amounts ultimately available to all stakeholders;
(b) Red Cross' ability to continue to operate its other activities being jeopardized;
(c) the Bank refusing to continue to support even the current level of funding and demanding repayment, thereby jeopardizing Red Cross and all of Red Cross' activities including the National Blood Program;
(d) CBS and H-Q becoming unprepared to complete an acquisition on the same financial terms given, among other things, the costs which they will incur in adjusting for later transfer dates, raising the risks of exproporiation or some other, less favourable taking of Red Cross' assets, or the Governments simply proceeding to set up the means to operate the National Blood Program without paying the Red Cross for its assets.

36 These conclusions, and the evidentiary base underlying them, are in my view irrefutable in the context of these proceedings.

37 Those supporting the Lavigne Proposal argued vigorously that approval of the proposed sale transaction in advance of a creditors' vote on the Red Cross Plan of Arrangement (which has not yet been filed) would strip the Lavigne Proposal of its underpinnings and, accordingly, would deprive those "creditor" Transfusion Claimants from their statutory right under the Act to put forward a Plan and to have a vote on their proposed Plan. In my opinion, however, Mr. Zarnett's response to that submission is the correct one in law. Sections 4 and 5 of the CCAA do not give the creditors a right to a meeting or a right to put forward a Plan and to insist on that Plan being put to a vote; they have a right to request the Court to order a meeting, and the Court will do so if it is in the best interests of the debtor company and the stakeholders to do so. In this case I accept the submission that the Court ought not to order a meeting for consideration of the Lavigne Proposal because the reality is that the Proposal is unworkable and unrealistic in the circumstances and I see nothing to be gained by the creditors being called to consider it. In addition, as I have pointed out earlier in these Reasons, a large number of the creditors and of the Transfusion Claimants oppose such a development. The

existence of a statutory provision permitting creditors to apply for an order for the calling of a meeting does not detract from the Court's power to approve a sale of assets, assuming that the Court otherwise has that power in the circumstances.

38 The only alternative to the sale and transfer, on the one hand, and the Lavigne Proposal, on the other hand, is a liquidation scenario for the Red Cross, and a cessation of its operations altogether. This is not in the interests of anyone, if it can reasonably be avoided. The opinion of the valuation experts is that on a liquidation basis, rather than on a "going concern" basis, as is contemplated in the sale transaction, the value of the Red Cross blood supply operations and assets varies between the mid - $30 million and about $74 million. This is quite considerable less than the $169 million (+/-) which will be generated by the sale transaction.

39 Having rejected the Lavigne Proposal in this context, it follows from what I have earlier said that I conclude the purchase price under the Acquisition Agreement is fair and reasonable, and a price that is as close to the maximum as is reasonably likely to be obtained for the assets.

Jurisdiction Issue

40 The issue of whether the Court has jurisdiction to make an order approving the sale of substantial assets of the debtor company before a Plan has been put forward and placed before the creditors for approval, has been raised by Mr. Bennett. I turn now to a consideration of that question.

41 Mr. Bennett argues that the Court does not have the jurisdiction under the CCAA to make an order approving the sale of substantial assets by the Applicant Company before a Plan has even been filed and the creditors have had an opportunity to consider and vote on it. He submits that section 11 of the Act permits the Court to extend to a debtor the protection of the Court pending a restructuring attempt but only in the form of a stay of proceedings against the debtor or in the form of an order restraining or prohibiting new proceedings. There is no jurisdiction to approve a sale of assets in advance he submits, or otherwise than in the context of the sanctioning of a Plan already approved by the creditors.

42 While Mr. Kaufman does not take the same approach to a jurisdictional argument, he submits nonetheless that although he does not oppose the transfer and approval of the sale, the Court cannot grant its approval at this stage if it involves "sanitizing" the transaction. By this, as I understand it, he means that the Court can "permit" the sale to go through - and presumably the purchase price to be paid - but that it cannot shield the assets conveyed from claims that may subsequently arise - such as fraudulent preference claims or oppression remedy claims in relation to the transaction. Apart from the fact that there is no evidence of the existence of any such claims, it seems to me that the argument is not one of "jurisdiction" but rather one of "appropriateness". The submission is that the assets should not be freed up from further claims until at least the Red Cross has filed its Plan and the creditors have had a chance to vote on it. In other words, the approval of the sale transaction and the transfer of the blood supply assets and operations should have been made a part and parcel

of the Plan of Arrangement put forward by the debtor, and the question of whether or not it is appropriate and supportable in that context debated and fought out on the voting floor, and not separately before-the-fact. These sentiments were echoed by Mr. Klein and by Mr. Thompson as well. In my view, however, the assets either have to be sold free and clear of claims against them - for a fair and reasonable price - or not sold. A purchaser cannot be expected to pay the fair and reasonable purchase price but at the same time leave it open for the assets purchased to be later attacked and, perhaps, taken back. In the context of the transfer of the Canadian blood supply operations, the prospect of such a claw back of assets sold, at a later time, has very troubling implications for the integrity and safety of that system. I do not think, firstly, that the argument is a jurisdictional one, and secondly, that it can prevail in any event.

43 I cannot accept the submission that the Court has no jurisdiction to make the order sought. The source of the authority is twofold: it is to be found in the power of the Court to impose terms and conditions on the granting of a stay under section 11; and it may be grounded upon the inherent jurisdiction of the Court, not to make orders which contradict a statute, but to "fill in the gaps in legislation so as to give effect to the objects of the CCAA, including the survival program of a debtor until it can present a plan": Re Dylex Limited and Others, (1995), 31 C.B.R. (3d) 106, per Farley J., at p. 110.

44 As Mr. Zarnett pointed out, paragraph 20 of the Initial Order granted in these proceedings on July 20, 1998, makes it a condition of the protection and stay given to the Red Cross that it not be permitted to sale or dispose of assets valued at more than $1 million without the approval of the Court. Clearly this is a condition which the Court has the jurisdiction to impose under section 11 of the Act. It is a necessary conjunction to such a condition that the debtor be entitled to come back to the Court and seek approval of a sale of such assets, if it can show it is in the best interests of the Company and its creditors as a whole that such approval be given. That is what it has done.

45 It is very common in CCAA restructurings for the Court to approve the sale and disposition of assets during the process and before the Plan if formally tendered and voted upon. There are many examples where this has occurred, the recent Eaton's restructuring being only one of them. The CCAA is designed to be a flexible instrument, and it is that very flexibility which gives it its efficacy. As Farley J. said in Dylex, supra (p. 111), "the history of CCAA law has been an evolution of judicial interpretation". It is not infrequently that judges are told, by those opposing a particular initiative at a particular time, that if they make a particular order that is requested it will be the first time in Canadian jurisprudence (sometimes in global jurisprudence, depending upon the level of the rhetoric) that such an order has made! Nonetheless, the orders are made, if the circumstances are appropriate and the orders can be made within the framework and in the spirit of the CCAA legislation. Mr. Justice Farley has well summarized this approach in the following passage from his decision in Re Lehndorff General Partner (1993), 17 C.B.R. (3d) 24, at p. 31, which I adopt:

> The CCAA is intended to facilitate compromises and arrangements between companies and their creditors as an alternative to bankruptcy and, as

> such, is remedial legislation entitled to a liberal interpretation. It seems to me that the purpose of the statute is to enable insolvent companies to carry on business in the ordinary course or otherwise deal with their assets so as to enable plan of compromise or arrangement to be prepared, filed and considered by their creditors for the proposed compromise or arrangement which will be to the benefit of both the company and its creditors. See the preamble to and sections 4, 5, 7, 8 and 11 of the CCAA (a lengthy list of authorities cited here is omitted).
>
> The CCAA is intended to provide a structured environment for the negotiation of compromises between a debtor company and its creditors for the benefit of both. Where a debtor company realistically plans to continue operating or to otherwise deal with its assets but it requires the protection of the court in order to do so and it is otherwise too early for the court to determine whether the debtor company will succeed, relief should be granted under the CCAA (citations omitted)
>
> (emphasis added)

46 In the spirit of that approach, and having regard to the circumstances of this case, I am satisfied not only that the Court has the jurisdiction to make the approval and related orders sought, but also that it should do so. There is no realistic alternative to the sale and transfer that is proposed, and the alternative is a liquidation/bankruptcy scenario which, on the evidence would yield an average of about 44% of the purchase price which the two agencies will pay. To forego that purchase price - supported as it is by reliable expert evidence - would in the circumstances be folly, not only for the ordinary creditors but also for the Transfusion Claimants, in my view.

47 While the authorities as to exactly what considerations a court should have in mind in approving a transaction such as this are scarce, I agree with Mr. Zarnett that an appropriate analogy may be found in cases dealing with the approval of a sale by a court-appointed receiver. In those circumstances, as the Ontario Court of Appeal has indicated in Royal Bank v. Soundair Corp. (1991), 7 C.B.R. (3d) 1, at p. 6 the Court's duties are,

> (i) to consider whether the receiver has made a sufficient effort to get the best price and has not acted improvidently;
>
> (ii) to consider the interests of the parties;
>
> (iii)to consider the efficacy and integrity of the process by which offers are obtained; and,

(iv) to consider whether there has been unfairness in the working out of the process.

48 I am satisfied on all such counts in the circumstances of this case.

49 Some argument was directed towards the matter of an order under the Bulk Sales Act. Because of the nature and extent of the Red Cross assets being disposed of, the provisions of that Act must either be complied with, or an exemption from compliance obtained under s. 3 thereof. The circumstances warrant the granting of such an exemption in my view. While there were submissions about whether or not the sale would impair the Society's ability to pay its creditors in full, I do not believe that the sale will impair that ability. In fact, it may well enhance it. Even if one accepts the argument that the emphasis should be placed upon the language regarding payment "in full" rather than on "impair", the case qualifies for an exemption. It is conceded that the Transfusion claimants do not qualify as "creditors" as that term is defined under the Bulk Sales Act; and if the claims of the Transfusion Claimants are removed from the equation, it seems evident that other creditors could be paid from the proceeds in full.

Conclusion and Treatment of Other Motions

50 I conclude that the Red Cross is entitled to the relief it seeks at this stage, and orders will go accordingly. In the end, I come to these conclusions having regard in particular to the public interest imperative which requires a Canadian Blood Supply with integrity and a seamless, effective and relatively early transfer of blood supply operations to the new agencies; having regard to the interests in the Red Cross in being able to put forward a Plan that may enable it to avoid bankruptcy and be able to continue on with its non-blood supply humanitarian efforts; and having regard to the interests of the Transfusion Claimants in seeing the value of the blood supply assets maximized.

51 Accordingly an order is granted - subject to the caveat following - approving the sale and authorizing and approving the transactions contemplated in the Acquisition Agreement, granting a vesting order, and declaring that the Bulk Sales Act does not apply to the sale, together with the other related relief claimed in paragraphs (a) through (g) of the Red Cross's Notice of Motion herein. The caveat is that the final terms and settlement of the Order are to be negotiated and approved by the Court before the Order is issued. If the parties cannot agree on the manner in which the "Agreement Content" issues raised by Ms. Huff and Mr. Kaufman in their joint memorandum of comments submitted in argument yesterday, I will hear submissions to resolve those issues.

Other Motions

52 The Motions by Mr. Klein and by W. Lauzon to be appointed Representative Counsel for the British Columbia and Quebec Pre86/Post 90 Hepatitis C Claimants, respectively, are granted. It is true that Mr. Klein had earlier authorized Mr. Kaufman to accept the appointment on behalf of his British Columbia group of clients, but nonetheless it may be - because of differing settlement proposals emanating to differing groups in differing Provinces - that there are differences in

interests between these groups, as well as differences in perspectives in the Canadian way. As I commented earlier, in making the original order appointing Representative Counsel, the Court endeavours to conduct a process which is both fair and perceived to be fair. Having regard to the nature of the claims, the circumstances in which the injuries and diseases inflicting the Transfusion Claimants have been sustained, and the place in Canadian Society at the moment for those concerns, it seems to me that those particular claimants, in those particular Provinces, are entitled if they wish to have their views put forward by those counsel who are already and normally representing them in their respective class proceedings.

53 I accept the concerns expressed by Mr. Zarnett on behalf of the Red Cross, and by Mr. Robertson on behalf of the Bank, about the impact of funding on the Society's cash flow and position. In my earlier endorsement dealing with the appointment of Representative Counsel and funding, I alluded to the fact that if additional funding was required to defray these costs those in a position to provide such funding may have to do so. The reference, of course, was to the Governments and the Purchasers. It is the quite legitimate but nonetheless operative concerns of the Governments to ensure the effective and safe transfer of the blood supply operations to the new agencies which are driving much of what is happening here. Since the previous judicial hint was not responded to, I propose to make it a specific term and condition of the approval Order that the Purchasers, or the Governments, establish a fund - not to exceed $2,000,000 at the present time without further order - to pay the professional costs incurred by Representative Counsel and by Richter & Partners.

54 The other Motions which were pending at the outset of yesterday's Hearing are adjourned to another date to be fixed by the Commercial List Registrar.

55 Orders are to go in accordance with the foregoing.

BLAIR J.

** Preliminary Version **

Case Name:

Century Services Inc. v. Canada (Attorney General)

Century Services Inc., Appellant;
v.
Attorney General of Canada on behalf of Her Majesty The Queen in Right of Canada, Respondent.

[2010] S.C.J. No. 60

[2010] A.C.S. no 60

2010 SCC 60

[2010] 3 S.C.R. 379

[2010] 3 R.C.S. 379

2011 D.T.C. 5006

409 N.R. 201

296 B.C.A.C. 1

12 B.C.L.R. (5th) 1

2010 CarswellBC 3419

326 D.L.R. (4th) 577

EYB 2010-183759

2011EXP-9

J.E. 2011-5

2011 G.T.C. 2006

[2011] 2 W.W.R. 383

72 C.B.R. (5th) 170

[2010] G.S.T.C. 186

196 A.C.W.S. (3d) 27

File No.: 33239.

Supreme Court of Canada

Heard: May 11, 2010;
Judgment: December 16, 2010.

Present: McLachlin C.J. and Binnie, LeBel, Deschamps, Fish, Abella, Charron, Rothstein and Cromwell JJ.

(136 paras.)

Appeal From:

ON APPEAL FROM THE COURT OF APPEAL FOR BRITISH COLUMBIA

Bankruptcy and insolvency law -- Companies' Creditors Arrangement Act (CCAA) matters -- Application of Act -- Compromises and arrangements -- Where Crown affected -- Effect of related legislation -- Bankruptcy and Insolvency Act -- Appeal by Century Services Inc. from judgment of British Columbia Court of Appeal reversing a judgment dismissing a Crown application for payment of unremitted GST monies allowed -- Section 222(3) of the Excise Tax Act evinced no explicit intention of Parliament to repeal s. 18.3 of CCAA -- Parliament's intent with respect to GST deemed trusts was to be found in the CCAA -- Judge had the discretion under the CCAA to continue the stay of the Crown's claim for enforcement of the GST deemed trust while otherwise lifting it to permit debtor company to make an assignment in bankruptcy.

Appeal by Century Services Inc. from a judgment of the British Columbia Court of Appeal reversing a judgment dismissing a Crown application for payment of unremitted GST monies. The debtor company commenced proceedings under the Companies' Creditors Arrangement Act (CCAA), obtaining a stay of proceedings with a view to reorganizing its financial affairs. Among the debts owed by the debtor company at the commencement of the reorganization was an amount of GST collected but unremitted to the Crown. The Excise Tax Act (ETA) created a deemed trust in favour of the Crown for amounts collected in respect of GST. The ETA provided that the deemed

trust operated despite any other enactment of Canada except the Bankruptcy and Insolvency Act (BIA). However, the CCAA also provided that subject to certain exceptions, none of which mentioned GST, deemed trusts in favour of the Crown did not operate under the CCAA. In the context of the CCAA proceedings, a chambers judge approved a payment not exceeding $5 million to the debtor company's major secured creditor, Century Services. The judge agreed to the debtor company's proposal to hold back an amount equal to the GST monies collected but unremitted to the Crown and place it in the Monitor's trust account until the outcome of the reorganization was known. After concluding that reorganization was not possible, the debtor company sought leave to partially lift the stay of proceedings so it could make an assignment in bankruptcy under the Bankruptcy and Insolvency Act (BIA). The Crown sought an order that the GST monies held by the Monitor be paid to the Receiver General of Canada. The judge denied the Crown's motion, and allowed the assignment in bankruptcy. The Court of Appeal found two independent bases for allowing the Crown's appeal. First, the court's authority under s. 11 of the CCAA was held not to extend to staying the Crown's application for immediate payment of the GST funds subject to the deemed trust after it was clear that reorganization efforts had failed and that bankruptcy was inevitable. As restructuring was no longer a possibility, staying the Crown's claim to the GST funds no longer served a purpose under the CCAA and the court was bound under the priority scheme provided by the ETA to allow payment to the Crown. Second, the Court of Appeal concluded that by ordering the GST funds segregated in the Monitor's trust account, the judge had created an express trust in favour of the Crown from which the monies in question could not be diverted for any other purposes.

HELD: Appeal allowed. Section 222(3) of the ETA evinced no explicit intention of Parliament to repeal CCAA s. 18.3. Had Parliament sought to give the Crown a priority for GST claims, it could have done so explicitly, as it did for source deductions. There was no express statutory basis for concluding that GST claims enjoyed a preferred treatment under the CCAA or the BIA. Parliament's intent with respect to GST deemed trusts was to be found in the CCAA. With respect to the scope of a court's discretion when supervising reorganization, the broad discretionary jurisdiction conferred on the supervising judge had to be interpreted having regard to the remedial nature of the CCAA and insolvency legislation generally. The question was whether the order advanced the underlying purpose of the CCAA. The judge's order staying Crown enforcement of the GST claim ensured that creditors would not be disadvantaged by the attempted reorganization under the CCAA. The effect of his order was to blunt any impulse of creditors to interfere in an orderly liquidation. His order was thus in furtherance of the CCAA's objectives to the extent that it allowed a bridge between the CCAA and BIA proceedings. The order fostered a harmonious transition between reorganization and liquidation while meeting the objective of a single collective proceeding that was common to both statutes. The breadth of the court's discretion under the CCAA was sufficient to lift the stay to allow entry into liquidation. No express trust was created by the judge's order because there was no certainty of object inferrable from his order. Further, no deemed trust was created.

Statutes, Regulations and Rules Cited:

An Act to establish the Wage Earner Protection Program Act, to amend the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act and to make consequential amendments to other Acts, S.C. 2005, c. 47, s. 69, s. 128, s. 131

Bank Act, S.C. 1991, c. 46,

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-, s. 67, s. 86

Canada Pension Plan, R.S.C. 1985, c. C-8, s. 23

Cities and Towns Act, R.S.Q., c. C-19,

Civil Code of QuÚbec, S.Q. 1991, c. 64, art. 2930

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 11, s. 11.4, s. 18.3, s. 18.4, s. 20, s. 21

Companies' Creditors Arrangement Act, 1933, S.C. 1932-33, c. 36,

Employment Insurance Act, S.C. 1996, c. 23, s. 86(2), s. 86(2.1)

Excise Tax Act, R.S.C. 1985, c. E-15, s. 222

Income Tax Act, R.S.C. 1985, c. 1 (5th Supp.), s. 227(4), s. 227(4.1)

Interpretation Act, R.S.C. 1985, c. I-21, s. 2, s. 44(f)

Personal Property Security Act, S.A. 1988, c. P-4.05,

Winding-up and Restructuring Act, R.S.C. 1985, c. W-11,

Subsequent History:

NOTE: This document is subject to editorial revision before its reproduction in final form in the Canada Supreme Court Reports.

Court Catchwords:

Bankruptcy and Insolvency -- Priorities -- Crown applying on eve of bankruptcy of debtor company to have GST monies held in trust paid to Receiver General of Canada -- Whether deemed trust in favour of Crown under Excise Tax Act prevails over provisions of Companies' Creditors Arrangement Act purporting to nullify deemed trusts in favour of Crown -- Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 18.3(1) -- Excise Tax Act, R.S.C. 1985, c. E-15, s. 222(3).

Bankruptcy and insolvency -- Procedure -- Whether chambers judge had authority to make order partially lifting stay of proceedings to allow debtor company to make assignment in bankruptcy and to stay Crown's right to enforce GST deemed trust -- Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 11.

Trusts -- Express trusts -- GST collected but unremitted to Crown -- Judge ordering that GST be held by Monitor in trust account -- Whether segregation of Crown's GST claim in Monitor's account created an express trust in favour of Crown.

Court Summary:

The debtor company commenced proceedings under the *Companies' Creditors Arrangement Act* ("*CCAA*"), obtaining a stay of proceedings to allow it time to reorganize its financial affairs. One of the debtor company's outstanding debts at the commencement of the reorganization was an amount of unremitted Goods and Services Tax ("GST") payable to the Crown. Section 222(3) of the *Excise Tax Act* ("*ETA*") created a deemed trust over unremitted GST, which operated despite any other enactment of Canada except the *Bankruptcy and Insolvency Act* ("*BIA*"). However, s. 18.3(1) of the *CCAA* provided that any statutory deemed trusts in favour of the Crown did not operate under the *CCAA*, subject to certain exceptions, none of which mentioned GST.

Pursuant to an order of the *CCAA* chambers judge, a payment not exceeding $5 million was approved to the debtor company's major secured creditor, Century Services. However, the chambers judge also ordered the debtor company to hold back and segregate in the Monitor's trust account an amount equal to the unremitted GST pending the outcome of the reorganization. On concluding that reorganization was not possible, the debtor company sought leave of the court to partially lift the stay of proceedings so it could make an assignment in bankruptcy under the *BIA*. The Crown moved for immediate payment of unremitted GST to the Receiver General. The chambers judge denied the Crown's motion, and allowed the assignment in bankruptcy. The Court of Appeal allowed the appeal on two grounds. First, it reasoned that once reorganization efforts had failed, the chambers judge was bound under the priority scheme provided by the *ETA* to allow payment of unremitted GST to the Crown and had no discretion under s. 11 of the *CCAA* to continue the stay against the Crown's claim. Second, the Court of Appeal concluded that by ordering the GST funds segregated in the Monitor's trust account, the chambers judge had created an express trust in favour of the Crown.

Held (Abella J. dissenting): The appeal should be allowed.

Per McLachlin C.J., Binnie, LeBel, **Deschamps**, Charron, Rothstein and Cromwell JJ.: The apparent conflict between s. 222(3) of the *ETA* and s. 18.3(1) of the *CCAA* can be resolved through an interpretation that properly recognizes the history of the *CCAA*, its function amidst the body of insolvency legislation enacted by Parliament and the principles for interpreting the *CCAA* that have been recognized in the jurisprudence. The history of the *CCAA* distinguishes it from the *BIA* because although these statutes share the same remedial purpose of avoiding the social and

economic costs of liquidating a debtor's assets, the *CCAA* offers more flexibility and greater judicial discretion than the rules-based mechanism under the *BIA*, making the former more responsive to complex reorganizations. Because the *CCAA* is silent on what happens if reorganization fails, the *BIA* scheme of liquidation and distribution necessarily provides the backdrop against which creditors assess their priority in the event of bankruptcy. The contemporary thrust of legislative reform has been towards harmonizing aspects of insolvency law common to the *CCAA* and the *BIA*, and one of its important features has been a cutback in Crown priorities. Accordingly, the *CCAA* and the *BIA* both contain provisions nullifying statutory deemed trusts in favour of the Crown, and both contain explicit exceptions exempting source deductions deemed trusts from this general rule. Meanwhile, both Acts are harmonious in treating other Crown claims as unsecured. No such clear and express language exists in those Acts carving out an exception for GST claims.

When faced with the apparent conflict between s. 222(3) of the *ETA* and s. 18.3(1) of the *CCAA*, courts have been inclined to follow *Ottawa Senators Hockey Club Corp.(Re)* and resolve the conflict in favour of the *ETA*. *Ottawa Senators* should not be followed. Rather, the *CCAA* provides the rule. Section 222(3) of the *ETA* evinces no explicit intention of Parliament to repeal *CCAA* s. 18.3. Where Parliament has sought to protect certain Crown claims through statutory deemed trusts and intended that these deemed trusts continue in insolvency, it has legislated so expressly and elaborately. Meanwhile, there is no express statutory basis for concluding that GST claims enjoy a preferred treatment under the *CCAA* or the *BIA*. The internal logic of the *CCAA* appears to subject a GST deemed trust to the waiver by Parliament of its priority. A strange asymmetry would result if differing treatments of GST deemed trusts under the *CCAA* and the *BIA* were found to exist, as this would encourage statute shopping, undermine the *CCAA*'s remedial purpose and invite the very social ills that the statute was enacted to avert. The later in time enactment of the more general s. 222(3) of the *ETA* does not require application of the doctrine of implied repeal to the earlier and more specific s. 18.3(1) of the *CCAA* in the circumstances of this case. In any event, recent amendments to the *CCAA* in 2005 resulted in s. 18.3 of the Act being renumbered and reformulated, making it the later in time provision. This confirms that Parliament's intent with respect to GST deemed trusts is to be found in the *CCAA*. The conflict between the *ETA* and the *CCAA* is more apparent than real.

The exercise of judicial discretion has allowed the *CCAA* to adapt and evolve to meet contemporary business and social needs. As reorganizations become increasingly complex, *CCAA* courts have been called upon to innovate. In determining their jurisdiction to sanction measures in a *CCAA* proceeding, courts should first interpret the provisions of the *CCAA* before turning to their inherent or equitable jurisdiction. Noteworthy in this regard is the expansive interpretation the language of the *CCAA* is capable of supporting. The general language of the *CCAA* should not be read as being restricted by the availability of more specific orders. The requirements of appropriateness, good faith and due diligence are baseline considerations that a court should always bear in mind when exercising *CCAA* authority. The question is whether the order will usefully further efforts to avoid the social and economic losses resulting from liquidation of an insolvent company, which extends to both the purpose of the order and the means it employs. Here, the chambers judge's order staying

the Crown's GST claim was in furtherance of the *CCAA*'s objectives because it blunted the impulse of creditors to interfere in an orderly liquidation and fostered a harmonious transition from the *CCAA* to the *BIA*, meeting the objective of a single proceeding that is common to both statutes. The transition from the *CCAA* to the *BIA* may require the partial lifting of a stay of proceedings under the *CCAA* to allow commencement of *BIA* proceedings, but no gap exists between the two statutes because they operate in tandem and creditors in both cases look to the *BIA* scheme of distribution to foreshadow how they will fare if the reorganization is unsuccessful. The breadth of the court's discretion under the *CCAA* is sufficient to construct a bridge to liquidation under the *BIA*. Hence, the chambers judge's order was authorized.

No express trust was created by the chambers judge's order in this case because there is no certainty of object inferrable from his order. Creation of an express trust requires certainty of intention, subject matter and object. At the time the chambers judge accepted the proposal to segregate the monies in the Monitor's trust account there was no certainty that the Crown would be the beneficiary, or object, of the trust because exactly who might take the money in the final result was in doubt. In any event, no dispute over the money would even arise under the interpretation of s. 18.3(1) of the *CCAA* established above, because the Crown's deemed trust priority over GST claims would be lost under the *CCAA* and the Crown would rank as an unsecured creditor for this amount.

Per Fish J.: The GST monies collected by the debtor are not subject to a deemed trust or priority in favour of the Crown. In recent years, Parliament has given detailed consideration to the Canadian insolvency scheme but has declined to amend the provisions at issue in this case, a deliberate exercise of legislative discretion. On the other hand, in upholding deemed trusts created by the *ETA* notwithstanding insolvency proceedings, courts have been unduly protective of Crown interests which Parliament itself has chosen to subordinate to competing prioritized claims. In the context of the Canadian insolvency regime, deemed trusts exist only where there is a statutory provision *creating* the trust and a *CCAA* or *BIA* provision explicitly *confirming* its effective operation. The *Income Tax Act*, the *Canada Pension Plan Act* and the *Employment Insurance Act* all contain deemed trust provisions that are strikingly similar to that in s. 222 of the *ETA* but they are all also confirmed in s. 37 of the *CCAA* and in s. 67(3) of the *BIA* in clear and unmistakeable terms. The same is not true of the deemed trust created under the *ETA*. Although Parliament created a deemed trust in favour of the Crown to hold unremitted GST monies, and although it purports to maintain this trust notwithstanding any contrary federal or provincial legislation, it did not *confirm* the continued operation of the trust in either the *BIA* or the *CCAA*, reflecting Parliament's intention to allow the deemed trust to lapse with the commencement of insolvency proceedings.

Per Abella J (dissenting): Section 222(3) of the *ETA* gives priority during *CCAA* proceedings to the Crown's deemed trust in unremitted GST. This provision unequivocally defines its boundaries in the clearest possible terms and excludes only the *BIA* from its legislative grasp. The language used reflects a clear legislative intention that s. 222(3) would prevail if in conflict with any other law except the *BIA*. This is borne out by the fact that following the enactment of s. 222(3), amendments to the *CCAA* were introduced, and despite requests from various constituencies, s. 18.3(1) was not

amended to make the priorities in the *CCAA* consistent with those in the *BIA*. This indicates a deliberate legislative choice to protect the deemed trust in s. 222(3) from the reach of s. 18.3(1) of the *CCAA*.

The application of other principles of interpretation reinforces this conclusion. An earlier, specific provision may be overruled by a subsequent general statute if the legislature indicates, through its language, an intention that the general provision prevails. Section 222(3) achieves this through the use of language stating that it prevails despite any law of Canada, of a province, or "any other law" *other than the BIA*. Section 18.3(1) of the *CCAA* is thereby rendered inoperative for purposes of s. 222(3). By operation of s. 44(f) of the *Interpretation Act*, the transformation of s. 18(3) into s. 37(1) after the enactment of s. 222(3) of the *ETA* has no effect on the interpretive queue, and s. 222(3) of the *ETA* remains the "later in time" provision. This means that the deemed trust provision in s. 222(3) of the *ETA* takes precedence over s. 18.3(1) during *CCAA* proceedings. While s. 11 gives a court discretion to make orders notwithstanding the *BIA* and the *Winding-up Act,* that discretion is not liberated from the operation of any other federal statute. Any exercise of discretion is therefore circumscribed by whatever limits are imposed by statutes *other* than the *BIA* and the *Winding-up Act*. That includes the *ETA*. The chambers judge in this case was, therefore, required to respect the priority regime set out in s. 222(3) of the *ETA*. Neither s. 18.3(1) nor s. 11 of the *CCAA* gave him the authority to ignore it. He could not, as a result, deny the Crown's request for payment of the GST funds during the *CCAA* proceedings.

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By Deschamps J.

Overruled: *Ottawa Senators Hockey Club Corp. (Re)* (2005), 73 O.R. (3d) 737; **distinguished:** *Doré v. Verdun (City)*, [1997] 2 S.C.R. 862; **referred to**: *Reference re Companies' Creditors Arrangement Act*, [1934] S.C.R. 659; *Quebec (Revenue) v. Caisse populaire Desjardins de Montmagny*, 2009 SCC 49, [2009] 3 S.C.R. 286; *Deputy Minister of Revenue v. Rainville*, [1980] 1 S.C.R. 35; *Gauntlet Energy Corp., Re*, 2003 ABQB 894, 30 Alta. L.R. (4) 192; *Komunik Corp. (Arrangement relatif à)*, 2009 QCCS 6332 (CanLII), leave to appeal granted, 2010 QCCA 183 (CanLII); *Royal Bank of Canada v. Sparrow Electric Corp.*, [1997] 1 S.C.R. 411; *First Vancouver Finance v. M.N.R.*, 2002 SCC 49, [2002] 2 S.C.R. 720; *Solid Resources Ltd., Re* (2002), 40 C.B.R. (4) 219; *Metcalfe & Mansfield Alternative Investments II Corp. (Re)*, 2008 ONCA 587, 92 O.R. (3d) 513; *Dylex Ltd., Re* (1995), 31 C.B.R. (3d) 106; *Elan Corp. v. Comiskey* (1990), 41 O.A.C. 282; *Chef Ready Foods Ltd. v. Hongkong Bank of Can.* (1990), 51 B.C.L.R. (2d) 84; *Pacific National Lease Holding Corp, Re* (1992), 19 B.C.AC. 134; *Canadian Airlines Corp., Re*, 2000 ABQB 442, 84 Alta. L.R. (3d) 9; *Air Canada, Re* (2003), 42 C.B.R. (4) 173; *Air Canada, Re*, 2003 CanLII 49366; *Canadian Red Cross Society/Société Canadienne de la Croix Rouge, Re* (2000), 19 C.B.R. (4) 158; *Skydome Corp., Re* (1998), 16 C.B.R. (4) 118; *United Used Auto & Truck Parts Ltd., Re*, 2000 BCCA 146, 135 B.C.A.C. 96, aff'g (1999), 12 C.B.R. (4) 144; *Skeena Cellulose Inc., Re*, 2003 BCCA 344, 13 B.C.L.R. (4) 236; *Stelco Inc. (Re)* (2005), 75 O.R. (3d) 5; *Philip's*

Manufacturing Ltd., Re (1992), 9 C.B.R. (3d) 25; *Ivaco Inc. (Re)* (2006), 83 O.R. (3d) 108.

By Fish J.

Referred to: *Ottawa Senators Hockey Club Corp. (Re)* (2005), 73 O.R. (3d) 737.

By Abella J. (dissenting)

Ottawa Senators Hockey Club Corp. (Re) (2005), 73 O.R. (3d) 737; *Tele-Mobile Co. v. Ontario*, 2008 SCC 12, [2008] 1 S.C.R. 305; *Doré v. Verdun (City)*, [1997] 2 S.C.R. 862; *Attorney General of Canada v. Public Service Staff Relations Board*, [1977] 2 F.C. 663.

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History and Disposition:

APPEAL from a judgment of the British Columbia Court of Appeal (Newbury, Tysoe and Smith JJ.A.), 2009 BCCA 205, 98 B.C.L.R. (4) 242, 270 B.C.A.C. 167, 454 W.A.C. 167, [2009] 12 W.W.R. 684, [2009] G.S.T.C. 79, [2009] B.C.J. No. 918 (QL), 2009 CarswellBC 1195, reversing a judgment of Brenner C.J.S.C., 2008 BCSC 1805, [2008] G.S.T.C. 221, [2008] B.C.J. No. 2611 (QL), 2008 CarswellBC 2895, dismissing a Crown application for payment of GST monies. Appeal allowed, Abella J. dissenting.

Counsel:

Mary I.A. Buttery, *Owen J. James* and *Matthew J.G. Curtis*, for the appellant.

Gordon Bourgard, *David Jacyk* and *Michael J. Lema*, for the respondent.

The judgment of McLachlin C.J. and Binnie, LeBel, Deschamps, Charron, Rothstein and

Cromwell JJ. was delivered by

1 DESCHAMPS J.:-- For the first time this Court is called upon to directly interpret the provisions of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*"). In that respect, two questions are raised. The first requires reconciliation of provisions of the *CCAA* and the *Excise Tax Act*, R.S.C. 1985, c. E-15 ("*ETA*"), which lower courts have held to be in conflict with one another. The second concerns the scope of a court's discretion when supervising reorganization. The relevant statutory provisions are reproduced in the Appendix. On the first question, having considered the evolution of Crown priorities in the context of insolvency and the wording of the various statutes creating Crown priorities, I conclude that it is the *CCAA* and not the *ETA* that provides the rule. On the second question, I conclude that the broad discretionary jurisdiction conferred on the supervising judge must be interpreted having regard to the remedial nature of the *CCAA* and insolvency legislation generally. Consequently, the court had the discretion to partially lift a stay of proceedings to allow the debtor to make an assignment under the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("*BIA*"). I would allow the appeal.

1. Facts and Decisions of the Courts Below

2 Ted LeRoy Trucking Ltd. ("LeRoy Trucking") commenced proceedings under the *CCAA* in the Supreme Court of British Columbia on December 13, 2007, obtaining a stay of proceedings with a view to reorganizing its financial affairs. LeRoy Trucking sold certain redundant assets as authorized by the order.

3 Amongst the debts owed by LeRoy Trucking was an amount for Goods and Services Tax ("GST") collected but unremitted to the Crown. The *ETA* creates a deemed trust in favour of the Crown for amounts collected in respect of GST. The deemed trust extends to any property or proceeds held by the person collecting GST and any property of that person held by a secured creditor, requiring that property to be paid to the Crown in priority to all security interests. The *ETA* provides that the deemed trust operates despite any other enactment of Canada except the *BIA*. However, the *CCAA* also provides that subject to certain exceptions, none of which mentions GST, deemed trusts in favour of the Crown do not operate under the *CCAA*. Accordingly, under the *CCAA* the Crown ranks as an unsecured creditor in respect of GST. Nonetheless, at the time LeRoy Trucking commenced *CCAA* proceedings the leading line of jurisprudence held that the *ETA* took precedence over the *CCAA* such that the Crown enjoyed priority for GST claims under the *CCAA*, even though it would have lost that same priority under the *BIA*. The *CCAA* underwent substantial amendments in 2005 in which some of the provisions at issue in this appeal were renumbered and reformulated (S.C. 2005, c. 47). However, these amendments only came into force on September 18, 2009. I will refer to the amended provisions only where relevant.

4 On April 29, 2008, Brenner C.J.S.C., in the context of the *CCAA* proceedings, approved a payment not exceeding $5 million, the proceeds of redundant asset sales, to Century Services, the debtor's major secured creditor. LeRoy Trucking proposed to hold back an amount equal to the GST

monies collected but unremitted to the Crown and place it in the Monitor's trust account until the outcome of the reorganization was known. In order to maintain the *status quo* while the success of the reorganization was uncertain, Brenner C.J.S.C. agreed to the proposal and ordered that an amount of $305,202.30 be held by the Monitor in its trust account.

5 On September 3, 2008, having concluded that reorganization was not possible, LeRoy Trucking sought leave to make an assignment in bankruptcy under the *BIA*. The Crown sought an order that the GST monies held by the Monitor be paid to the Receiver General of Canada. Brenner C.J.S.C. dismissed the latter application. Reasoning that the purpose of segregating the funds with the Monitor was "to facilitate an ultimate payment of the GST monies which were owed pre-filing, but only if a viable plan emerged", the failure of such a reorganization, followed by an assignment in bankruptcy, meant the Crown would lose priority under the *BIA* (2008 BCSC 1805, [2008] G.S.T.C. 221).

6 The Crown's appeal was allowed by the British Columbia Court of Appeal (2009 BCCA 205, 270 B.C.A.C. 167). Tysoe J.A. for a unanimous court found two independent bases for allowing the Crown's appeal.

7 First, the court's authority under s. 11 of the *CCAA* was held not to extend to staying the Crown's application for immediate payment of the GST funds subject to the deemed trust after it was clear that reorganization efforts had failed and that bankruptcy was inevitable. As restructuring was no longer a possibility, staying the Crown's claim to the GST funds no longer served a purpose under the *CCAA* and the court was bound under the priority scheme provided by the *ETA* to allow payment to the Crown. In so holding, Tysoe J.A. adopted the reasoning in *Ottawa Senators Hockey Club Corp. (Re)* (2005), 73 O.R. (3d) 737 (C.A.), which found that the *ETA* deemed trust for GST established Crown priority over secured creditors under the *CCAA*.

8 Second, Tysoe J.A. concluded that by ordering the GST funds segregated in the Monitor's trust account on April 29, 2008, the judge had created an express trust in favour of the Crown from which the monies in question could not be diverted for any other purposes. The Court of Appeal therefore ordered that the money held by the Monitor in trust be paid to the Receiver General.

2. Issues

9 This appeal raises three broad issues which are addressed in turn:

(1) Did s. 222(3) of the *ETA* displace s. 18.3(1) of the *CCAA* and give priority to the Crown's *ETA* deemed trust during *CCAA* proceedings as held in *Ottawa Senators*?

(2) Did the court exceed its *CCAA* authority by lifting the stay to allow the debtor to make an assignment in bankruptcy?

(3) Did the court's order of April 29, 2008 requiring segregation of the Crown's GST claim in the Monitor's trust account create an express trust in favour of the

Crown in respect of those funds?

3. <u>Analysis</u>

10 The first issue concerns Crown priorities in the context of insolvency. As will be seen, the *ETA* provides for a deemed trust in favour of the Crown in respect of GST owed by a debtor "[d]espite ... any other enactment of Canada (except the *Bankruptcy and Insolvency Act*)" (s. 222(3)), while the *CCAA* stated at the relevant time that "notwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be [so] regarded" (s. 18.3(1)). It is difficult to imagine two statutory provisions more apparently in conflict. However, as is often the case, the apparent conflict can be resolved through interpretation.

11 In order to properly interpret the provisions, it is necessary to examine the history of the *CCAA*, its function amidst the body of insolvency legislation enacted by Parliament, and the principles that have been recognized in the jurisprudence. It will be seen that Crown priorities in the insolvency context have been significantly pared down. The resolution of the second issue is also rooted in the context of the *CCAA*, but its purpose and the manner in which it has been interpreted in the case law are also key. After examining the first two issues in this case, I will address Tysoe J.A.'s conclusion that an express trust in favour of the Crown was created by the court's order of April 29, 2008.

3.1 *Purpose and Scope of Insolvency Law*

12 Insolvency is the factual situation that arises when a debtor is unable to pay creditors (see generally, R. J. Wood, *Bankruptcy and Insolvency Law* (2009), at p. 16). Certain legal proceedings become available upon insolvency, which typically allow a debtor to obtain a court order staying its creditors' enforcement actions and attempt to obtain a binding compromise with creditors to adjust the payment conditions to something more realistic. Alternatively, the debtor's assets may be liquidated and debts paid from the proceeds according to statutory priority rules. The former is usually referred to as reorganization or restructuring while the latter is termed liquidation.

13 Canadian commercial insolvency law is not codified in one exhaustive statute. Instead, Parliament has enacted multiple insolvency statutes, the main one being the *BIA*. The *BIA* offers a self-contained legal regime providing for both reorganization and liquidation. Although bankruptcy legislation has a long history, the *BIA* itself is a fairly recent statute -- it was enacted in 1992. It is characterized by a rules-based approach to proceedings. The *BIA* is available to insolvent debtors owing $1000 or more, regardless of whether they are natural or legal persons. It contains mechanisms for debtors to make proposals to their creditors for the adjustment of debts. If a proposal fails, the *BIA* contains a bridge to bankruptcy whereby the debtor's assets are liquidated and the proceeds paid to creditors in accordance with the statutory scheme of distribution.

14 Access to the *CCAA* is more restrictive. A debtor must be a company with liabilities in excess of $5 million. Unlike the *BIA*, the *CCAA* contains no provisions for liquidation of a debtor's assets if reorganization fails. There are three ways of exiting *CCAA* proceedings. The best outcome is achieved when the stay of proceedings provides the debtor with some breathing space during which solvency is restored and the *CCAA* process terminates without reorganization being needed. The second most desirable outcome occurs when the debtor's compromise or arrangement is accepted by its creditors and the reorganized company emerges from the *CCAA* proceedings as a going concern. Lastly, if the compromise or arrangement fails, either the company or its creditors usually seek to have the debtor's assets liquidated under the applicable provisions of the *BIA* or to place the debtor into receivership. As discussed in greater detail below, the key difference between the reorganization regimes under the *BIA* and the *CCAA* is that the latter offers a more flexible mechanism with greater judicial discretion, making it more responsive to complex reorganizations.

15 As I will discuss at greater length below, the purpose of the *CCAA* -- Canada's first reorganization statute -- is to permit the debtor to continue to carry on business and, where possible, avoid the social and economic costs of liquidating its assets. Proposals to creditors under the *BIA* serve the same remedial purpose, though this is achieved through a rules-based mechanism that offers less flexibility. Where reorganization is impossible, the *BIA* may be employed to provide an orderly mechanism for the distribution of a debtor's assets to satisfy creditor claims according to predetermined priority rules.

16 Prior to the enactment of the *CCAA* in 1933 (S.C. 1932-33, c. 36), practice under existing commercial insolvency legislation tended heavily towards the liquidation of a debtor company (J. Sarra, *Creditor Rights and the Public Interest: Restructuring Insolvent Corporations* (2003), at p. 12). The battering visited upon Canadian businesses by the Great Depression and the absence of an effective mechanism for reaching a compromise between debtors and creditors to avoid liquidation required a legislative response. The *CCAA* was innovative as it allowed the insolvent debtor to attempt reorganization under judicial supervision outside the existing insolvency legislation which, once engaged, almost invariably resulted in liquidation (*Reference re Companies' Creditors Arrangement Act*, [1934] S.C.R. 659, at pp. 660-61; Sarra, *Creditor Rights*, at pp. 12-13).

17 Parliament understood when adopting the *CCAA* that liquidation of an insolvent company was harmful for most of those it affected -- notably creditors and employees -- and that a workout which allowed the company to survive was optimal (Sarra, *Creditor Rights*, at pp. 13-15).

18 Early commentary and jurisprudence also endorsed the *CCAA*'s remedial objectives. It recognized that companies retain more value as going concerns while underscoring that intangible losses, such as the evaporation of the companies' goodwill, result from liquidation (S. E. Edwards, "Reorganizations Under the Companies' Creditors Arrangement Act" (1947), 25 *Can. Bar Rev.* 587, at p. 592). Reorganization serves the public interest by facilitating the survival of companies supplying goods or services crucial to the health of the economy or saving large numbers of jobs (*ibid.*, at p. 593). Insolvency could be so widely felt as to impact stakeholders other than creditors

and employees. Variants of these views resonate today, with reorganization justified in terms of rehabilitating companies that are key elements in a complex web of interdependent economic relationships in order to avoid the negative consequences of liquidation.

19 The *CCAA* fell into disuse during the next several decades, likely because amendments to the Act in 1953 restricted its use to companies issuing bonds (S.C. 1952-53, c. 3). During the economic downturn of the early 1980s, insolvency lawyers and courts adapting to the resulting wave of insolvencies resurrected the statute and deployed it in response to new economic challenges. Participants in insolvency proceedings grew to recognize and appreciate the statute's distinguishing feature: a grant of broad and flexible authority to the supervising court to make the orders necessary to facilitate the reorganization of the debtor and achieve the *CCAA*'s objectives. The manner in which courts have used *CCAA* jurisdiction in increasingly creative and flexible ways is explored in greater detail below.

20 Efforts to evolve insolvency law were not restricted to the courts during this period. In 1970, a government-commissioned panel produced an extensive study recommending sweeping reform but Parliament failed to act (see *Bankruptcy and Insolvency: Report of the Study Committee on Bankruptcy and Insolvency Legislation* (1970)). Another panel of experts produced more limited recommendations in 1986 which eventually resulted in enactment of the *Bankruptcy and Insolvency Act* of 1992 (S.C. 1992, c. 27) (see *Proposed Bankruptcy Act Amendments: Report of the Advisory Committee on Bankruptcy and Insolvency* (1986)). Broader provisions for reorganizing insolvent debtors were then included in Canada's bankruptcy statute. Although the 1970 and 1986 reports made no specific recommendations with respect to the *CCAA*, the House of Commons committee studying the *BIA*'s predecessor bill, C-22, seemed to accept expert testimony that the *BIA*'s new reorganization scheme would shortly supplant the *CCAA*, which could then be repealed, with commercial insolvency and bankruptcy being governed by a single statute (*Minutes of Proceedings and Evidence of the Standing Committee on Consumer and Corporate Affairs and Government Operations*, Issue No. 15, October 3, 1991, at pp. 15:15-15:16).

21 In retrospect, this conclusion by the House of Commons committee was out of step with reality. It overlooked the renewed vitality the *CCAA* enjoyed in contemporary practice and the advantage that a flexible judicially supervised reorganization process presented in the face of increasingly complex reorganizations, when compared to the stricter rules-based scheme contained in the *BIA*. The "flexibility of the *CCAA* [was seen as] a great benefit, allowing for creative and effective decisions" (Industry Canada, Marketplace Framework Policy Branch, *Report on the Operation and Administration of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act* (2002), at p. 41). Over the past three decades, resurrection of the *CCAA* has thus been the mainspring of a process through which, one author concludes, "the legal setting for Canadian insolvency restructuring has evolved from a rather blunt instrument to one of the most sophisticated systems in the developed world" (R. B. Jones, "The Evolution of Canadian Restructuring: Challenges for the Rule of Law", in J. P. Sarra, ed., *Annual Review of Insolvency Law 2005* (2006), 481, at p. 481).

22 While insolvency proceedings may be governed by different statutory schemes, they share some commonalities. The most prominent of these is the single proceeding model. The nature and purpose of the single proceeding model are described by Professor Wood in *Bankruptcy and Insolvency Law*:

> They all provide a collective proceeding that supersedes the usual civil process available to creditors to enforce their claims. The creditors' remedies are collectivized in order to prevent the free-for-all that would otherwise prevail if creditors were permitted to exercise their remedies. In the absence of a collective process, each creditor is armed with the knowledge that if they do not strike hard and swift to seize the debtor's assets, they will be beat out by other creditors. [pp. 2-3]

The single proceeding model avoids the inefficiency and chaos that would attend insolvency if each creditor initiated proceedings to recover its debt. Grouping all possible actions against the debtor into a single proceeding controlled in a single forum facilitates negotiation with creditors because it places them all on an equal footing, rather than exposing them to the risk that a more aggressive creditor will realize its claims against the debtor's limited assets while the other creditors attempt a compromise. With a view to achieving that purpose, both the *CCAA* and the *BIA* allow a court to order all actions against a debtor to be stayed while a compromise is sought.

23 Another point of convergence of the *CCAA* and the *BIA* relates to priorities. Because the *CCAA* is silent about what happens if reorganization fails, the *BIA* scheme of liquidation and distribution necessarily supplies the backdrop for what will happen if a *CCAA* reorganization is ultimately unsuccessful. In addition, one of the important features of legislative reform of both statutes since the enactment of the *BIA* in 1992 has been a cutback in Crown priorities (S.C. 1992, c. 27, s. 39; S.C. 1997, c. 12, ss. 73 and 125; S.C. 2000, c. 30, s. 148; S.C. 2005, c. 47, ss. 69 and 131; S.C. 2009, c. 33, ss. 25 and 29; see also *Quebec (Revenue) v. Caisse populaire Desjardins de Montmagny*, 2009 SCC 49, [2009] 3 S.C.R. 286; *Deputy Minister of Revenue v. Rainville*, [1980] 1 S.C.R. 35; *Proposed Bankruptcy Act Amendments: Report of the Advisory Committee on Bankruptcy and Insolvency* (1986)).

24 With parallel *CCAA* and *BIA* restructuring schemes now an accepted feature of the insolvency law landscape, the contemporary thrust of legislative reform has been towards harmonizing aspects of insolvency law common to the two statutory schemes to the extent possible and encouraging reorganization over liquidation (see *An Act to establish the Wage Earner Protection Program Act, to amend the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act and to make consequential amendments to other Acts*, S.C. 2005, c. 47; *Gauntlet Energy Corp., Re*, 2003 ABQB 894, 30 Alta. L.R. (4th) 192, at para. 19).

25 Mindful of the historical background of the *CCAA* and *BIA*, I now turn to the first question at issue.

3.2 *GST Deemed Trust Under the CCAA*

26 The Court of Appeal proceeded on the basis that the *ETA* precluded the court from staying the Crown's enforcement of the GST deemed trust when partially lifting the stay to allow the debtor to enter bankruptcy. In so doing, it adopted the reasoning in a line of cases culminating in *Ottawa Senators*, which held that an *ETA* deemed trust remains enforceable during *CCAA* reorganization despite language in the *CCAA* that suggests otherwise.

27 The Crown relies heavily on the decision of the Ontario Court of Appeal in *Ottawa Senators* and argues that the later in time provision of the *ETA* creating the GST deemed trust trumps the provision of the *CCAA* purporting to nullify most statutory deemed trusts. The Court of Appeal in this case accepted this reasoning but not all provincial courts follow it (see, e.g., *Komunik Corp. (Arrangement relatif à)*, 2009 QCCS 6332 (CanLII), leave to appeal granted, 2010 QCCA 183 (CanLII)). Century Services relied, in its written submissions to this Court, on the argument that the court had authority under the *CCAA* to continue the stay against the Crown's claim for unremitted GST. In oral argument, the question of whether *Ottawa Senators* was correctly decided nonetheless arose. After the hearing, the parties were asked to make further written submissions on this point. As appears evident from the reasons of my colleague Abella J., this issue has become prominent before this Court. In those circumstances, this Court needs to determine the correctness of the reasoning in *Ottawa Senators*.

28 The policy backdrop to this question involves the Crown's priority as a creditor in insolvency situations which, as I mentioned above, has evolved considerably. Prior to the 1990s, Crown claims largely enjoyed priority in insolvency. This was widely seen as unsatisfactory as shown by both the 1970 and 1986 insolvency reform proposals, which recommended that Crown claims receive no preferential treatment. A closely related matter was whether the *CCAA* was binding at all upon the Crown. Amendments to the *CCAA* in 1997 confirmed that it did indeed bind the Crown (see *CCAA*, s. 21, as am. by S.C. 1997, c. 12, s. 126).

29 Claims of priority by the state in insolvency situations receive different treatment across jurisdictions worldwide. For example, in Germany and Australia, the state is given no priority at all, while the state enjoys wide priority in the United States and France (see B. K. Morgan, "Should the Sovereign be Paid First? A Comparative International Analysis of the Priority for Tax Claims in Bankruptcy" (2000), 74 *Am. Bank. L.J.* 461, at p. 500). Canada adopted a middle course through legislative reform of Crown priority initiated in 1992. The Crown retained priority for source deductions of income tax, Employment Insurance ("EI") and Canada Pension Plan ("CPP") premiums, but ranks as an ordinary unsecured creditor for most other claims.

30 Parliament has frequently enacted statutory mechanisms to secure Crown claims and permit their enforcement. The two most common are statutory deemed trusts and powers to garnish funds third parties owe the debtor (see F. L. Lamer, *Priority of Crown Claims in Insolvency* (loose-leaf), at s. 2).

31 With respect to GST collected, Parliament has enacted a deemed trust. The *ETA* states that every person who collects an amount on account of GST is deemed to hold that amount in trust for the Crown (s. 222(1)). The deemed trust extends to other property of the person collecting the tax equal in value to the amount deemed to be in trust if that amount has not been remitted in accordance with the *ETA*. The deemed trust also extends to property held by a secured creditor that, but for the security interest, would be property of the person collecting the tax (s. 222(3)).

32 Parliament has created similar deemed trusts using almost identical language in respect of source deductions of income tax, EI premiums and CPP premiums (see s. 227(4) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) ("*ITA*"), ss. 86(2) and (2.1) of the *Employment Insurance Act*, S.C. 1996, c. 23, and ss. 23(3) and (4) of the *Canada Pension Plan*, R.S.C. 1985, c. C-8). I will refer to income tax, EI and CPP deductions as "source deductions".

33 In *Royal Bank of Canada v. Sparrow Electric Corp.*, [1997] 1 S.C.R. 411, this Court addressed a priority dispute between a deemed trust for source deductions under the *ITA* and security interests taken under both the *Bank Act*, S.C. 1991, c. 46, and the Alberta *Personal Property Security Act*, S.A. 1988, c. P-4.05 ("*PPSA*"). As then worded, an *ITA* deemed trust over the debtor's property equivalent to the amount owing in respect of income tax became effective at the time of liquidation, receivership, or assignment in bankruptcy. *Sparrow Electric* held that the *ITA* deemed trust could not prevail over the security interests because, being fixed charges, the latter attached as soon as the debtor acquired rights in the property such that the *ITA* deemed trust had no property on which to attach when it subsequently arose. Later, in *First Vancouver Finance v. M.N.R.*, 2002 SCC 49, [2002] 2 S.C.R. 720, this Court observed that Parliament had legislated to strengthen the statutory deemed trust in the *ITA* by deeming it to operate from the moment the deductions were not paid to the Crown as required by the *ITA*, and by granting the Crown priority over all security interests (paras. 27-29) (the "*Sparrow Electric* amendment").

34 The amended text of s. 227(4.1) of the *ITA* and concordant source deductions deemed trusts in the *Canada Pension Plan* and the *Employment Insurance Act* state that the deemed trust operates notwithstanding any other enactment of Canada, except ss. 81.1 and 81.2 of the *BIA*. The *ETA* deemed trust at issue in this case is similarly worded, but it excepts the *BIA* in its entirety. The provision reads as follows:

> **222....**
>
> ...
>
> (3) Despite any other provision of this Act (except subsection (4)), any other enactment of Canada (except the *Bankruptcy and Insolvency Act*), any enactment of a province or any other law, if at any time an amount deemed by subsection (1) to be held by a person in trust for Her Majesty is not remitted to the Receiver General or withdrawn in the manner and at the time provided under this Part, property of the person and property held by any secured creditor of the

> person that, but for a security interest, would be property of the person, equal in value to the amount so deemed to be held in trust, is deemed .... .

35 The Crown submits that the *Sparrow Electric* amendment, added by Parliament to the *ETA* in 2000, was intended to preserve the Crown's priority over collected GST under the *CCAA* while subordinating the Crown to the status of an unsecured creditor in respect of GST only under the *BIA*. This is because the *ETA* provides that the GST deemed trust is effective "despite" any other enactment except the *BIA*.

36 The language used in the *ETA* for the GST deemed trust creates an apparent conflict with the *CCAA*, which provides that subject to certain exceptions, property deemed by statute to be held in trust for the Crown shall not be so regarded.

37 Through a 1997 amendment to the *CCAA* (S.C. 1997, c. 12, s. 125), Parliament appears to have, subject to specific exceptions, nullified deemed trusts in favour of the Crown once reorganization proceedings are commenced under the Act. The relevant provision reads:

> **18.3** (1) Subject to subsection (2), notwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.

This nullification of deemed trusts was continued in further amendments to the *CCAA* (S.C. 2005, c. 47), where s. 18.3(1) was renumbered and reformulated as s. 37(1):

> **37.** (1) Subject to subsection (2), despite any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as being held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.

38 An analogous provision exists in the *BIA*, which, subject to the same specific exceptions, nullifies statutory deemed trusts and makes property of the bankrupt that would otherwise be subject to a deemed trust part of the debtor's estate and available to creditors (S.C. 1992, c. 27, s. 39; S.C. 1997, c. 12, s. 73; *BIA*, s. 67(2)). It is noteworthy that in both the *CCAA* and the *BIA*, the exceptions concern source deductions (*CCAA*, s. 18.3(2); *BIA*, s. 67(3)). The relevant provision of the *CCAA* reads:

> **18.3** ...
>
> (2) Subsection (1) does not apply in respect of amounts deemed to be held

> in trust under subsection 227(4) or (4.1) of the *Income Tax Act*, subsection 23(3) or (4) of the *Canada Pension Plan* or subsection 86(2) or (2.1) of the *Employment Insurance Act*... .

Thus, the Crown's deemed trust and corresponding priority in source deductions remain effective both in reorganization and in bankruptcy.

39 Meanwhile, in both s. 18.4(1) of the *CCAA* and s. 86(1) of the *BIA*, other Crown claims are treated as unsecured. These provisions, establishing the Crown's status as an unsecured creditor, explicitly exempt statutory deemed trusts in source deductions (*CCAA*, s. 18.4(3); *BIA*, s. 86(3)). The *CCAA* provision reads as follows:

> **18.4** ...
>
> ...
>
> (3) Subsection (1) [Crown ranking as unsecured creditor] does not affect the operation of
>
> (*a*) subsections 224(1.2) and (1.3) of the *Income Tax Act*,
>
> (*b*) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution ... .

Therefore, not only does the *CCAA* provide that Crown claims do not enjoy priority over the claims of other creditors (s. 18.3(1)), but the exceptions to this rule (i.e., that Crown priority is maintained for source deductions) are repeatedly stated in the statute.

40 The apparent conflict in this case is whether the rule in the *CCAA* first enacted as s. 18.3 in 1997, which provides that subject to certain explicit exceptions, statutory deemed trusts are ineffective under the *CCAA*, is overridden by the one in the *ETA* enacted in 2000 stating that GST deemed trusts operate despite any enactment of Canada except the *BIA*. With respect for my colleague Fish J., I do not think the apparent conflict can be resolved by denying it and creating a rule requiring both a statutory provision enacting the deemed trust, and a second statutory provision confirming it. Such a rule is unknown to the law. Courts must recognize conflicts, apparent or real, and resolve them when possible.

41 A line of jurisprudence across Canada has resolved the apparent conflict in favour of the *ETA*, thereby maintaining GST deemed trusts under the *CCAA*. *Ottawa Senators*, the leading case, decided the matter by invoking the doctrine of implied repeal to hold that the later in time provision

of the *ETA* should take precedence over the *CCAA* (see also *Solid Resources Ltd., Re* (2002), 40 C.B.R. (4th) 219 (Alta. Q.B.); *Gauntlet*).

42 The Ontario Court of Appeal in *Ottawa Senator* s rested its conclusion on two considerations. First, it was persuaded that by explicitly mentioning the *BIA* in *ETA* s. 222(3), but not the *CCAA*, Parliament made a deliberate choice. In the words of MacPherson J.A.:

> The *BIA* and the *CCAA* are closely related federal statutes. I cannot conceive that Parliament would specifically identify the *BIA* as an exception, but accidentally fail to consider the *CCAA* as a possible second exception. In my view, the omission of the *CCAA* from s. 222(3) of the *ETA* was almost certainly a considered omission. [para. 43]

43 Second, the Ontario Court of Appeal compared the conflict between the *ETA* and the *CCAA* to that before this Court in *Doré v. Verdun (City)*, [1997] 2 S.C.R. 862, and found them to be "identical" (para. 46). It therefore considered *Doré* binding (para. 49). In *Doré*, a limitations provision in the more general and recently enacted *Civil Code of Québec*, S.Q. 1991, c. 64 ("*C.C.Q.*"), was held to have repealed a more specific provision of the earlier Quebec *Cities and Towns Act*, R.S.Q., c. C-19, with which it conflicted. By analogy, the Ontario Court of Appeal held that the later in time and more general provision, s. 222(3) of the *ETA*, impliedly repealed the more specific and earlier in time provision, s. 18.3(1) of the *CCAA* (paras. 47-49).

44 Viewing this issue in its entire context, several considerations lead me to conclude that neither the reasoning nor the result in *Ottawa Senators* can stand. While a conflict may exist at the level of the statutes' wording, a purposive and contextual analysis to determine Parliament's true intent yields the conclusion that Parliament could not have intended to restore the Crown's deemed trust priority in GST claims under the *CCAA* when it amended the *ETA* in 2000 with the *Sparrow Electric* amendment.

45 I begin by recalling that Parliament has shown its willingness to move away from asserting priority for Crown claims in insolvency law. Section 18.3(1) of the *CCAA* (subject to the s. 18.3(2) exceptions) provides that the Crown's deemed trusts have no effect under the *CCAA*. Where Parliament has sought to protect certain Crown claims through statutory deemed trusts and intended that these deemed trusts continue in insolvency, it has legislated so explicitly and elaborately. For example, s. 18.3(2) of the *CCAA* and s. 67(3) of the *BIA* expressly provide that deemed trusts for source deductions remain effective in insolvency. Parliament has, therefore, clearly carved out exceptions from the general rule that deemed trusts are ineffective in insolvency. The *CCAA* and *BIA* are in harmony, preserving deemed trusts and asserting Crown priority only in respect of source deductions. Meanwhile, there is no express statutory basis for concluding that GST claims enjoy a preferred treatment under the *CCAA* or the *BIA*. Unlike source deductions, which are clearly and expressly dealt with under both these insolvency statutes, no such clear and express language exists in those Acts carving out an exception for GST claims.

46 The internal logic of the *CCAA* also militates against upholding the *ETA* deemed trust for GST. The *CCAA* imposes limits on a suspension by the court of the Crown's rights in respect of source deductions but does not mention the *ETA* (s. 11.4). Since source deductions deemed trusts are granted explicit protection under the *CCAA*, it would be inconsistent to afford a better protection to the *ETA* deemed trust absent explicit language in the *CCAA*. Thus, the logic of the *CCAA* appears to subject the *ETA* deemed trust to the waiver by Parliament of its priority (s. 18.4).

47 Moreover, a strange asymmetry would arise if the interpretation giving the *ETA* priority over the *CCAA* urged by the Crown is adopted here: the Crown would retain priority over GST claims during *CCAA* proceedings but not in bankruptcy. As courts have reflected, this can only encourage statute shopping by secured creditors in cases such as this one where the debtor's assets cannot satisfy both the secured creditors' and the Crown's claims (*Gauntlet*, at para. 21). If creditors' claims were better protected by liquidation under the *BIA*, creditors' incentives would lie overwhelmingly with avoiding proceedings under the *CCAA* and not risking a failed reorganization. Giving a key player in any insolvency such skewed incentives against reorganizing under the *CCAA* can only undermine that statute's remedial objectives and risk inviting the very social ills that it was enacted to avert.

48 Arguably, the effect of *Ottawa Senators* is mitigated if restructuring is attempted under the *BIA* instead of the *CCAA*, but it is not cured. If *Ottawa Senators* were to be followed, Crown priority over GST would differ depending on whether restructuring took place under the *CCAA* or the *BIA*. The anomaly of this result is made manifest by the fact that it would deprive companies of the option to restructure under the more flexible and responsive *CCAA* regime, which has been the statute of choice for complex reorganizations.

49 Evidence that Parliament intended different treatments for GST claims in reorganization and bankruptcy is scant, if it exists at all. Section 222(3) of the *ETA* was enacted as part of a wide-ranging budget implementation bill in 2000. The summary accompanying that bill does not indicate that Parliament intended to elevate Crown priority over GST claims under the *CCAA* to the same or a higher level than source deductions claims. Indeed, the summary for deemed trusts states only that amendments to existing provisions are aimed at "ensuring that employment insurance premiums and Canada Pension Plan contributions that are required to be remitted by an employer are fully recoverable by the Crown in the case of the bankruptcy of the employer" (Summary to S.C. 2000, c. 30, at p. 4a). The wording of GST deemed trusts resembles that of statutory deemed trusts for source deductions and incorporates the same overriding language and reference to the *BIA*. However, as noted above, Parliament's express intent is that only source deductions deemed trusts remain operative. An exception for the *BIA* in the statutory language establishing the source deductions deemed trusts accomplishes very little, because the explicit language of the *BIA* itself (and the *CCAA*) carves out these source deductions deemed trusts and maintains their effect. It is however noteworthy that no equivalent language maintaining GST deemed trusts exists under either the *BIA* or the *CCAA*.

50 It seems more likely that by adopting the same language for creating GST deemed trusts in the *ETA* as it did for deemed trusts for source deductions, and by overlooking the inclusion of an exception for the *CCAA* alongside the *BIA* in s. 222(3) of the *ETA*, Parliament may have inadvertently succumbed to a drafting anomaly. Because of a statutory lacuna in the *ETA*, the GST deemed trust could be seen as remaining effective in the *CCAA*, while ceasing to have any effect under the *BIA*, thus creating an apparent conflict with the wording of the *CCAA*. However, it should be seen for what it is: a facial conflict only, capable of resolution by looking at the broader approach taken to Crown priorities and by giving precedence to the statutory language of s. 18.3 of the *CCAA* in a manner that does not produce an anomalous outcome.

51 Section 222(3) of the *ETA* evinces no explicit intention of Parliament to repeal *CCAA* s. 18.3. It merely creates an apparent conflict that must be resolved by statutory interpretation. Parliament's intent when it enacted *ETA* s. 222(3) was therefore far from unambiguous. Had it sought to give the Crown a priority for GST claims, it could have done so explicitly as it did for source deductions. Instead, one is left to infer from the language of *ETA* s. 222(3) that the GST deemed trust was intended to be effective under the *CCAA*.

52 I am not persuaded that the reasoning in *Doré* requires the application of the doctrine of implied repeal in the circumstances of this case. The main issue in *Doré* concerned the impact of the adoption of the *C.C.Q.* on the administrative law rules with respect to municipalities. While Gonthier J. concluded in that case that the limitation provision in art. 2930 *C.C.Q.* had repealed by implication a limitation provision in the *Cities and Towns Act*, he did so on the basis of more than a textual analysis. The conclusion in *Doré* was reached after thorough contextual analysis of both pieces of legislation, including an extensive review of the relevant legislative history (paras. 31-41). Consequently, the circumstances before this Court in *Doré* are far from "identical" to those in the present case, in terms of text, context and legislative history. Accordingly, *Doré* cannot be said to require the automatic application of the rule of repeal by implication.

53 A noteworthy indicator of Parliament's overall intent is the fact that in subsequent amendments it has not displaced the rule set out in the *CCAA*. Indeed, as indicated above, the recent amendments to the *CCAA* in 2005 resulted in the rule previously found in s. 18.3 being renumbered and reformulated as s. 37. Thus, to the extent the interpretation allowing the GST deemed trust to remain effective under the *CCAA* depends on *ETA* s. 222(3) having impliedly repealed *CCAA* s. 18.3(1) because it is later in time, we have come full circle. Parliament has renumbered and reformulated the provision of the *CCAA* stating that, subject to exceptions for source deductions, deemed trusts do not survive the *CCAA* proceedings and thus the *CCAA* is now the later in time statute. This confirms that Parliament's intent with respect to GST deemed trusts is to be found in the *CCAA*.

54 I do not agree with my colleague Abella J. that s. 44(*f*) of the *Interpretation Act*, R.S.C. 1985, c. I-21, can be used to interpret the 2005 amendments as having no effect. The new statute can hardly be said to be a mere re-enactment of the former statute. Indeed, the *CCAA* underwent a

substantial review in 2005. Notably, acting consistently with its goal of treating both the *BIA* and the *CCAA* as sharing the same approach to insolvency, Parliament made parallel amendments to both statutes with respect to corporate proposals. In addition, new provisions were introduced regarding the treatment of contracts, collective agreements, interim financing and governance agreements. The appointment and role of the Monitor was also clarified. Noteworthy are the limits imposed by *CCAA* s. 11.09 on the court's discretion to make an order staying the Crown's source deductions deemed trusts, which were formerly found in s. 11.4. No mention whatsoever is made of GST deemed trusts (see Summary to S.C. 2005, c. 47). The review went as far as looking at the very expression used to describe the statutory override of deemed trusts. The comments cited by my colleague only emphasize the clear intent of Parliament to maintain its policy that only source deductions deemed trusts survive in *CCAA* proceedings.

55 In the case at bar, the legislative context informs the determination of Parliament's legislative intent and supports the conclusion that *ETA* s. 222(3) was not intended to narrow the scope of the *CCAA*'s override provision. Viewed in its entire context, the conflict between the *ETA* and the *CCAA* is more apparent than real. I would therefore not follow the reasoning in *Ottawa Senators* and affirm that *CCAA* s. 18.3 remained effective.

56 My conclusion is reinforced by the purpose of the *CCAA* as part of Canadian remedial insolvency legislation. As this aspect is particularly relevant to the second issue, I will now discuss how courts have interpreted the scope of their discretionary powers in supervising a *CCAA* reorganization and how Parliament has largely endorsed this interpretation. Indeed, the interpretation courts have given to the *CCAA* helps in understanding how the *CCAA* grew to occupy such a prominent role in Canadian insolvency law.

3.3 *Discretionary Power of a Court Supervising a CCAA Reorganization*

57 Courts frequently observe that "[t]he *CCAA* is skeletal in nature" and does not "contain a comprehensive code that lays out all that is permitted or barred" (*Metcalfe & Mansfield Alternative Investments II Corp. (Re)*, 2008 ONCA 587, 92 O.R. (3d) 513, at para. 44, *per* Blair J.A.). Accordingly, "[t]he history of CCAA law has been an evolution of judicial interpretation" (*Dylex Ltd., Re* (1995), 31 C.B.R. (3d) 106 (Ont. Ct. (Gen. Div.)), at para. 10, *per* Farley J.).

58 *CCAA* decisions are often based on discretionary grants of jurisdiction. The incremental exercise of judicial discretion in commercial courts under conditions one practitioner aptly describes as "the hothouse of real-time litigation" has been the primary method by which the *CCAA* has been adapted and has evolved to meet contemporary business and social needs (see Jones, at p. 484).

59 Judicial discretion must of course be exercised in furtherance of the *CCAA*'s purposes. The remedial purpose I referred to in the historical overview of the Act is recognized over and over again in the jurisprudence. To cite one early example:

> The legislation is remedial in the purest sense in that it provides a means whereby the devastating social and economic effects of bankruptcy or creditor initiated termination of ongoing business operations can be avoided while a court-supervised attempt to reorganize the financial affairs of the debtor company is made.
>
> (*Elan Corp. v. Comiskey* (1990), 41 O.A.C. 282 , at para. 57, *per* Doherty J.A., dissenting)

60 Judicial decision making under the *CCAA* takes many forms. A court must first of all provide the conditions under which the debtor can attempt to reorganize. This can be achieved by staying enforcement actions by creditors to allow the debtor's business to continue, preserving the *status quo* while the debtor plans the compromise or arrangement to be presented to creditors, and supervising the process and advancing it to the point where it can be determined whether it will succeed (see, e.g., *Chef Ready Foods Ltd. v. Hongkong Bank of Can.* (1990), 51 B.C.L.R. (2d) 84 (C.A.), at pp. 88-89; *Pacific National Lease Holding Corp., Re* (1992), 19 B.C.A.C. 134, at para. 27). In doing so, the court must often be cognizant of the various interests at stake in the reorganization, which can extend beyond those of the debtor and creditors to include employees, directors, shareholders, and even other parties doing business with the insolvent company (see, e.g., *Canadian Airlines Corp., Re*, 2000 ABQB 442, 84 Alta. L.R. (3d) 9, at para. 144, *per* Paperny J. (as she then was); *Air Canada, Re* (2003), 42 C.B.R. (4th) 173 (Ont. S.C.J.), at para. 3; *Air Canada, Re*, 2003 CanLII 49366 (Ont. S.C.J.), at para. 13, *per* Farley J.; Sarra, *Creditor Rights*, at pp. 181-92 and 217-26). In addition, courts must recognize that on occasion the broader public interest will be engaged by aspects of the reorganization and may be a factor against which the decision of whether to allow a particular action will be weighed (see, e.g., *Canadian Red Cross Society/Société Canadienne de la Croix Rouge, Re* (2000), 19 C.B.R. (4th) 158 (Ont. S.C.J.), at para. 2, *per* Blair J. (as he then was); Sarra, *Creditor Rights*, at pp. 195-214).

61 When large companies encounter difficulty, reorganizations become increasingly complex. *CCAA* courts have been called upon to innovate accordingly in exercising their jurisdiction beyond merely staying proceedings against the debtor to allow breathing room for reorganization. They have been asked to sanction measures for which there is no explicit authority in the *CCAA*. Without exhaustively cataloguing the various measures taken under the authority of the *CCAA*, it is useful to refer briefly to a few examples to illustrate the flexibility the statute affords supervising courts.

62 Perhaps the most creative use of *CCAA* authority has been the increasing willingness of courts to authorize post-filing security for debtor in possession financing or super-priority charges on the debtor's assets when necessary for the continuation of the debtor's business during the reorganization (see, e.g., *Skydome Corp., Re* (1998), 16 C.B.R. (4th) 118 (Ont. Ct. (Gen. Div.)); *United Used Auto & Truck Parts Ltd., Re*, 2000 BCCA 146, 135 B.C.A.C. 96, aff'g (1999), 12 C.B.R. (4th) 144 (S.C.); and generally, J. P. Sarra, *Rescue! The Companies' Creditors Arrangement Act* (2007), at pp. 93-115). The *CCAA* has also been used to release claims against third parties as

part of approving a comprehensive plan of arrangement and compromise, even over the objections of some dissenting creditors (see *Metcalfe & Mansfield*). As well, the appointment of a Monitor to oversee the reorganization was originally a measure taken pursuant to the *CCAA*'s supervisory authority; Parliament responded, making the mechanism mandatory by legislative amendment.

63 Judicial innovation during *CCAA* proceedings has not been without controversy. At least two questions it raises are directly relevant to the case at bar: (1) what are the sources of a court's authority during *CCAA* proceedings? (2) what are the limits of this authority?

64 The first question concerns the boundary between a court's statutory authority under the *CCAA* and a court's residual authority under its inherent and equitable jurisdiction when supervising a reorganization. In authorizing measures during *CCAA* proceedings, courts have on occasion purported to rely upon their equitable jurisdiction to advance the purposes of the Act or their inherent jurisdiction to fill gaps in the statute. Recent appellate decisions have counselled against purporting to rely on inherent jurisdiction, holding that the better view is that courts are in most cases simply construing the authority supplied by the *CCAA* itself (see, e.g., *Skeena Cellulose Inc., Re*, 2003 BCCA 344, 13 B.C.L.R. (4th) 236, at paras. 45-47, *per* Newbury J.A.; *Stelco Inc. (Re)* (2005), 75 O.R. (3d) 5 (C.A.), paras. 31-33, *per* Blair J.A.).

65 I agree with Justice Georgina R. Jackson and Professor Janis Sarra that the most appropriate approach is a hierarchical one in which courts rely first on an interpretation of the provisions of the *CCAA* text before turning to inherent or equitable jurisdiction to anchor measures taken in a *CCAA* proceeding (see G. R. Jackson and J. Sarra, "Selecting the Judicial Tool to get the Job Done: An Examination of Statutory Interpretation, Discretionary Power and Inherent Jurisdiction in Insolvency Matters", in J. P. Sarra, ed., *Annual Review of Insolvency Law 2007* (2008), 41, at p. 42). The authors conclude that when given an appropriately purposive and liberal interpretation, the *CCAA* will be sufficient in most instances to ground measures necessary to achieve its objectives (p. 94).

66 Having examined the pertinent parts of the *CCAA* and the recent history of the legislation, I accept that in most instances the issuance of an order during *CCAA* proceedings should be considered an exercise in statutory interpretation. Particularly noteworthy in this regard is the expansive interpretation the language of the statute at issue is capable of supporting.

67 The initial grant of authority under the *CCAA* empowered a court "where an application is made under this Act in respect of a company ... on the application of any person interested in the matter ..., subject to this Act, [to] make an order under this section" (*CCAA*, s. 11(1)). The plain language of the statute was very broad.

68 In this regard, though not strictly applicable to the case at bar, I note that Parliament has in recent amendments changed the wording contained in s. 11(1), making explicit the discretionary authority of the court under the *CCAA*. Thus in s. 11 of the *CCAA* as currently enacted, a court may, "subject to the restrictions set out in this Act, ... make any order that it considers appropriate in the

circumstances" (S.C. 2005, c. 47, s. 128). Parliament appears to have endorsed the broad reading of *CCAA* authority developed by the jurisprudence.

69 The *CCAA* also explicitly provides for certain orders. Both an order made on an initial application and an order on subsequent applications may stay, restrain, or prohibit existing or new proceedings against the debtor. The burden is on the applicant to satisfy the court that the order is appropriate in the circumstances and that the applicant has been acting in good faith and with due diligence (*CCAA*, ss. 11(3), (4) and (6)).

70 The general language of the *CCAA* should not be read as being restricted by the availability of more specific orders. However, the requirements of appropriateness, good faith, and due diligence are baseline considerations that a court should always bear in mind when exercising *CCAA* authority. Appropriateness under the *CCAA* is assessed by inquiring whether the order sought advances the policy objectives underlying the *CCAA*. The question is whether the order will usefully further efforts to achieve the remedial purpose of the *CCAA* -- avoiding the social and economic losses resulting from liquidation of an insolvent company. I would add that appropriateness extends not only to the purpose of the order, but also to the means it employs. Courts should be mindful that chances for successful reorganizations are enhanced where participants achieve common ground and all stakeholders are treated as advantageously and fairly as the circumstances permit.

71 It is well-established that efforts to reorganize under the *CCAA* can be terminated and the stay of proceedings against the debtor lifted if the reorganization is "doomed to failure" (see *Chef Ready*, at p. 88; *Philip's Manufacturing Ltd., Re* (1992), 9 C.B.R. (3d) 25 (B.C.C.A.), at paras. 6-7). However, when an order is sought that does realistically advance the *CCAA*'s purposes, the ability to make it is within the discretion of a *CCAA* court.

72 The preceding discussion assists in determining whether the court had authority under the *CCAA* to continue the stay of proceedings against the Crown once it was apparent that reorganization would fail and bankruptcy was the inevitable next step.

73 In the Court of Appeal, Tysoe J.A. held that no authority existed under the *CCAA* to continue staying the Crown's enforcement of the GST deemed trust once efforts at reorganization had come to an end. The appellant submits that in so holding, Tysoe J.A. failed to consider the underlying purpose of the *CCAA* and give the statute an appropriately purposive and liberal interpretation under which the order was permissible. The Crown submits that Tysoe J.A. correctly held that the mandatory language of the *ETA* gave the court no option but to permit enforcement of the GST deemed trust when lifting the *CCAA* stay to permit the debtor to make an assignment under the *BIA*. Whether the *ETA* has a mandatory effect in the context of a *CCAA* proceeding has already been discussed. I will now address the question of whether the order was authorized by the *CCAA*.

74 It is beyond dispute that the *CCAA* imposes no explicit temporal limitations upon proceedings commenced under the Act that would prohibit ordering a continuation of the stay of the Crown's

GST claims while lifting the general stay of proceedings temporarily to allow the debtor to make an assignment in bankruptcy.

75 The question remains whether the order advanced the underlying purpose of the *CCAA*. The Court of Appeal held that it did not because the reorganization efforts had come to an end and the *CCAA* was accordingly spent. I disagree.

76 There is no doubt that had reorganization been commenced under the *BIA* instead of the *CCAA*, the Crown's deemed trust priority for the GST funds would have been lost. Similarly, the Crown does not dispute that under the scheme of distribution in bankruptcy under the *BIA*, the deemed trust for GST ceases to have effect. Thus, after reorganization under the *CCAA* failed, creditors would have had a strong incentive to seek immediate bankruptcy and distribution of the debtor's assets under the *BIA*. In order to conclude that the discretion does not extend to partially lifting the stay in order to allow for an assignment in bankruptcy, one would have to assume a gap between the *CCAA* and the *BIA* proceedings. Brenner C.J.S.C.'s order staying Crown enforcement of the GST claim ensured that creditors would not be disadvantaged by the attempted reorganization under the *CCAA*. The effect of his order was to blunt any impulse of creditors to interfere in an orderly liquidation. His order was thus in furtherance of the *CCAA*'s objectives to the extent that it allowed a bridge between the *CCAA* and *BIA* proceedings. This interpretation of the tribunal's discretionary power is buttressed by s. 20 of the *CCAA*. That section provides that the *CCAA* "may be applied together with the provisions of any Act of Parliament ... that authorizes or makes provision for the sanction of compromises or arrangements between a company and its shareholders or any class of them", such as the *BIA*. Section 20 clearly indicates the intention of Parliament for the *CCAA* to operate *in tandem* with other insolvency legislation, such as the *BIA*.

77 The *CCAA* creates conditions for preserving the *status quo* while attempts are made to find common ground amongst stakeholders for a reorganization that is fair to all. Because the alternative to reorganization is often bankruptcy, participants will measure the impact of a reorganization against the position they would enjoy in liquidation. In the case at bar, the order fostered a harmonious transition between reorganization and liquidation while meeting the objective of a single collective proceeding that is common to both statutes.

78 Tysoe J.A. therefore erred in my view by treating the *CCAA* and the *BIA* as distinct regimes subject to a temporal gap between the two, rather than as forming part of an integrated body of insolvency law. Parliament's decision to maintain two statutory schemes for reorganization, the *BIA* and the *CCAA*, reflects the reality that reorganizations of differing complexity require different legal mechanisms. By contrast, only one statutory scheme has been found to be needed to liquidate a bankrupt debtor's estate. The transition from the *CCAA* to the *BIA* may require the partial lifting of a stay of proceedings under the *CCAA* to allow commencement of the *BIA* proceedings. However, as Laskin J.A. for the Ontario Court of Appeal noted in a similar competition between secured creditors and the Ontario Superintendent of Financial Services seeking to enforce a deemed trust, "[t]he two statutes are related" and no "gap" exists between the two statutes which would allow the

enforcement of property interests at the conclusion of *CCAA* proceedings that would be lost in bankruptcy (*Ivaco Inc. (Re)* (2006), 83 O.R. (3d) 108, at paras. 62-63).

79 The Crown's priority in claims pursuant to source deductions deemed trusts does not undermine this conclusion. Source deductions deemed trusts survive under both the *CCAA* and the *BIA*. Accordingly, creditors' incentives to prefer one Act over another will not be affected. While a court has a broad discretion to stay source deductions deemed trusts in the *CCAA* context, this discretion is nevertheless subject to specific limitations applicable only to source deductions deemed trusts (*CCAA*, s. 11.4). Thus, if *CCAA* reorganization fails (e.g., either the creditors or the court refuse a proposed reorganization), the Crown can immediately assert its claim in unremitted source deductions. But this should not be understood to affect a seamless transition into bankruptcy or create any "gap" between the *CCAA* and the *BIA* for the simple reason that, regardless of what statute the reorganization had been commenced under, creditors' claims in both instances would have been subject to the priority of the Crown's source deductions deemed trust.

80 Source deductions deemed trusts aside, the comprehensive and exhaustive mechanism under the *BIA* must control the distribution of the debtor's assets once liquidation is inevitable. Indeed, an orderly transition to liquidation is mandatory under the *BIA* where a proposal is rejected by creditors. The *CCAA* is silent on the transition into liquidation but the breadth of the court's discretion under the Act is sufficient to construct a bridge to liquidation under the *BIA*. The court must do so in a manner that does not subvert the scheme of distribution under the *BIA*. Transition to liquidation requires partially lifting the *CCAA* stay to commence proceedings under the *BIA*. This necessary partial lifting of the stay should not trigger a race to the courthouse in an effort to obtain priority unavailable under the *BIA*.

81 I therefore conclude that Brenner C.J.S.C. had the authority under the *CCAA* to lift the stay to allow entry into liquidation.

3.4 *Express Trust*

82 The last issue in this case is whether Brenner C.J.S.C. created an express trust in favour of the Crown when he ordered on April 29, 2008, that proceeds from the sale of LeRoy Trucking's assets equal to the amount of unremitted GST be held back in the Monitor's trust account until the results of the reorganization were known. Tysoe J.A. in the Court of Appeal concluded as an alternative ground for allowing the Crown's appeal that it was the beneficiary of an express trust. I disagree.

83 Creation of an express trust requires the presence of three certainties: intention, subject matter, and object. Express or "true trusts" arise from the acts and intentions of the settlor and are distinguishable from other trusts arising by operation of law (see D. W. M. Waters, M. R. Gillen and L. D. Smith, eds., *Waters' Law of Trusts in Canada* (3rd ed. 2005), at pp. 28-29 especially fn. 42).

84 Here, there is no certainty to the object (i.e. the beneficiary) inferrable from the court's order

of April 29, 2008, sufficient to support an express trust.

85 At the time of the order, there was a dispute between Century Services and the Crown over part of the proceeds from the sale of the debtor's assets. The court's solution was to accept LeRoy Trucking's proposal to segregate those monies until that dispute could be resolved. Thus there was no certainty that the Crown would actually be the beneficiary, or object, of the trust.

86 The fact that the location chosen to segregate those monies was the Monitor's trust account has no independent effect such that it would overcome the lack of a clear beneficiary. In any event, under the interpretation of *CCAA* s. 18.3(1) established above, no such priority dispute would even arise because the Crown's deemed trust priority over GST claims would be lost under the *CCAA* and the Crown would rank as an unsecured creditor for this amount. However, Brenner C.J.S.C. may well have been proceeding on the basis that, in accordance with *Ottawa Senators*, the Crown's GST claim would remain effective if reorganization was successful, which would not be the case if transition to the liquidation process of the *BIA* was allowed. An amount equivalent to that claim would accordingly be set aside pending the outcome of reorganization.

87 Thus, uncertainty surrounding the outcome of the *CCAA* restructuring eliminates the existence of any certainty to permanently vest in the Crown a beneficial interest in the funds. That much is clear from the oral reasons of Brenner C.J.S.C. on April 29, 2008, when he said: "Given the fact that [*CCAA* proceedings] are known to fail and filings in bankruptcy result, it seems to me that maintaining the status quo in the case at bar supports the proposal to have the monitor hold these funds in trust." Exactly who might take the money in the final result was therefore evidently in doubt. Brenner C.J.S.C.'s subsequent order of September 3, 2008, denying the Crown's application to enforce the trust once it was clear that bankruptcy was inevitable, confirms the absence of a clear beneficiary required to ground an express trust.

4. Conclusion

88 I conclude that Brenner C.J.S.C. had the discretion under the *CCAA* to continue the stay of the Crown's claim for enforcement of the GST deemed trust while otherwise lifting it to permit LeRoy Trucking to make an assignment in bankruptcy. My conclusion that s. 18.3(1) of the *CCAA* nullified the GST deemed trust while proceedings under that Act were pending confirms that the discretionary jurisdiction under s. 11 utilized by the court was not limited by the Crown's asserted GST priority, because there is no such priority under the *CCAA*.

89 For these reasons, I would allow the appeal and declare that the $305,202.30 collected by LeRoy Trucking in respect of GST but not yet remitted to the Receiver General of Canada is not subject to deemed trust or priority in favour of the Crown. Nor is this amount subject to an express trust. Costs are awarded for this appeal and the appeal in the court below.

The following are the reasons delivered by

FISH J.:--

I

90 I am in general agreement with the reasons of Justice Deschamps and would dispose of the appeal as she suggests.

91 More particularly, I share my colleague's interpretation of the scope of the judge's discretion under s. 11 of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*"). And I share my colleague's conclusion that Brenner C.J.S.C. did not create an express trust in favour of the Crown when he segregated GST funds into the Monitor's trust account (2008 BCSC 1805, [2008] G.S.T.C. 221).

92 I nonetheless feel bound to add brief reasons of my own regarding the interaction between the *CCAA* and the *Excise Tax Act*, R.S.C. 1985, c. E-15 ("*ETA*").

93 In upholding deemed trusts created by the *ETA* notwithstanding insolvency proceedings, *Ottawa Senators Hockey Club Corp. (Re)* (2005), 73 O.R. (3d) 737 (C.A.), and its progeny have been unduly protective of Crown interests which Parliament itself has chosen to subordinate to competing prioritized claims. In my respectful view, a clearly marked departure from that jurisprudential approach is warranted in this case.

94 Justice Deschamps develops important historical and policy reasons in support of this position and I have nothing to add in that regard. I do wish, however, to explain why a comparative analysis of related statutory provisions adds support to our shared conclusion.

95 Parliament has in recent years given detailed consideration to the Canadian insolvency scheme. It has declined to amend the provisions at issue in this case. Ours is not to wonder why, but rather to treat Parliament's preservation of the relevant provisions as a deliberate exercise of the legislative discretion that is Parliament's alone. With respect, I reject any suggestion that we should instead characterize the apparent conflict between s. 18.3(1) (now s. 37(1)) of the *CCAA* and s. 222 of the *ETA* as a drafting anomaly or statutory lacuna properly subject to judicial correction or repair.

II

96 In the context of the Canadian insolvency regime, a deemed trust will be found to exist only where two complementary elements co-exist: first, a statutory provision *creating* the trust; and second, a *CCAA* or *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("*BIA*") provision *confirming* -- or explicitly preserving -- its effective operation.

97 This interpretation is reflected in three federal statutes. Each contains a deemed trust provision framed in terms strikingly similar to the wording of s. 222 of the *ETA*.

98 The first is the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) ("*ITA*") where s. 227(4) *creates*

a deemed trust:

> (4) Every person who deducts or withholds an amount under this Act is deemed, notwithstanding any security interest (as defined in subsection 224(1.3)) in the amount so deducted or withheld, to hold the amount separate and apart from the property of the person and from property held by any secured creditor (as defined in subsection 224(1.3)) of that person that but for the security interest would be property of the person, in trust for Her Majesty and for payment to Her Majesty in the manner and at the time provided under this Act. [Here and below, the emphasis is of course my own.]

99 In the next subsection, Parliament has taken care to make clear that this trust is unaffected by federal or provincial legislation to the contrary:

> (4.1) Notwithstanding any other provision of this Act, the *Bankruptcy and Insolvency Act* (except sections 81.1 and 81.2 of that Act), any other enactment of Canada, any enactment of a province or any other law, where at any time an amount deemed by subsection 227(4) to be held by a person in trust for Her Majesty is not paid to Her Majesty in the manner and at the time provided under this Act, property of the person ... equal in value to the amount so deemed to be held in trust is deemed
>
> (*a*) to be held, from the time the amount was deducted or withheld by the person, separate and apart from the property of the person, in trust for Her Majesty whether or not the property is subject to such a security interest, ...
>
> ...
>
> ... and the proceeds of such property shall be paid to the Receiver General in priority to all such security interests.

100 The continued operation of this deemed trust is expressly *confirmed* in s. 18.3 of the *CCAA*:

> **18.3** (1) Subject to subsection (2), notwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as being held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.
>
> (2) Subsection (1) does not apply in respect of amounts deemed to be held in trust under subsection 227(4) or (4.1) of the *Income Tax Act*, subsection 23(3)

> or (4) of the *Canada Pension Plan* or subsection 86(2) or (2.1) of the *Employment Insurance Act* .... .

101 The operation of the *ITA* deemed trust is also confirmed in s. 67 of the *BIA*:

> (2) Subject to subsection (3), notwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a bankrupt shall not be regarded as held in trust for Her Majesty for the purpose of paragraph (1)(*a*) unless it would be so regarded in the absence of that statutory provision.
>
> (3) Subsection (2) does not apply in respect of amounts deemed to be held in trust under subsection 227(4) or (4.1) of the *Income Tax Act*, subsection 23(3) or (4) of the *Canada Pension Plan* or subsection 86(2) or (2.1) of the *Employment Insurance Act* .... .

102 Thus, Parliament has first *created* and then *confirmed the continued operation of* the Crown's *ITA* deemed trust under *both* the *CCAA* and the *BIA* regimes.

103 The second federal statute for which this scheme holds true is the *Canada Pension Plan*, R.S.C. 1985, c. C-8 ("*CPP*"). At s. 23, Parliament creates a deemed trust in favour of the Crown and specifies that it exists despite all contrary provisions in any other Canadian statute. Finally, and in almost identical terms, the *Employment Insurance Act*, S.C. 1996, c. 23 ("*EIA*"), creates a deemed trust in favour of the Crown: see ss. 86(2) and (2.1).

104 As we have seen, the survival of the deemed trusts created under these provisions of the *ITA*, the *CPP* and the *EIA* is confirmed in s. 18.3(2) the *CCAA* and in s. 67(3) the *BIA*. In all three cases, Parliament's intent to enforce the Crown's deemed trust through insolvency proceedings is expressed in clear and unmistakable terms.

105 The same is not true with regard to the deemed trust created under the *ETA*. Although Parliament creates a deemed trust in favour of the Crown to hold unremitted GST monies, and although it purports to maintain this trust notwithstanding any contrary federal or provincial legislation, it does not *confirm* the trust -- or expressly provide for its continued operation -- in either the *BIA* or the *CCAA*. The second of the two mandatory elements I have mentioned is thus absent reflecting Parliament's intention to allow the deemed trust to lapse with the commencement of insolvency proceedings.

106 The language of the relevant *ETA* provisions is identical in substance to that of the *ITA*, *CPP*, and *EIA* provisions:

> **222**. (1) Subject to subsection (1.1), every person who collects an amount

as or on account of tax under Division II is deemed, for all purposes and despite any security interest in the amount, to hold the amount in trust for Her Majesty in right of Canada, separate and apart from the property of the person and from property held by any secured creditor of the person that, but for a security interest, would be property of the person, until the amount is remitted to the Receiver General or withdrawn under subsection (2).

...

(3) Despite any other provision of this Act (except subsection (4)), any other enactment of Canada (except the *Bankruptcy and InsolvencyAct*), any enactment of a province or any other law, if at any time an amount deemed by subsection (1) to be held by a person in trust for Her Majesty is not remitted to the Receiver General or withdrawn in the manner and at the time provided under this Part, property of the person and property held by any secured creditor of the person that, but for a security interest, would be property of the person, equal in value to the amount so deemed to be held in trust, is deemed

(*a*) to be held, from the time the amount was collected by the person, in trust for Her Majesty, separate and apart from the property of the person, whether or not the property is subject to a security interest, ...

...

... and the proceeds of the property shall be paid to the Receiver General in priority to all security interests.

107 Yet no provision of the *CCAA* provides for the continuation of this deemed trust after the *CCAA* is brought into play.

108 In short, Parliament has imposed *two* explicit conditions, or "building blocks", for survival under the *CCAA* of deemed trusts created by the *ITA*, *CPP*, and *EIA*. Had Parliament intended to likewise preserve under the *CCAA* deemed trusts created by the *ETA*, it would have included in the *CCAA* the sort of confirmatory provision that explicitly preserves other deemed trusts.

109 With respect, unlike Tysoe J.A., I do not find it "inconceivable that Parliament would specifically identify the *BIA* as an exception when enacting the current version of s. 222(3) of the *ETA* without considering the *CCAA* as a possible second exception" (2009 BCCA 205, 98 B.C.L.R. (4th) 242, at para. 37). *All* of the deemed trust provisions excerpted above make explicit reference to the *BIA*. Section 222 of the *ETA* does not break the pattern. Given the near-identical wording of the four deemed trust provisions, it would have been surprising indeed had Parliament not addressed the *BIA* at all in the *ETA*.

110 Parliament's evident intent was to render GST deemed trusts inoperative upon the institution of insolvency proceedings. Accordingly, s. 222 mentions the *BIA* so as to *exclude* it from its ambit -- rather than to *include* it, as do the *ITA*, the *CPP*, and the *EIA*.

111 Conversely, I note that *none* of these statutes mentions the *CCAA* expressly. Their specific reference to the *BIA* has no bearing on their interaction with the *CCAA*. Again, it is the confirmatory provisions *in the insolvency statutes* that determine whether a given deemed trust will subsist during insolvency proceedings.

112 Finally, I believe that chambers judges should not segregate GST monies into the Monitor's trust account during *CCAA* proceedings, as was done in this case. The result of Justice Deschamps's reasoning is that GST claims become unsecured under the *CCAA*. Parliament has deliberately chosen to nullify certain Crown super-priorities during insolvency; this is one such instance.

III

113 For these reasons, like Justice Deschamps, I would allow the appeal with costs in this Court and in the courts below and order that the $305,202.30 collected by LeRoy Trucking in respect of GST but not yet remitted to the Receiver General of Canada be subject to no deemed trust or priority in favour of the Crown.

The following are the reasons delivered by

114 ABELLA J. (dissenting):-- The central issue in this appeal is whether s. 222 of the *Excise Tax Act*, R.S.C. 1985, c. E-15 ("*ETA*"), and specifically s. 222(3), gives priority during *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*"), proceedings to the Crown's deemed trust in unremitted GST. I agree with Tysoe J.A. that it does. It follows, in my respectful view, that a court's discretion under s. 11 of the *CCAA* is circumscribed accordingly.

115 Section 11[1] of the *CCAA* stated:

> **11.** (1) Notwithstanding anything in the *Bankruptcy and Insolvency Act* or the *Winding-up Act*, where an application is made under this Act in respect of a company, the court, on the application of any person interested in the matter, may, subject to this Act, on notice to any other person or without notice as it may see fit, make an order under this section.

To decide the scope of the court's discretion under s. 11, it is necessary to first determine the priority issue. Section 222(3), the provision of the *ETA* at issue in this case, states:

> (3) Despite any other provision of this Act (except subsection (4)), any other enactment of Canada (except the *Bankruptcy and Insolvency Act*), any enactment of a province or any other law, if at any time an amount deemed by

subsection (1) to be held by a person in trust for Her Majesty is not remitted to the Receiver General or withdrawn in the manner and at the time provided under this Part, property of the person and property held by any secured creditor of the person that, but for a security interest, would be property of the person, equal in value to the amount so deemed to be held in trust, is deemed

> (*a*) to be held, from the time the amount was collected by the person, in trust for Her Majesty, separate and apart from the property of the person, whether or not the property is subject to a security interest, and
>
> (*b*) to form no part of the estate or property of the person from the time the amount was collected, whether or not the property has in fact been kept separate and apart from the estate or property of the person and whether or not the property is subject to a security interest

and is property beneficially owned by Her Majesty in right of Canada despite any security interest in the property or in the proceeds thereof and the proceeds of the property shall be paid to the Receiver General in priority to all security interests.

116 Century Services argued that the *CCAA*'s general override provision, s. 18.3(1), prevailed, and that the deeming provisions in s. 222 of the *ETA* were, accordingly, inapplicable during *CCAA* proceedings. Section 18.3(1) states:

> **18.3** (1) ... [N]otwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.

117 As MacPherson J.A. correctly observed in *Ottawa Senators Hockey Club Corp.* (*Re*) (2005), 73 O.R. (3d) 737 (C.A.), s. 222(3) of the *ETA* is in "clear conflict" with s. 18.3(1) of the *CCAA* (para. 31). Resolving the conflict between the two provisions is, essentially, what seems to me to be a relatively uncomplicated exercise in statutory interpretation: does the language reflect a clear legislative intention? In my view it does. The deemed trust provision, s. 222(3) of the *ETA*, has unambiguous language stating that it operates notwithstanding any law except the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("*BIA*").

118 By expressly excluding only one statute from its legislative grasp, and by unequivocally stating that it applies despite any other law anywhere in Canada *except* the *BIA*, s. 222(3) has defined its boundaries in the clearest possible terms. I am in complete agreement with the following

comments of MacPherson J.A. in *Ottawa Senators*:

> The legislative intent of s. 222(3) of the *ETA* is clear. If there is a conflict with "any other enactment of Canada (except the *Bankruptcy and Insolvency Act*)", s. 222(3) prevails. In these words Parliament did two things: it decided that s. 222(3) should trump all other federal laws and, importantly, it addressed the topic of exceptions to its trumping decision and identified a single exception, the *Bankruptcy and Insolvency Act*... . The *BIA* and the *CCAA* are closely related federal statutes. I cannot conceive that Parliament would specifically identify the *BIA* as an exception, but accidentally fail to consider the *CCAA* as a possible second exception. In my view, the omission of the *CCAA* from s. 222(3) of the *ETA* was almost certainly a considered omission. [para. 43]

119 MacPherson J.A.'s view that the failure to exempt the *CCAA* from the operation of the *ETA* is a reflection of a clear legislative intention, is borne out by how the *CCAA* was subsequently changed after s. 18.3(1) was enacted in 1997. In 2000, when s. 222(3) of the *ETA* came into force, amendments were also introduced to the *CCAA*. Section 18.3(1) was not amended.

120 The failure to amend s. 18.3(1) is notable because its effect was to protect the legislative *status quo*, notwithstanding repeated requests from various constituencies that s. 18.3(1) be amended to make the priorities in the *CCAA* consistent with those in the *BIA*. In 2002, for example, when Industry Canada conducted a review of the *BIA* and the *CCAA*, the Insolvency Institute of Canada and the Canadian Association of Insolvency and Restructuring Professionals recommended that the priority regime under the *BIA* be extended to the *CCAA* (Joint Task Force on Business Insolvency Law Reform, *Report* (March 15, 2002), Sch. B, proposal 71, at pp. 37-38). The same recommendations were made by the Standing Senate Committee on Banking, Trade and Commerce in its 2003 report, *Debtors and Creditors Sharing the Burden: A Review of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act*; by the Legislative Review Task Force (Commercial) of the Insolvency Institute of Canada and the Canadian Association of Insolvency and Restructuring Professionals in its 2005 *Report on the Commercial Provisions of Bill C-55*; and in 2007 by the Insolvency Institute of Canada in a submission to the Standing Senate Committee on Banking, Trade and Commerce commenting on reforms then under consideration.

121 Yet the *BIA* remains the only exempted statute under s. 222(3) of the *ETA*. Even after the 2005 decision in *Ottawa Senators* which confirmed that the *ETA* took precedence over the *CCAA*, there was no responsive legislative revision. I see this lack of response as relevant in this case, as it was in *Tele-Mobile Co. v. Ontario*, 2008 SCC 12, [2008] 1 S.C.R. 305, where this Court stated:

> While it cannot be said that legislative silence is necessarily determinative of legislative intention, in this case the silence is Parliament's answer to the consistent urging of Telus and other affected businesses and organizations that there be express language in the legislation to ensure that businesses can be

> reimbursed for the reasonable costs of complying with evidence-gathering orders. I see the legislative history as reflecting Parliament's intention that compensation not be paid for compliance with production orders. [para. 42]

122 All this leads to a clear inference of a deliberate legislative choice to protect the deemed trust in s. 222(3) from the reach of s. 18.3(1) of the *CCAA*.

123 Nor do I see any "policy" justification for interfering, through interpretation, with this clarity of legislative intention. I can do no better by way of explaining why I think the policy argument cannot succeed in this case, than to repeat the words of Tysoe J.A. who said:

> I do not dispute that there are valid policy reasons for encouraging insolvent companies to attempt to restructure their affairs so that their business can continue with as little disruption to employees and other stakeholders as possible. It is appropriate for the courts to take such policy considerations into account, but only if it is in connection with a matter that has not been considered by Parliament. Here, Parliament must be taken to have weighed policy considerations when it enacted the amendments to the *CCAA* and *ETA* described above. As Mr. Justice MacPherson observed at para. 43 of *Ottawa Senators,* it is inconceivable that Parliament would specifically identify the *BIA* as an exception when enacting the current version of s. 222(3) of the *ETA* without considering the *CCAA* as a possible second exception. I also make the observation that the 1992 set of amendments to the *BIA* enabled proposals to be binding on secured creditors and, while there is more flexibility under the *CCAA*, it is possible for an insolvent company to attempt to restructure under the auspices of the *BIA*. [para. 37]

124 Despite my view that the clarity of the language in s. 222(3) is dispositive, it is also my view that even the application of other principles of interpretation reinforces this conclusion. In their submissions, the parties raised the following as being particularly relevant: the Crown relied on the principle that the statute which is "later in time" prevails; and Century Services based its argument on the principle that the general provision gives way to the specific (*generalia specialibus non derogant*).

125 The "later in time" principle gives priority to a more recent statute, based on the theory that the legislature is presumed to be aware of the content of existing legislation. If a new enactment is inconsistent with a prior one, therefore, the legislature is presumed to have intended to derogate from the earlier provisions (Ruth Sullivan, *Sullivan on the Construction of Statutes* (5th ed. 2008), at pp. 346-47; Pierre-André Côté, *The Interpretation of Legislation in Canada* (3rd ed. 2000), at p. 358).

126 The exception to this presumptive displacement of pre-existing inconsistent legislation, is the *generalia specialibus non derogant* principle that "[a] more recent, general provision will not be

construed as affecting an earlier, special provision" (Côté, at p. 359). Like a Russian Doll, there is also an exception within this exception, namely, that an earlier, specific provision may in fact be "overruled" by a subsequent general statute if the legislature indicates, through its language, an intention that the general provision prevails (*Doré v. Verdun (City)*, [1997] 2 S.C.R. 862).

127 The primary purpose of these interpretive principles is to assist in the performance of the task of determining the intention of the legislature. This was confirmed by MacPherson J.A. in *Ottawa Senators*, at para. 42:

> [T]he overarching rule of statutory interpretation is that statutory provisions should be interpreted to give effect to the intention of the legislature in enacting the law. This primary rule takes precedence over all maxims or canons or aids relating to statutory interpretation, including the maxim that the specific prevails over the general (*generalia specialibus non derogant*). As expressed by Hudson J. in *Canada v. Williams*, [1944] S.C.R. 226, ... at p. 239 ... :
>
>> The maxim *generalia specialibus non derogant* is relied on as a rule which should dispose of the question, but the maxim is not a rule of law but a rule of construction and bows to the intention of the legislature, if such intention can reasonably be gathered from all of the relevant legislation.

(See also Côté, at p. 358, and Pierre-Andre Côté, with the collaboration of S. Beaulac and M. Devinat, *Interprétation des lois* (4th ed. 2009), at para. 1335.)

128 I accept the Crown's argument that the "later in time" principle is conclusive in this case. Since s. 222(3) of the *ETA* was enacted in 2000 and s. 18.3(1) of the *CCAA* was introduced in 1997, s. 222(3) is, on its face, the later provision. This chronological victory can be displaced, as Century Services argues, if it is shown that the more recent provision, s. 222(3) of the *ETA*, is a general one, in which case the earlier, specific provision, s. 18.3(1), prevails (*generalia specialibus non derogant*). But, as previously explained, the prior specific provision does not take precedence if the subsequent general provision appears to "overrule" it. This, it seems to me, is precisely what s. 222(3) achieves through the use of language stating that it prevails despite any law of Canada, of a province, or "any other law" *other than the BIA*. Section 18.3(1) of the *CCAA*, is thereby rendered inoperative for purposes of s. 222(3).

129 It is true that when the *CCAA* was amended in 2005,[2] s. 18.3(1) was re-enacted as s. 37(1) (S.C. 2005, c. 47, s. 131). Deschamps J. suggests that this makes s. 37(1) the new, "later in time" provision. With respect, her observation is refuted by the operation of s. 44(f) of the *Interpretation Act*, R.S.C. 1985, c. I-21, which expressly deals with the (non) effect of re-enacting, without significant substantive changes, a repealed provision (see *Attorney General of Canada v. Public Service Staff Relations Board*, [1977] 2 F.C. 663, dealing with the predecessor provision to s. 44(f)). It directs that new enactments not be construed as "new law" unless they differ in substance from

the repealed provision:

> **44.** Where an enactment, in this section called the "former enactment", is repealed and another enactment, in this section called the "new enactment", is substituted therefor,
>
> ...
>
> (*f*) except to the extent that the provisions of the new enactment are not in substance the same as those of the former enactment, the new enactment shall not be held to operate as new law, but shall be construed and have effect as a consolidation and as declaratory of the law as contained in the former enactment;

Section 2 of the *Interpretation Act* defines an enactment as "an Act or regulation or any portion of an Act or regulation".

130 Section 37(1) of the current *CCAA* is almost identical to s. 18.3(1). These provisions are set out for ease of comparison, with the differences between them underlined:

> **37.** (1) Subject to subsection (2), despite any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as being held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.

> **18.3** (1) Subject to subsection (2), notwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.

131 The application of s. 44(*f*) of the *Interpretation Act* simply confirms the government's clearly expressed intent, found in Industry Canada's clause-by-clause review of Bill C-55, where s. 37(1) was identified as "a technical amendment to re-order the provisions of this Act". During second reading, the Hon. Bill Rompkey, then the Deputy Leader of the Government in the Senate, confirmed that s. 37(1) represented only a technical change:

> On a technical note relating to the treatment of deemed trusts for taxes, the bill [*sic*] makes no changes to the underlying policy intent, despite the fact that in the case of a restructuring under the CCAA, sections of the act [*sic*] were repealed and substituted with renumbered versions due to the extensive

reworking of the CCAA.

(*Debates of the Senate*, vol. 142, 1st Sess., 38th Parl., November 23, 2005, at p. 2147)

132 Had the substance of s. 18.3(1) altered in any material way when it was replaced by s. 37(1), I would share Deschamps J.'s view that it should be considered a new provision. But since s. 18.3(1) and s. 37(1) are the same in substance, the transformation of s. 18.3(1) into s. 37(1) has no effect on the interpretive queue, and s. 222(3) of the *ETA* remains the "later in time" provision (Sullivan, at p. 347).

133 This means that the deemed trust provision in s. 222(3) of the *ETA* takes precedence over s. 18.3(1) during *CCAA* proceedings. The question then is how that priority affects the discretion of a court under s. 11 of the *CCAA*.

134 While s. 11 gives a court discretion to make orders notwithstanding the *BIA* and the *Winding-up Act*, R.S.C. 1985, c. W-11, that discretion is not liberated from the operation of any other federal statute. Any exercise of discretion is therefore circumscribed by whatever limits are imposed by statutes *other* than the *BIA* and the *Winding-up Act*. That includes the *ETA*. The chambers judge in this case was, therefore, required to respect the priority regime set out in s. 222(3) of the *ETA*. Neither s. 18.3(1) nor s. 11 of the *CCAA* gave him the authority to ignore it. He could not, as a result, deny the Crown's request for payment of the GST funds during the *CCAA* proceedings.

135 Given this conclusion, it is unnecessary to consider whether there was an express trust.

136 I would dismiss the appeal.

Appeal allowed with costs, ABELLA J. *dissenting.*

* * * * *

APPENDIX

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36 (as at December 13, 2007)

11. (1) [Powers of court] Notwithstanding anything in the *Bankruptcy and Insolvency Act* or the *Winding-up Act*, where an application is made under this Act in respect of a company, the court, on the application of any person interested in the matter, may, subject to this Act, on notice to any other person or without notice as it may see fit, make an order under this section.

...

(3) [Initial application court orders] A court may, on an initial application in respect of a company, make an order on such terms as it may impose, effective for such period as the court deems necessary not exceeding thirty days,

> (*a*) staying, until otherwise ordered by the court, all proceedings taken or that might be taken in respect of the company under an Act referred to in subsection (1);
>
> (*b*) restraining, until otherwise ordered by the court, further proceedings in any action, suit or proceeding against the company; and
>
> (*c*) prohibiting, until otherwise ordered by the court, the commencement of or proceeding with any other action, suit or proceeding against the company.

(4) [Other than initial application court orders] A court may, on an application in respect of a company other than an initial application, make an order on such terms as it may impose,

> (*a*) staying, until otherwise ordered by the court, for such period as the court deems necessary, all proceedings taken or that might be taken in respect of the company under an Act referred to in subsection (1);
>
> (*b*) restraining, until otherwise ordered by the court, further proceedings in any action, suit or proceeding against the company; and
>
> (*c*) prohibiting, until otherwise ordered by the court, the commencement of or proceeding with any other action, suit or proceeding against the company.

...

(6) [Burden of proof on application] The court shall not make an order under subsection (3) or (4) unless

> (*a*) the applicant satisfies the court that circumstances exist that make such an order appropriate; and
>
> (*b*) in the case of an order under subsection (4), the applicant also satisfies the court that the applicant has acted, and is acting, in good faith and with due diligence.

11.4 (1) [Her Majesty affected] An order made under section 11 may provide that

(*a*) Her Majesty in right of Canada may not exercise rights under subsection 224(1.2) of the *Income Tax Act* or any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, in respect of the company if the company is a tax debtor under that subsection or provision, for such period as the court considers appropriate but ending not later than

(i) the expiration of the order,
(ii) the refusal of a proposed compromise by the creditors or the court,
(iii) six months following the court sanction of a compromise or arrangement,
(iv) the default by the company on any term of a compromise or arrangement, or
(v) the performance of a compromise or arrangement in respect of the company; and

(*b*) Her Majesty in right of a province may not exercise rights under any provision of provincial legislation in respect of the company where the company is a debtor under that legislation and the provision has a similar purpose to subsection 224(1.2) of the *Income Tax Act*, or refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, where the sum

(i) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or
(ii) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection,

for such period as the court considers appropriate but ending not later than the occurrence or time referred to in whichever of subparagraphs (*a*)(i) to (v) may apply.

(2) [When order ceases to be in effect] An order referred to in subsection (1) ceases to be in

effect if

(*a*) the company defaults on payment of any amount that becomes due to Her Majesty after the order is made and could be subject to a demand under

(i) subsection 224(1.2) of the *Income Tax Act*,
(ii) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, or
(iii) under any provision of provincial legislation that has a similar purpose to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, where the sum

(A) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or
(B) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection; or

(*b*) any other creditor is or becomes entitled to realize a security on any property that could be claimed by Her Majesty in exercising rights under

(i) subsection 224(1.2) of the *Income Tax Act*,
(ii) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, or
(iii) any provision of provincial legislation that has a similar purpose to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection,

to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, where the sum

(A) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(B) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection.

(3) [Operation of similar legislation] An order made under section 11, other than an order referred to in subsection (1) of this section, does not affect the operation of

(*a*) subsections 224(1.2) and (1.3) of the *Income Tax Act*,

(*b*) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, or

(*c*) any provision of provincial legislation that has a similar purpose to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, where the sum

(i) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(ii) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection,

and for the purpose of paragraph (*c*), the provision of provincial legislation is, despite any Act of Canada or of a province or any other law, deemed to have the same effect and scope against any

creditor, however secured, as subsection 224(1.2) of the *Income Tax Act* in respect of a sum referred to in subparagraph (*c*)(i), or as subsection 23(2) of the *Canada Pension Plan* in respect of a sum referred to in subparagraph (*c*)(ii), and in respect of any related interest, penalties or other amounts.

18.3 (1) [Deemed trusts] Subject to subsection (2), notwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.

(2) [Exceptions] Subsection (1) does not apply in respect of amounts deemed to be held in trust under subsection 227(4) or (4.1) of the *Income Tax Act*, subsection 23(3) or (4) of the *Canada Pension Plan* or subsection 86(2) or (2.1) of the *Employment Insurance Act* (each of which is in this subsection referred to as a "federal provision") nor in respect of amounts deemed to be held in trust under any law of a province that creates a deemed trust the sole purpose of which is to ensure remittance to Her Majesty in right of the province of amounts deducted or withheld under a law of the province where

(*a*) that law of the province imposes a tax similar in nature to the tax imposed under the *Income Tax Act* and the amounts deducted or withheld under that law of the province are of the same nature as the amounts referred to in subsection 227(4) or (4.1) of the *Income Tax Act*, or

(*b*) the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan*, that law of the province establishes a "provincial pension plan" as defined in that subsection and the amounts deducted or withheld under that law of the province are of the same nature as amounts referred to in subsection 23(3) or (4) of the *Canada Pension Plan*,

and for the purpose of this subsection, any provision of a law of a province that creates a deemed trust is, notwithstanding any Act of Canada or of a province or any other law, deemed to have the same effect and scope against any creditor, however secured, as the corresponding federal provision.

18.4 (1) [Status of Crown claims] In relation to a proceeding under this Act, all claims, including secured claims, of Her Majesty in right of Canada or a province or any body under an enactment respecting workers' compensation, in this section and in section 18.5 called a "workers' compensation body", rank as unsecured claims.

...

(3) [Operation of similar legislation] Subsection (1) does not affect the operation of

(*a*) subsections 224(1.2) and (1.3) of the *Income Tax Act*,

(*b*) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, or

(*c*) any provision of provincial legislation that has a similar purpose to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, where the sum

(i) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or
(ii) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection,

and for the purpose of paragraph (*c*), the provision of provincial legislation is, despite any Act of Canada or of a province or any other law, deemed to have the same effect and scope against any creditor, however secured, as subsection 224(1.2) of the *Income Tax Act* in respect of a sum referred to in subparagraph (*c*)(i), or as subsection 23(2) of the *Canada Pension Plan* in respect of a sum referred to in subparagraph (*c*)(ii), and in respect of any related interest, penalties or other amounts.

20. [Act to be applied conjointly with other Acts] The provisions of this Act may be applied together with the provisions of any Act of Parliament or of the legislature of any province, that authorizes or makes provision for the sanction of compromises or arrangements between a company and its shareholders or any class of them.

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36 (as at September 18, 2009)

11. [General power of court] Despite anything in the *Bankruptcy and Insolvency Act* or the *Winding-up and Restructuring Act*, if an application is made under this Act in respect of a debtor company, the court, on the application of any person interested in the matter, may, subject to the restrictions set out in this Act, on notice to any other person or without notice as it may see fit, make any order that it considers appropriate in the circumstances.

11.02 (1) [Stays, etc. -- initial application] A court may, on an initial application in respect of a debtor company, make an order on any terms that it may impose, effective for the period that the court considers necessary, which period may not be more than 30 days,

(*a*) staying, until otherwise ordered by the court, all proceedings taken or that might be taken in respect of the company under the *Bankruptcy and Insolvency Act* or the *Winding-up and Restructuring Act*;

(*b*) restraining, until otherwise ordered by the court, further proceedings in any action, suit or proceeding against the company; and

(*c*) prohibiting, until otherwise ordered by the court, the commencement of any action, suit or proceeding against the company.

(2) [Stays, etc. -- other than initial application] A court may, on an application in respect of a debtor company other than an initial application, make an order, on any terms that it may impose,

(*a*) staying, until otherwise ordered by the court, for any period that the court considers necessary, all proceedings taken or that might be taken in respect of the company under an Act referred to in paragraph (1)(*a*);

(*b*) restraining, until otherwise ordered by the court, further proceedings in any action, suit or proceeding against the company; and

(*c*) prohibiting, until otherwise ordered by the court, the commencement of any action, suit or proceeding against the company.

(3) [Burden of proof on application] The court shall not make the order unless

(a) the applicant satisfies the court that circumstances exist that make the order appropriate; and
(b) in the case of an order under subsection (2), the applicant also satisfies the court that the applicant has acted, and is acting, in good faith and with due diligence.

...

11.09 (1) [Stay -- Her Majesty] An order made under section 11.02 may provide that

(*a*) Her Majesty in right of Canada may not exercise rights under subsection 224(1.2) of the *Income Tax Act* or any provision of the *Canada Pension Plan* or

of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, in respect of the company if the company is a tax debtor under that subsection or provision, for the period that the court considers appropriate but ending not later than

(i) the expiry of the order,
(ii) the refusal of a proposed compromise by the creditors or the court,
(iii) six months following the court sanction of a compromise or an arrangement,
(iv) the default by the company on any term of a compromise or an arrangement, or

(v) the performance of a compromise or an arrangement in respect of the company; and

(*b*) Her Majesty in right of a province may not exercise rights under any provision of provincial legislation in respect of the company if the company is a debtor under that legislation and the provision has a purpose similar to subsection 224(1.2) of the *Income Tax Act*, or refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, and the sum

(i) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or
(ii) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection,

for the period that the court considers appropriate but ending not later than the occurrence or time referred to in whichever of subparagraphs (*a*)(i) to (v) that may apply.

(2) [When order ceases to be in effect] The portions of an order made under section 11.02 that affect the exercise of rights of Her Majesty referred to in paragraph (1)(*a*) or (*b*) cease to be in effect if

(*a*) the company defaults on the payment of any amount that becomes due to Her Majesty after the order is made and could be subject to a demand under

(i) subsection 224(1.2) of the *Income Tax Act*,
(ii) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, or
(iii) any provision of provincial legislation that has a purpose similar to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, and the sum

(A) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or
(B) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection; or

(*b*) any other creditor is or becomes entitled to realize a security on any property that could be claimed by Her Majesty in exercising rights under

(i) subsection 224(1.2) of the *Income Tax Act*,
(ii) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, or
(iii) any provision of provincial legislation that has a purpose similar to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, and the sum

(A) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(B) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection.

(3) [Operation of similar legislation] An order made under section 11.02, other than the portions of that order that affect the exercise of rights of Her Majesty referred to in paragraph (1)(*a*) or (*b*), does not affect the operation of

(*a*) subsections 224(1.2) and (1.3) of the *Income Tax Act*,

(*b*) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, or

(*c*) any provision of provincial legislation that has a purpose similar to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, and the sum

(i) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(ii) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection,

and for the purpose of paragraph (*c*), the provision of provincial legislation is, despite any Act of Canada or of a province or any other law, deemed to have the same effect and scope against any creditor, however secured, as subsection 224(1.2) of the *Income Tax Act* in respect of a sum referred to in subparagraph (*c*)(i), or as subsection 23(2) of the *Canada Pension Plan* in respect of a sum referred to in subparagraph (*c*)(ii), and in respect of any related interest, penalties or other amounts.

37. (1) [Deemed trusts] Subject to subsection (2), despite any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as being held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.

(2) [Exceptions] Subsection (1) does not apply in respect of amounts deemed to be held in trust under subsection 227(4) or (4.1) of the *Income Tax Act*, subsection 23(3) or (4) of the *Canada Pension Plan* or subsection 86(2) or (2.1) of the *Employment Insurance Act* (each of which is in this subsection referred to as a "federal provision"), nor does it apply in respect of amounts deemed to be held in trust under any law of a province that creates a deemed trust the sole purpose of which is to ensure remittance to Her Majesty in right of the province of amounts deducted or withheld under a law of the province if

> (*a*) that law of the province imposes a tax similar in nature to the tax imposed under the *Income Tax Act* and the amounts deducted or withheld under that law of the province are of the same nature as the amounts referred to in subsection 227(4) or (4.1) of the *Income Tax Act*, or
>
> (*b*) the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan*, that law of the province establishes a "provincial pension plan" as defined in that subsection and the amounts deducted or withheld under that law of the province are of the same nature as amounts referred to in subsection 23(3) or (4) of the *Canada Pension Plan*,

and for the purpose of this subsection, any provision of a law of a province that creates a deemed trust is, despite any Act of Canada or of a province or any other law, deemed to have the same effect and scope against any creditor, however secured, as the corresponding federal provision.

Excise Tax Act, R.S.C. 1985, c. E-15 (as at December 13, 2007)

222. (1) [Trust for amounts collected] Subject to subsection (1.1), every person who collects an amount as or on account of tax under Division II is deemed, for all purposes and despite any security interest in the amount, to hold the amount in trust for Her Majesty in right of Canada, separate and apart from the property of the person and from property held by any secured creditor of the person that, but for a security interest, would be property of the person, until the amount is remitted to the Receiver General or withdrawn under subsection (2).

(1.1) [Amounts collected before bankruptcy] Subsection (1) does not apply, at or after the time a person becomes a bankrupt (within the meaning of the *Bankruptcy and Insolvency Act*), to any amounts that, before that time, were collected or became collectible by the person as or on account of tax under Division II.

...

(3) [Extension of trust] Despite any other provision of this Act (except subsection (4)), any other enactment of Canada (except the *Bankruptcy and Insolvency Act*), any enactment of a province or any other law, if at any time an amount deemed by subsection (1) to be held by a person in trust for Her Majesty is not remitted to the Receiver General or withdrawn in the manner and at the time provided under this Part, property of the person and property held by any secured creditor of the person that, but for a security interest, would be property of the person, equal in value to the amount so deemed to be held in trust, is deemed

(*a*) to be held, from the time the amount was collected by the person, in trust for Her Majesty, separate and apart from the property of the person, whether or not the property is subject to a security interest, and

(*b*) to form no part of the estate or property of the person from the time the amount was collected, whether or not the property has in fact been kept separate and apart from the estate or property of the person and whether or not the property is subject to a security interest

and is property beneficially owned by Her Majesty in right of Canada despite any security interest in the property or in the proceeds thereof and the proceeds of the property shall be paid to the Receiver General in priority to all security interests.

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3 (as at December 13, 2007)

67. (1) [Property of bankrupt] The property of a bankrupt divisible among his creditors shall not comprise

(*a*) property held by the bankrupt in trust for any other person,

(*b*) any property that as against the bankrupt is exempt from execution or seizure under any laws applicable in the province within which the property is situated and within which the bankrupt resides, or

(*b*.1) such goods and services tax credit payments and prescribed payments relating to the essential needs of an individual as are made in prescribed circumstances and are not property referred to in paragraph (*a*) or (*b*),

but it shall comprise

(*c*) all property wherever situated of the bankrupt at the date of his bankruptcy or

that may be acquired by or devolve on him before his discharge, and

> (*d*) such powers in or over or in respect of the property as might have been exercised by the bankrupt for his own benefit.

(2) [Deemed trusts] Subject to subsection (3), notwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a bankrupt shall not be regarded as held in trust for Her Majesty for the purpose of paragraph (1)(*a*) unless it would be so regarded in the absence of that statutory provision.

(3) [Exceptions] Subsection (2) does not apply in respect of amounts deemed to be held in trust under subsection 227(4) or (4.1) of the *Income Tax Act*, subsection 23(3) or (4) of the *Canada Pension Plan* or subsection 86(2) or (2.1) of the *Employment Insurance Act* (each of which is in this subsection referred to as a "federal provision") nor in respect of amounts deemed to be held in trust under any law of a province that creates a deemed trust the sole purpose of which is to ensure remittance to Her Majesty in right of the province of amounts deducted or withheld under a law of the province where

> (*a*) that law of the province imposes a tax similar in nature to the tax imposed under the *Income Tax Act* and the amounts deducted or withheld under that law of the province are of the same nature as the amounts referred to in subsection 227(4) or (4.1) of the *Income Tax Act*, or

> (*b*) the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan*, that law of the province establishes a "provincial pension plan" as defined in that subsection and the amounts deducted or withheld under that law of the province are of the same nature as amounts referred to in subsection 23(3) or (4) of the *Canada Pension Plan*,

and for the purpose of this subsection, any provision of a law of a province that creates a deemed trust is, notwithstanding any Act of Canada or of a province or any other law, deemed to have the same effect and scope against any creditor, however secured, as the corresponding federal provision.

86. (1) [Status of Crown claims] In relation to a bankruptcy or proposal, all provable claims, including secured claims, of Her Majesty in right of Canada or a province or of any body under an Act respecting workers' compensation, in this section and in section 87 called a "workers' compensation body", rank as unsecured claims.

...

(3) [Exceptions] Subsection (1) does not affect the operation of

(*a*) subsections 224(1.2) and (1.3) of the *Income Tax Act*;

(*b*) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts; or

(*c*) any provision of provincial legislation that has a similar purpose to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, where the sum

(i) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(ii) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection,

and for the purpose of paragraph (*c*), the provision of provincial legislation is, despite any Act of Canada or of a province or any other law, deemed to have the same effect and scope against any creditor, however secured, as subsection 224(1.2) of the *Income Tax Act* in respect of a sum referred to in subparagraph (*c*)(i), or as subsection 23(2) of the *Canada Pension Plan* in respect of a sum referred to in subparagraph (*c*)(ii), and in respect of any related interest, penalties or other amounts.

Solicitors:

Solicitors for the appellant: Fraser Milner Casgrain, Vancouver.

Solicitor for the respondent: Department of Justice, Vancouver.

1 Section 11 was amended, effective September 18, 2009, and now states:

> **11.** Despite anything in the *Bankruptcy and Insolvency Act* or the *Winding-up and Restructuring Act*, if an application is made under this Act in respect of a debtor company, the court, on the application of any person interested in the matter, may, subject to the restrictions set out in this Act, on notice to any other person or without notice as it may see fit, make any order that it considers appropriate in the circumstances.

2 The amendments did not come into force until September 18, 2009.

Indexed as:

Playdium Entertainment Corp. (Re)

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 Playdium Entertainment Corporation et al

[2001] O.J. No. 4252

[2001] O.T.C. 828

18 B.L.R. (3d) 298

31 C.B.R. (4th) 302

109 A.C.W.S. (3d) 207

2001 CarswellOnt 3893

Court File No. 01-CL-4037

Ontario Superior Court of Justice
Commercial List

Spence J.

Heard: October 29-30, 2001.
Judgment: November 2, 2001.

(34 paras.)

Creditors and debtors -- Debtors' relief legislation -- Companies' creditors arrangement legislation -- Arrangement, judicial approval.

Motion by secured creditors of Playdium Entertainment Corporation to transfer its assets to a new corporation to continue to operate the business as a going concern, to implement assignment of the material contracts of the business, to extend a stay, and to appoint an interim receiver. The motion followed unsuccessful restructuring efforts under the Companies' Creditors Arrangement Act. One

of the parties to one of the contracts subject to assignment objected to the assignment and as such withheld its consent.

HELD: Motion allowed. The consent was not unreasonably withheld. However, by allowing the proposed transactions to proceed, there was the possibility for any disputes to be pursued in litigation. The proposal to continue the business operations had potential benefits for trade creditors, employees and members of the public.

Statutes, Regulations and Rules Cited:

Companies' Creditors Arrangement Act.

[Quicklaw note: Supplementary reasons for judgment were released November 15, 2001. See [2001] O.J. No. 4459.]

Counsel:

Paul G. Macdonald and Alexander L. MacFarlane, for Covington Fund I Inc.
Gary C. Grierson and J. Anthony Caldwell, for Famous Players Inc.
Craig J. Hill, for the Pricewaterhouse Coopers Inc.
Roger Jaipargas, for Monitor.
Gavin J. Tighe, for Toronto-Dominion Bank.
Michael B. Rosztain, for Canadian Imperial Bank of Commerce.
Geoff R. Hall, for Ontario Municipal Employees Retirement Board.
David B. Bish, for Playdium Entertainment Corporation.
Julian Binavince, for Cambridge Shopping Centres Limited.

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1 **SPENCE J.**:-- These reasons are provided in brief form to accommodate the exigencies of this matter.

2 The Playdium corporations and entities (the "Playdium Group") have been engaged in restructuring efforts under the Companies' Creditors Arrangement Act (the "CCAA"). These efforts have been unsuccessful. It is now proposed that substantially all the Playdium assets will be transferred to a new corporation ("New Playdium") which will be indirectly controlled by Covington Fund I Inc. and Toronto-Dominion Bank. This transfer would be made in satisfaction of the claims of those two creditors and Canadian Imperial Bank of Commerce, the primary secured creditors and the only creditors with an economic interest in the Playdium Group.

3 The primary secured creditors intend that the Playdium Group's business will continue to be operated as a going concern. If successful, this would potentially save 300 jobs as well as various

existing trade contracts and leases.

4 This transaction is considered to be the only viable alternative to a liquidation of Playdium Group and the adverse consequences that would flow from a liquidation. Interests of members of the public also stand to be affected, in respect of prepaid game cards and discount coupons, which are to be honoured by the new entity.

5 The proposed transaction would involve assignment to the new entity of the material contracts of the business, including the Techtown Agreement with Famous Players.

6 Playdium Group is not currently in compliance with the equipment supply provisions of s. 9(e) of the Techtown Agreement. The new entity is to take steps, as soon as reasonably practicable, that are intended to achieve compliance with s. 9(e). Famous Players disputes that the proposed steps will have that effect and opposes approval of the proposed assignment of the Techtown Agreement to the new entity.

7 Covington says that the assignment of the Techtown Agreement is a critical condition of the proposed transaction: without the assignment, the transaction cannot proceed.

8 Covington says that the structure of the proposed transaction is such that it does not require the consent of Famous Players. This is disputed by Famous Players, based on s. 35 of the Agreement and the fact that the assignee is to be controlled by Covington and TD Bank.

9 Covington submits that it is in the best interests of all the shareholders that the proposed transaction, including the assignment of the Techtown Agreement, be implemented. Covington and TD Bank seek an order authorising the assignment and precluding termination of the Techtown Agreement by reason only of the assignment or certain defaults. Famous Players has not given any notice of default to date. The prohibition against termination for default is not to apply to a continuing default under para. 9(e) of the Agreement.

10 The primary secured creditors also seek an extension of the existing stay until November 29, 2001 to finalize these transactions. To facilitate the transactions, Covington and TD Bank seek the appointment of Pricewaterhouse Coopers as Interim Receiver.

11 Based on the cases cited, including Re Lehndorff General Partner Limited (1993) 17 C.B.R. (3d) 24 (Ont. Gen. Div. [Commercial List]), Re Canadian Red Cross Society (1998) 5 C.B.R. (4th) 299 (Ont. Gen. Div. [Commercial List]), and Re T. Eaton Co. (1999) 14 C.B.R. (4th) 298 (Ont. Gen. Div. [Commercial List]), and the statutory provisions and text commentary cited, the court has the jurisdiction to grant the orders that are sought, and may do so over the objections of creditors or other affected parties. Also, the decision in Ministry of Indian Affairs and Northern Development v. Curragh Inc. (1994), 114 D.L.R. (4th) 176, supports the appointment of an interim receiver to do what "justice dictates" and "practicality demands".

12 Famous Players says that no reason has been shown to expect the proposed course of action will bring the Techtown Agreement into compliance and make it properly operational; Covington has not shown it has expertise to bring to the business operations; the operations are grossly in default at present, and the indicated plans are inadequate to cure the default, which has serious adverse consequences to Famous Players.

The Relief Sought

13 The applicants revised the form of order that they seek, to provide (in paragraph 15) that a counterparty to a Material Agreement is not to be prevented from exercising a contractual right to terminate such an agreement as a result of a default that arises or continues to arise after the filing of the Interim Receiver's transfer certificate following completion of the contemplated transactions.

14 Famous Players moved for certain relief that was apparently formulated before the applicants' revisions to their draft order. From the submissions made at the hearing, I understand the position of Famous Players to be that it opposes the order sought by the applicants, at least insofar as it would approve the assignment of the Techtown Agreement, but the submissions of Famous Players did not address specifically the relief sought in their notice of motion, presumably because of the revision to the applicants' draft order as regards continuing defaults.

Section 35 of the Techtown Agreement

15 Section 35 permits an assignment to a Playdium affiliate. The proposed assignee is to be a new company, "New Playdium", to be incorporated on behalf of the Playdium Group, and to be owned by it at the precise time when the assignment occurs. The assignment will occur, it may be presumed, if and only if the contemplated transactions of transfer are completed. On completion of the contemplated transactions, New Playdium will be owned by a corporation controlled by Covington and TD Bank. That outcome reflects the purpose of the assignment, which is to transfer the benefit of the Techtown Agreement to the new owners. Accordingly the assignment, viewed in terms of its substance and not simply its momentary constituent formalities, is not a transfer to a Playdium affiliate. This view is in keeping with the decision in GATX v. Hawker Siddley Canada Inc. (1996), 27 B.L.R. (2d) 251.

16 Under s. 35, the Agreement therefore may not be assigned without the consent of Famous Players, which consent may not be unreasonably withheld. Famous Players says that it has not been properly requested to consent and it has not received adequate financial information and assurances as to the provision of satisfactory management expertise and as to how the Agreement is to be brought into good standing.

17 The submission to the contrary is that the Agreement is really in the nature of a lease, not a joint venture involving the requirement for the provision to the venture of management services. This submission has some merit. Playdium seems principally to be required to supply game equipment. Section 26 of the Agreement disclaims any partnership or joint venture. If the business

is to be sold to the new owners as a going concern, it would be likely to have the same competence as before, unless the contrary is shown, which is not so. Covington says that financial information was offered and not accepted and (although this is either disputed or not accepted) that no further request was made for it.

18 Reference was made to the decision in Dominion Stores v. Bramalea, [1985] O.J. No. 1784, that an assignment clause of this kind is to be construed strictly, as a restraint upon alienation, and its purpose is to protect the landlord as to the type of business carried on. The case also says that a refusal for a collateral purpose or unconnected with the lease is unreasonable.

19 On the material filed, Famous Players has the prospect of a better deal with Starburst and this must be considered a factor in their withholding of consent. It is also relevant that Playdium is not in compliance with the Agreement and it is not clear how soon compliance is intended to be achieved under the Covington proposal. It is not clearly unreasonable for a party in the position of Famous Players to look for a better deal when the counterparty is in a condition of continuing non-compliance.

20 The propriety of the proposed Starburst deal is disputed on the basis of a possible breach of the Non-Disclosure Agreement between Starburst and Playdium. The relevance of this dispute is considered below.

Whether Court should approve the Assignment of the Techtown Agreement

21 This is the pivotal issue in respect of the motion.

22 Famous Players objects to the assignment. Famous Players refuses its consent. With regard to s. 35 of the Agreement, and without reference to considerations relating to CCAA (which are dealt with below), I cannot conclude that the withholding of consent is unreasonable. So s. 35 does not provide any right of assignment.

23 If there were no CCAA order in place and Playdium wished to assign to the proposed assignees, it would not be able to do so, in view of Famous Players' withholding of its consent. The CCAA order affords a context in which the court has the jurisdiction to make the order. For the order to be appropriate, it must be in keeping with the purposes and spirit of the regime created by CCAA: see the Red Cross decision.

The factors to be considered

24 The applicants submit that it is clear from the Monitor's reports that a viable plan cannot be developed under CCAA and the present proposal is the only viable alternative to a liquidation in bankruptcy. The applicants say that the present proposal has the potential to save jobs and to benefit the interests of other stakeholders.

25 Famous Players submits that, on the basis of the Red Cross decision, the court should approve the appointment of an interim receiver with power to vest assets, in a CCAA situation, where there is no plan, only where certain appropriate circumstances exist as set out in Red Cross, and those circumstances do not exist here.

26 In this regard, the first factor mentioned in Red Cross is whether the debtor has made a sufficient effort to obtain the best price and has not acted unprovidently. Famous Players says that there has been no substantial effort to develop a plan to sell the business components (such as the LBE's) as going concerns, no tender process, no marketing effort and no expert analysis. From the reports of the monitor it appears efforts were made to find prospects to purchase debt or equity or assets and there was no indication of viable deals. Whether or not the best price has been obtained, on the material it appears the value of the assets would not satisfy the claims of the principal secured creditors. There is nothing to suggest that a better deal could be done without including the Techtown Agreement; according to the monitor it would have been a key part of any viable plan. Famous Players is not in the position of a creditor looking to be paid out, so its submissions as to the need to get the best price do not seem to be well addressed to its proper interest in this case, and the others who have appeared who are creditors are not objecting to the process and the result.

27 The second factor mentioned in the Red Cross decision is that the proposal should take into consideration the interests of the parties. The proposal has potential benefits for trade creditors, employees and members of the public which would flow from continuing the business operations as proposed.

28 The other two criteria in Red Cross are that the court is to consider the efficacy and integrity of the process by which the offers were obtained and whether there has been unfairness in the working out of the process. Famous Players says that, as regards its interests, there has been no participation afforded to it in designing the proposal, although the Techtown Agreement is said to be critical to the proposal, and nothing to show how or when the s. 9(e) requirements will be brought into compliance. There were discussions between the parties in August but they did not lead to any productive result. It is true that it is not clear how or when compliance will be brought about. This point is considered below.

The effect on Famous Players

29 Famous Players says that if the applicants are given the relief they seek, the proposed transactions will close and the CCAA stay will be lifted - which would happen at the end of November, on the present proposal - and the prospect would be that Famous Players would then issue notices of default in respect of s. 9(e), notice of termination would follow and the entire matter would end up in litigation within two months. That is possible. It is also possible that the parties would work out a deal. Covington is to invest about $3 million in the new entity so there will be an incentive for it to find ways to make the new business work.

30 If the parties cannot resolve their differences, then litigation might well result. Famous Players

would be saved that prospect if the assignment were not to be approved and the companies instead were liquidated in bankruptcy. The delay occasioned by a further stay and subsequent litigation would also presumably result in increased losses of revenue to Famous Players compared to a full compliance situation or an immediate termination. There is nothing before the court to suggest that, if Famous Players has to resort to litigation and succeeds, it would not be able to recover from the new company. On this basis, the right of Famous Players to seek relief for a default seems to address adequately the risk of continuing non-compliance with s. 9(e). Accordingly, the provision preserving that right is a key consideration in favour of the motion.

31 The other reason Famous Players evidently has for opposing the applicants' motion is that it could do a better deal with Starburst. If that were the only reason it had for withholding consent to an assignment of the Agreement, it would not be a reasonable basis for withholding consent under s. 35 of the Agreement. It can be inferred from that consideration that it should also not be regarded as, by itself, a proper reason to allow the objection to stand in the way of the proposed assignment as part of the proposal to enable the business to continue.

32 Moreover, as noted above, the propriety of the Starburst transaction is disputed, on the basis of a possible breach of the Non-Disclosure Agreement between Starburst and Playdium. Based on the submissions before the court, the dispute could not be said to be without substance. If the proposed transactions are allowed to proceed and litigation ensues between Famous Players and New Playdium, there would presumably also be an opportunity for the dispute about the possible breach, and its implications for the propriety of the proposed deal between Starburst and Famous Players, to be pursued in litigation.

33 If instead the proposed transactions are precluded by a denial of the requested order, Playdium would go into bankruptcy and it would lose any opportunity to obtain the benefit of any rights it would otherwise have to oppose the proposed deal between Starburst and Famous Players. Allowing the Playdium transactions to proceed would effectively preserve those rights.

Conclusion

34 For the above reasons the motion of the applicants is granted. The initial order of this court made February 22, 2001 shall be continued to November 29, 2001, and the stay period provided for therein shall be extended to November 29, 2001. The parties may consult me about the other terms of the order, and costs.

SPENCE J.

Case Name:

Hayes Forest Services Ltd. (Re)

IN THE MATTER OF the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36
AND IN THE MATTER OF the Business Corporations Act, S.B.C. 2002, c. 57
AND IN THE MATTER OF Hayes Forest Services Limited, Hayes Holding Services Limited and Hayes Helicopter Services Ltd.

[2009] B.C.J. No. 1725

2009 BCSC 1169

57 C.B.R. (5th) 52

2009 CarswellBC 2286

Docket: S085453

Registry: Vancouver

British Columbia Supreme Court
Vancouver, British Columbia

G.D. Burnyeat J.

Heard: July 8, 10, 24 and August 14, 2009.
Judgment: August 27, 2009.

(52 paras.)

Bankruptcy and insolvency law -- Companies Creditors' Arrangement Act (CCAA) matters -- Compromises and arrangements -- Applications -- Application for an order approving the sale of a stump to dump logging contract allowed -- The Court's jurisdiction under the CCAA was broad enough to substitute a decision for the arbitration process under the contract -- Teal Cedar Products Ltd. (Teal) unreasonably withheld its consent to the assignment of the contract -- The equipment, crew and expertise to undertake the work required would be available to North View

Lumber Ltd. -- North View was financially capable and it's offer was better and was paid off more quickly than the offer Teal wanted approved -- Timber Harvesting Contract and Subcontract Regulation, s. 4(1).

Natural resources law -- Forestry and timber -- Sale of forest products -- Tree farms -- Application for an order approving the sale of a stump to dump logging contract allowed -- The Court's jurisdiction under the CCAA was broad enough to substitute a decision for the arbitration process under the contract -- Teal Cedar Products Ltd. (Teal) unreasonably withheld its consent to the assignment of the contract -- The equipment, crew and expertise to undertake the work required would be available to North View Lumber Ltd. -- North View was financially capable and it's offer was better and was paid off more quickly than the offer Teal wanted approved -- Timber Harvesting Contract and Subcontract Regulation, s. 4(1).

The applicant corporations applied for an order approving the sale of a stump to dump logging contract, between the applicant Hayes Forest Services Limited and Teal Cedar Products Ltd. (Teal), to North View Lumber Ltd. ("North View"). The applicants sought to sell the contract as part of a restructuring under the Companies Creditors' Arrangement Act (CCAA). North View had made a $50,000 deposit to purchase the contract, $277,000 was due at closing and the $1,614,266 balance would be paid at the rate of $3.00 per cubic metre of timber harvested. Teal opposed the application, applying to lift the stay of proceedings to commence arbitration proceedings pursuant to the terms of the contract. In the alternative Teal sought an order approving the sale of the contract to 0858434 B.C. Ltd. ("858") for $1,400,000, consisting of a $400,000 down payment with the balance to be paid at the rate of $2.00 per cubic metre of timber harvested. Teal provided the offer through 858 and there was no information regarding the financial capability of 858 before the Court.

HELD: Application allowed. The Court's jurisdiction under the CCAA was broad enough to substitute a decision for the arbitration process under the contract. The arbitration process was less expeditious, more expensive and was subject to judicial review. Teal unreasonably withheld its consent to the assignment of the contract. The equipment, crew and expertise to undertake the work required would be available to North View and North View was financially capable. North View's offer was better, was paid off more quickly than 858's and there was no information regarding the financial capability of 858 before the Court.

Statutes, Regulations and Rules Cited:

Business Corporations Act, SBC 2002, CHAPTER 57,

Companies Creditors' Arrangement Act, R.S.C. 1985, c. C-36,

Forest Act, RSBC 1996, CHAPTER 157,

Forest Act Regulation, s. 5, s. 48, s. 49, s. 50, s. 51

Rules of Court, Rule 3(3.1), Rule 10, Rule 12, Rule 12, Rule 13(1), Rule 13(6), Rule 14, Rule 44

Timber Harvesting Contract and Subcontract Regulation, B.C. Reg. 22/93, s. 4(1)

Counsel:

Counsel for Teal Cedar Products Ltd.: S.C. Fitzpatrick.

Counsel for Hayes Forest Services Limited, Hayes Holding Services Limited and Hayes Helicopter Services Ltd.:
J.I. McLean.

Counsel for Western Forest Products Inc.: E.J. Milton, Q.C.

Counsel for G.E. Canada Corporation: J. Cytrynbaum.

Counsel for Steelworkers Locals 1-80 and 1-85: J. Mistry.

Counsel for Canadian Imperial Bank of Commerce: F.R. Dearlove.

Reasons for Judgment
(from Chambers)

1 G.D. BURNYEAT J.:-- Hayes Forest Services Limited, Hayes Holding Services Limited and Hayes Helicopter Services Ltd. ("Hayes") apply pursuant to the *Companies Creditors' Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*"), the *Forest Act*, R.S.B.C. 1996, c. 157 and its Regulations, Rules 3(3.1), 10, 12, 13(1), 13(6), 14 and 44 of the *Rules of Court* and the inherent jurisdiction of the Court for Orders approving the sale of that "certain replaceable stump to dump logging contract" ("Contract") between Hayes Forest Services Limited and Teal Cedar Products Ltd. ("Teal") to North View Timber Ltd. ("North View") relating to Timber Forest Licence 46 ("TRL46"). A $50,000.00 deposit has been paid by North View, and a further $277,000.00 would be paid at the time of the closing contemplated by the purchase. The balance of the purchase price of $1,614,266.00 is to be paid at the rate of $3.00 per cubic metre of the timber harvested under the Contract.

2 In opposing that application, Teal applies to lift the stay of proceedings granted under the July 31, 2008 Order so that Teal may commence arbitration proceedings in respect of the issue of whether it is reasonable to withhold its consent to the assignment of the Contract to North View and adjourning the application of Hayes pending the completion of the arbitration proceedings. In the

alternative, Teal requests an order adjourning the application pending the production of certain documentation and information concerning the proposed sale to North View. In the further alternative, Teal seeks an order that a sale of the Contract be approved to 0858434 B.C. Ltd. ("858") for a purchase price of $1,400,000.00, with a down payment of $400,000.00, and with the balance of the purchase price to be paid at the rate of $2.00 per cubic metre of timber harvested under the Contract.

3 As part of a July 31, 2008 Order, a Monitor was appointed to report to the Court and the creditors from time to time. In a June 25, 2009 letter to counsel for Hayes, the Monitor states in part regarding the proposed sale to North View:

> In our opinion, the offer represents a reasonable price for this asset in today's market and we believe that the Company has diligently attempted to market this asset over an extended period of time.
>
> The purchase price is payable based on Northview logging activity under the contract. We believe that this is the only realistic mechanism to conclude a sale at this value. In order to protect its position and ensure future payments are made, the Company will receive a deposit of $327,000 on completion of the sale, and take security over the contract such that in the event Northview defaults on its future obligations the Company will be in a position to enforce that security and retake ownership of the contract.

BACKGROUND

4 A "replaceable stump to dump" logging contract in respect of Tree Farm Licence 46 dated January 9, 1990 was entered into by Fletcher Challenge Canada Ltd. as the holder of the contract and Pat Carson Bulldozing Ltd. as the contractor. The interests of the original parties have both been acquired by other parties. The interest of Pat Carson Bulldozing Ltd. was acquired by Hayes Forest Services Limited. The interest of Fletcher Challenge Canada Ltd. was acquired by Teal pursuant to a January 19, 2004 Asset Purchase Agreement and a May 6, 2004 Assignment of Agreement. From January 1, 2008 through August 2, 2008, Hayes logged approximately 43,000 cubic meters of timber for Teal under the Contract.

5 These proceedings under the *CCAA* were commenced on July 31, 2008. At the time of the July 31, 2008 "initial Order", there were four ongoing disputes regarding key operating and financial terms of the Contract. In each dispute, the dispute resolution mechanism under the provisions under the *Forest Act* and its Regulations and under the Contract required mediation, arbitration and court proceedings. The applicable "Dispute Resolution" mechanism under the Contract was set out in paragraph 22.01:

> The Company and the Contractor mutually agree that where a dispute arises

> between them regarding a term, condition or obligation under this Agreement, and the Work under this Agreement is carried out on lands managed by the Company under a Tree Farm Licence or Forest Licence, then either party may require the dispute to be resolved in accordance with the Dispute Resolution Clause attached as Schedule "D" to this Agreement.

6 Portions of the Schedule "D" referred to in Paragraph 22.01 of the Contract are attached as Appendix "A" to these Reasons for Judgment.

7 In a September 30, 2008 letter, Hayes notified Teal that Hayes was in the process of seeking expressions of interest with respect to the purchase of the Contract as part of the restructuring contemplated under the *CCAA* filing. In an October 10, 2008 response, counsel for Teal advised counsel for Hayes that:

> Teal is certainly prepared to consider any potential assignee of the contract, and will expect the usual information, including financial information, that would normally be produced in that process.

8 The relationship between Hayes and Teal was such that a number of positions were taken by Teal which resulted in applications by Hayes in the *CCAA* proceedings. Hayes took the position that monies were owing by Teal under the Contract. Against what was owing, Teal attempted to set-off "unliquidated claims" it alleged it had under rate disputes arising out of the Contract. An Order was made on August 15, 2008 prohibiting such a set-off.

9 An attempt was made by Teal along with Western Forest Products Ltd. ("Western") to set aside the *CCAA* proceedings on September 4, 2008. That application was unsuccessful.

10 In October, 2008, Teal reduced the contract rate payable to Hayes for work done under the Contract. An order was made compelling payment on the existing contractual rates.

11 Teal sought to lift the stay of proceedings imposed under the July 31, 2008 Order to permit it to proceed with the various ongoing rate disputes under which it claimed Hayes owed it in excess of $2,500,000. Hayes consented to the lifting of the stay of proceedings to permit those claims to proceed. By November, 2008, Teal had not taken any steps to prosecute the arbitrations contemplated under the Contract. Hayes obtained an order establishing a "bar date" by which time Teal was required to have those claims arbitrated. Before the bar date was reached, Teal and Hayes settled all rate disputes between them on the basis that Hayes was not indebted to Teal. That settlement agreement was approved by the Court in February, 2009.

12 In November 2008, Teal made an offer to Hayes to purchase the Contract for $764,112 with $191,028 on closing and the remainder at the rate of $2.00 per cubic meter of timber harvested under the Contract paid quarterly with the first payment to be made on April 1, 2009. The offer had a December 15, 2009 completion date. The offer provided that Teal would be the successor

employer for those employees of Hayes engaged under the Contract who were not eligible for compensation under the B.C. Forestry Revitalization Trust. The offer was open for acceptance until December 1, 2008. The offer was not accepted by Hayes.

13 Under the Contract, Teal was to provide a 2009 logging plan to Hayes. The 2009 logging plan was provided to Hayes on December 9, 2008. On January 12, 2009, a representative of Teal advised a representative of Hayes that Teal was "... suspending operations indefinitely with respect to the work allocated to Hayes ..." Since December, 2008, Teal has not assigned work under the Contract to Hayes. Under the Contract, Hayes is entitled to 34.6% of the stump to dump logging work available relating to TFL46.

POSSIBLE TRANSFER OF THE CONTRACT TO NORTH VIEW

14 The *Timber Harvesting Contract and Subcontract Regulation*, B.C. Reg. 22/93, and paragraph 18 of the Contract governs the question of whether the Contract can be assigned. Section 4(1) of the Regulation provides: "Every replaceable contract must provide that the interests of the contractor are assignable, subject to the consent of the licence holder, and that consent must not be withheld unreasonably." In accordance with that section, paragraph 18 of the Contract provides:

> 18.01 The Contractor may assign any of its rights or interests under this Agreement, provided the Contractor first obtains the consent of the Company. The Company will not unreasonably withhold its consent to any assignment proposed by the Contractor.
>
> 18.02 Any assignment or transfer by the Contractor of this Agreement or of any interest therein ... without the written consent of the Company will be void. ...

15 In a May 8, 2009 letter to Teal, Hayes requested the consent of Teal to the assignment of the Contract to North View and advised that they contemplated completing the transfer prior to June 15, 2009. The letter also stated:

16 The outstanding payments under the Purchase Agreement will be secured by a security interest granted by the Purchaser (North View) to Hayes in all of the Purchaser's rights, title and interest in and to the Logging Contract and all proceeds thereof or therefrom.

17 In a May 14, 2009 letter, Hayes provided further information to Teal with respect to North View. In a May 15, 2009 letter, Teal sought information concerning North View and forwarded a questionnaire for completion and return. In a May 22, 2009 letter, Hayes provided the questionnaire to Teal. At that stage, it is clear that not all of the questions set out in the questionnaire had been answered in full. In any event, the questionnaire was not answered to the satisfaction of Teal. Despite the fact that all of the questions it had set out had not been answered, Teal wrote to Hayes on May 29, 2009 advising that it would be withholding their consent to the assignment of the

Contract because Teal was of the view that the information provided did not justify providing their consent.

18 The matters which remained of concern to Teal were set out in that letter, being that North View:

1. is not a going concern;
2. when it last operated, was a minor business with revenues of about 1 to 2% of what the Contract currently delivers to the contractor and financial statements that suggest it is financially not viable or capable of performing the Contract;
3. has no experience performing a Coastal stump to dump contract;
4. has no equipment or crew or substantive projections of the equipment or crew it needs to perform its obligations under the Contract;
5. despite the difficult circumstances in the Coastal forest industry, has no business plan demonstrating that it can viably perform the obligations under the Contract, and no apparent financial resources to fund acquisition of equipment or ongoing expenses of operations; and
6. has no executed assignment of the Contract conditional on our consent being provided.

19 The letter then detailed the nature of the concerns of Teal. Despite the position having been taken, Hayes continued to provide information and Teal continued to request further information. On June 5, 2009, Hayes provided further information regarding North View and on June 8, 2009, Teal requested further information. In a June 12, 2009 letter, Teal advised that it was continuing to withhold its consent setting out detailed reasons regarding why they were continuing to take that position. The following "summary" was provided by Teal regarding the proposed assignment to North View:

> In summary, the evidence continues to indicate North View is not a suitable assignee. It is a small and virtually inactive company, particularly in the context of the operation required under the Contract. It has no experience performing a Coastal stump to dump operation, let alone a significant one; no experience with a union operation; few financial resources; no commitments from financial institutions or others to provide the necessary working capital to begin operations; and no equipment or crew. Moreover, it has no firm plans to address these issues in the context of the five-year replaceable contract it seeks to obtain.
>
> In our view, these and the other concerns we have raised comprise, at any time, reasonable grounds for us to withhold consent.

> However, beyond this, you are proposing to assign this important Contract to a company with these shortcomings at a time when the Coast forest industry is, as you acknowledge, in a severe downturn. In these conditions, few licensees, Teal included, can afford to expend scarce resources dealing with weak or failing contractors. Teal has already incurred significant time and expenses addressing the financial difficulties experienced by you as the current contractor. You incurred these difficulties despite your significant resources and experience in Coastal, unionized, stump to dump operations. If a contractor with significant resources and experience has had difficulties, it is most probable an under-resourced and inexperienced contractor such as North View will also face significant difficulties. Teal is no position to bear the costs in time, money and process of another failure of the contractor holding this Contract. It is unreasonable to expect Teal to put itself in that position by consenting to an assignment to a contractor with North View's shortcomings.

SHOULD THE DISPUTE GO TO ARBITRATION?

20 The "Dispute Resolution Clause" set out in the Contract provides for a period of 30 days for the parties to attempt to resolve any dispute arising, the ability of either party to then refer the matter to arbitration, the ability of each party to have two days to complete their submissions and the requirement that the arbitrator shall hand down the arbitral award within seven days of the completion of the submissions. However, each party is entitled to an "examination for discovery" as that term is defined in the Rules of Court, including discovery of documents and discovery of one officer representative of the other party, to a maximum of three days. Once the award of the arbitrator has been received, a party would be at liberty to apply to this Court to have the award set aside. Any party not satisfied with the decision of a Judge of this Court could then apply to the Court of Appeal to overturn the decision reached by a Judge of this Court. These parties have had a history of a number of their disputes going to the Court of Appeal.

21 Teal contacted Mr. Daniel B. Johnston regarding his availability to act as an arbitrator. Although Mr. Johnston is Counsel for the law firm representing Hayes, Mr. Johnston has served as an mediator and arbitrator in disputes between Hayes and Teal pertaining to the Contract in the past and has advised Teal that it is "highly likely" that he would be available for "a few days over the next six weeks to act as the arbitrator. ..."

22 But for the filing under the *CCAA*, disputes under the Contract would be governed by the Dispute Resolution provisions under the Contract and under ss. 162 and 160 of the *Forest Act* and ss. 5 and 48 - 51 of the Regulation under that *Act*: *Hayes Forest Services Ltd. v. Teal Cedar Products Ltd.* (2008), 82 B.C.L.R. (4th) 110 (C.A.). However, the Court under the *CCAA* has the jurisdiction to decide a dispute which arises under the Contract between Hayes and Teal despite the provincial statutory authority and the terms of the Contract: *Luscar Ltd. v. Smoky River Coal Ltd.* (1999), 175 D.L.R. (4th) 703 (Alta. C.A.).

23 In *Luscar, supra*, the Court dealt with the issue of whether a judge had the discretion under the *CCAA* to establish a procedure for resolving a dispute between the parties who had previously agreed under a contract to arbitrate their disputes. The question before the Court was whether the dispute should be resolved as part of the "supervisory role of the reorganization" of the company under the *CCAA* or whether the Court should stay the proceedings while the dispute was resolved by an arbitrator. The decision of the Learned Chambers Judge was that the dispute should be resolved as expeditiously as possible by the Court of Queen's Bench under the *CCAA* proceedings.

24 In upholding the ruling of the Learned Chambers Judge, and concluding that the discretion of the Learned Chambers Judge had been exercised properly, Hunt J.A., on behalf of the Court stated:

> The above jurisprudence persuades me that "proceedings" in s. 11 includes the proposed arbitration under the B.C. Arbitration Act. The Appellants assert that arbitration is expeditious. That is often, but not always, the case. Arbitration awards can be appealed. Indeed, this is contemplated bys. 15(5) of the Rules. Arbitration awards, moreover, can be subject to judicial review, further lengthening and complicating the decision-making process. Thus, the efficacy of CCAA proceedings (many of which are time-sensitive) could be seriously undermined if a debtor company was forced to participate in an extra-CCAA arbitration. For these reasons, having taken into account the nature and purpose of the CCAA, I conclude that, in appropriate cases, arbitration is a "proceeding" that can be stayed under s. 11 of the CCAA.
>
> (at para. 33)
>
> The language of s. 11(4) is very broad. It allows the court to make an order "on such terms as it may impose". Paragraphs (a), (b) and (c) empower the court order to stay "all proceedings taken or that might be taken" against the debtor company; restrain further proceedings "in any action, suit or proceeding" against the debtor company; and prohibit "the commencement of or proceeding with any other action, suit or proceeding" (emphasis added). These words are sufficiently expansive to support the kind of discretion exercised by the chambers judge.

(at para. 50)

25 I agree that the language of s. 11(4) of the *CCAA* is broad enough to allow this Court to substitute a decision in these proceedings for the arbitration process contemplated under the Contract. In this regard, see also the decision in *Landawn Shopping Centers Ltd. v. Harzena Holdings Ltd.* (1997), 44 O.T.C. 288 (Ont. G.D.) where the Court allowed the arbitration stipulated under a contract to be replaced by a claim of the landlord being dealt with by the Court under the terms of a plan of arrangement.

26 Of similar effect are other decisions where the contracts between landlords and tenants were affected by the power contained under s. 11 of the *CCAA*: *Re T. Eaton Co.* (1997), 46 C.B.R. (3d) 293 (Ont. G.D.); *Re Dylex Ltd.* (1995), 31 C.B.R. (3d) 106 (Ont. G.D.); *Re Philip's Manufacturing Ltd.* (1991), 9 C.B.R. (3d) 1 (B.C.S.C.); *Re Playdium Entertainment Corp.* (2001) 31 C.B.R. (4th) 302 (Ont. S.C.J.) with additional reasons at (2001), 31 C.B.R. (4th) 309 (Ont. S.C.J.); *Armbro Enterprises Inc.* (1993), 22 C.B.R. (3d) 80 (Ont. G.D.); and *Skeena Cellulose Inc v. Clear Creek Contracting Ltd.* (2003), 13 B.C.L.R. (4th) 236 (C.A.).

27 *Skeena, supra*, dealt with the interaction between logging contracts established under the *Forest Act* and the scheme of judicial stays and creditors' compromises available under the *CCAA*. The Court authorized the termination of contracts similar to the Contract here despite the provisions in the contracts themselves. In this regard, Newbury J.A. on behalf of the Court stated at paragraph 37:

> In the exercise of their 'broad discretion' under the CCAA, it has now become common for courts to sanction the indefinite, or even permanent, affecting of contractual rights. Most notably, in *Re Dylex Ltd.* (1995) 31 C.B.R. (3d) 106 (Ont. Ct. (Gen. Div.)), Farley J. followed several other cases in holding that in "filling in the gaps" of the CCAA, a court may sanction a plan of arrangement that includes the termination of leases to which the debtor is a party. (See also the cases cited in *Dylex*, at para. 8; *Re T. Eaton Co.* (1999) 14 C.B.R. (4th) 288 (Ont. S.C.), at 293-4; *Smoky River Coal*; *supra*, and *Re Armbro Enterprises Inc.* (1993) 22 C.B.R. (3d) 80 (Ont. Ct. (Gen. Div.)), at para. 13.) In the latter case, R.A. Blair J. said he saw nothing in principle that precluded a court from "interfering with the rights of a landlord under a lease, in the CCAA context, any more than from interfering with the rights of a secured creditor under a security document. Both may be sanctioned when the exigencies of the particular re-organization justify such balancing of the prejudices." In its recent judgment in *Syndicat national de l'amiante d'Asbestos inc. v. Jeffrey Mines Ltd* [2003] Q.J. No. 264, the Quebec Court of Appeal observed that "A review of the jurisprudence shows that the debtor's right to cancel contracts prejudicial to it can be provided for in an order to stay proceedings under s. 11." (para. 74.)

28 In May 31, 2008 Oral Reasons for Judgment (Supreme Court of British Columbia Action No. S080752). In *Backbay Retailing Corporation, and Gray's Apparel Company Ltd.*, the Court approved an assignment of the interests of the Petitioner's interests in leases in certain retail outlets to a third party despite the objection of the landlords and despite the fact that leases provided that the approval or consent of the landlords was required prior to the transfer, assignment or assumption of the leases. The new tenants were not prepared to agree to be liable for past defaults under the leases and required that all of the rights under the leases including those that were expressed to be personal to Petitioners be assigned to them. The petitioners had asserted no common law entitlement to the orders that they sought but, rather, had submitted that the Court has a statutory

discretion under the *CCAA* to make the orders sought so long as that is consistent with the objectives of the *CCAA* to facilitate a restructuring. Citing with approval the decision in *Playdium, supra*, Hinkson J. concluded that the proposed purchase and sale agreement was in the best interests of the Petitioners, would afford significant benefits to their landlords, and that the refusal of the proposed tenants to assume the liabilities of the immediate predecessors was not a reasonable basis upon which to withhold consent.

29 Hinkson J. also cited with approval the decision of Kent J. in *Gauntlet Energy Corporation (Re)* (2003), 336 A.R. 302: "Interference with contractual rights of creditors and non-creditors is consistent with the objective of the CCAA to allow struggling companies an opportunity to survive whenever reasonably possible." (at para. 58). Hinkson J. also relied on the decision in *Doman Industries Ltd. (Re)* (2003), 14 B.C.L.R. (4th) 153 and *T. Eaton Co. (Re)*, [1997] O.J. No. 6388 (Ont. Ct. J. Gen. Div.). In July 11, 2008 Oral Reasons for Judgment, Levine J.A. denied leave to appeal the Order of Hinkson J.

30 I have concluded that I should override the arbitration provisions in this Contract to allow a Court determination of the issue of whether Teal is or is not unreasonably withholding its approval for the transfer of the Contract to North View. First, I am satisfied that the determination of this issue is less expeditious and more expensive under the arbitration provisions. The past history between these parties is that the arbitration proceedings have been both lengthy and incredibly costly. In the context of a previous application, counsel for Teal indicated that the cost of an arbitration might approach $250,000.00. Second, an arbitration award is subject to judicial review, further lengthening and complicating the decision-making process. Third, there are time constraints imposed by North View regarding the purchase of this Contract. Those deadlines cannot be met by the arbitration proceedings contemplated under the Contract. Fourth, there is no reason why the question whether the consent has been unreasonable withheld or not cannot be determined by the Court. Although a number of arbitrators are experienced in dealing with the type of issues that would arise in the arbitration of other issues which have arisen between Hayes and Teal, the question of whether consent has been unreasonably or reasonably withheld is an issue which is commonly dealt with by the Court and requires no forestry related expertise. Taking into account all of those factors, I am satisfied that the issue raised by the dispute between the parties should be dealt with by this Court in the *CCAA* proceedings. The application of Teal to lift the stay of proceedings granted on July 31, 2008 is dismissed.

CAN THE COURT APPROVE THE ASSIGNMENT OF THE CONTRACT, EVEN THOUGH IT IS NOT UNREASONABLE FOR TEAL TO WITHHOLD ITS CONSENT?

31 I am satisfied that the *CCAA* Court can approve an assignment even if I reach the conclusion that it is not unreasonable for Teal to withhold its consent. In *Playdium, supra*, Spence J. dealt with a proposal to transfer all of the assets of Playdium to a new corporation as the only viable alternative to a liquidation of the assets of the company. Under that tenancy, an agreement could not be assigned without the consent of Famous Players, which consent could not be unreasonably

withheld. Famous Players had argued that it had not been properly requested to consent and it had not received adequate financial information and assurances regarding management expertise and how their agreement might be brought into good standing. Save for the *CCAA* Order in place, Spence J. concluded that there could be no assignment but that the *CCAA* Order affords "... a context in which the court has the jurisdiction to make the order." Spence J. concluded that he had jurisdiction to compel the assignment of leases over the objections of other parties and held that he had the jurisdiction to approve the assignment of leases even though it would not have been unreasonable for Famous Players to withhold its consent to the assignment. I am prepared to adopt the path taken by Spence J. in *Playdium, supra,* if I conclude that it is reasonable for the consent of Teal to be withheld.

HAS THE CONSENT OF TEAL BEEN UNREASONABLY WITHHELD?

32 The determination of the reasonableness of withholding consent is a question of whether a reasonable person would have withheld consent in the circumstances. The determination will be dependent on such factors as the commercial realities of the marketplace, the economic impact of the assignment, and the financial position of the proposed assignee. *Exxonmobil Canada Energy v. Novagas Canada Ltd.*, [2003] 3 W.W.R. 657 (Alta. Q.B.), dealt with the assignment of the management of the interest of Exxonmobil Canada Energy in a gas processing plant. Regarding the argument that the assignment had been unreasonably withheld, Park J. concluded that it was reasonable to have refused the consent to the assignment and, in these regards, made the following statements:

> The reasons for including a consent requirement in the assignment was to allow each party the opportunity of reasonably assessing any future contractual partners. If a proposed assignee did not meet the criteria reasonably required by the other party, the assignment should not proceed. (at para. 54)
>
> On an objective basis it is entirely reasonable to enquire into the financial capability of a proposed business partner in determining whether to accept that party as a business partner. There must be adequate information provided to EMC regarding the strength of the Solex financial covenant. Further, if NCLP and Solex wish to argue (as they did) that EMC would be in a better position with the financial covenant of each of Solex and NCLP, in the absence of Solex being novated into the Agreement, then it would be reasonable for Solex and NCLP to provide adequate information on the strengths of those financial covenants rather than leaving EMC to surmise.
>
> However, it is not the final strength or weakness of Solex's financial covenant which prevents consent. Rather it is the failure of Solex to provide relevant and

> material financial information which will enable EMC to assess the financial strength of Solex on a go forward basis. The absence of financial information provided by Solex means that EMC has reasonably withheld its consent. EMC in the circumstances cannot satisfy itself as to the financial ability of Solex to meet its prospective obligations as the proposed assignee under the Agreement.
>
> Finally, I note that EMC has not withheld its consent for improper reasons. As I noted previously, the desire of EMC to resolve outstanding issues between itself and NCLP is a separate issue, and is not tied to EMC's desire to receive proper and adequate financial information from Solex as a separate entity. EMC did not withhold its consent in order to secure additional benefits as argued by Solex and NCLP.
>
> (at paras. 58-60)

33 The reasonableness of withholding consent has often been considered in the context of leases. In *1455202 Ontario Inc. v. Welbow Holdings Ltd.* (2003), 9 R.P.R. (4th) 103 (Ont. S.C.J.), Cullity J. concluded that the landlord was justified in its decision based on the lack of information concerning the business experience of the proposed assignee stating:

> In determining whether the Landlord has unreasonably withheld consent, I believe the following propositions are supported by the authorities cited by counsel and are of assistance:
>
> 1. The burden is on the Tenant to satisfy the court that the refusal to consent was unreasonable: *Shields v. Dickler*, [1948] O.W.N. 145 (C.A.), [1948] O.J. No. 539 at pages 149-50; *Sundance Investment Corporation Ltd. v. Richfield Properties Limited et al*, [1983] 2 W.W.R. 493 (Alta. C.A.), at page 500; cf. *Welch Foods Inc. v. Cadbury Beverages Canada Inc.* (2001), 140 O.A.C. 321 (C.A.), at page 331. In deciding whether the burden has been discharged, the question is not whether the court would have reached the same conclusion as the Landlord or even whether a reasonable person might have given consent; it is whether a reasonable person could have withheld consent: *Whiteminster Estates v. Hedges Menswear Ltd.* (1972), 232 Estates Gazette 715 (Ch. D.), at pages 715-6; *Zellers Inc. v. Brad-Jay Investments Ltd.*, [2002] O.J. No. 4100 (S.C.J.), at para. 35.
> 2. In determining the reasonableness of a refusal to consent, it is the information available to - and the reasons given by - the Landlord at the time of the refusal - and not any additional, or different, facts or reasons

provided subsequently to the court - that is material: *Bromley Park Garden Estates Ltd. v. Moss*, [1982] 2 All E.R. 890 (C.A.), at page 901-2 per Slade L.J. Further, it is not necessary for the Landlord to prove that the conclusions which led it to refuse consent were justified, if they were conclusions that might have been reached by a reasonable person in the circumstances: *Pimms, Ltd. v. Tallow Chandlers in the City of London*, [1964] 2 All E.R. 145 (C.A.), at page 151.

3. The question must be considered in the light of the existing provisions of the lease that define and delimit the subject matter of the assignment as well as the right of the Tenant to assign and that of the Landlord to withhold consent. The Landlord is not entitled to require amendments to the terms of lease that will provide it with more advantageous terms: *Jo-Emma Restaurants Ltd. v. A. Merkur & Sons Ltd.* (1989), 7 R.P.R. (2d) 298 (Ont. Div. Ct.); *Re Town Investments Ltd.*, [1954] Ch. 301 (Ch. D.) - but, as a general rule, it may reasonably withhold consent if the assignment will diminish the value of its rights under it, or of its reversion: *Federal Business Development Bank v. Starr* (1986), 55 O.R. (2d) 65 (H.C.), at page 72. A refusal will, however, be unreasonable if it was designed to achieve a collateral purpose, or benefit to the Landlord, that was wholly unconnected with the bargain between the Landlord and the Tenant reflected in the terms of the lease: *Bromley Park Garden Estates Ltd. v. Moss*, above, at page 901 per Dunn L.J.)
4. A probability that the proposed assignee will default in its obligations under the lease may, depending upon the circumstances, be a reasonable ground for withholding consent. A refusal to consent will not necessarily be unreasonable simply because the Landlord will have the same legal rights in the event of default by the assignee as it has against the assignor: *Ashworth Frazer Ltd., v. Gloucester City Council*, [2001] H.L.J. 57.
5. The financial position of the assignee may be a relevant consideration. This was encompassed by the references to the "personality" of an assignee in the older cases see, for example, *Shanley v. Ward* (1913), 29 T.L.R. 714 (C.A.); *Dominion Stores Ltd. v. Bramalea Ltd.* [1985] O.J. No. 1874 (Dist. Ct.)
6. The question of reasonableness is essentially one of fact that must be determined on the circumstances of the particular case, including the commercial realities of the market place and the economic impact of an assignment on the Landlord. Decisions in other cases that consent was reasonably, or unreasonably, withheld are not precedents that will dictate the result in the case before the court: *Bickel et al. v. Duke of Westminster et al.*, [1976] 3 All E.R. 801 (C.A.), at pages 804-5; *Ashworth Frazer Ltd. v. Gloucester City Council*, above, at para. 67; *Dominion Stores Ltd. v.*

Bramalea Ltd., above, at para. 25.

(at para. 9)

34 Of the six general areas of concern raised by Teal, the objection that there was no executed Assignment of Contract is no longer an issue as an executed assignment conditional on the consent of Teal has now been provided.

35 Regarding the concern regarding the lack of equipment or crew, I am satisfied that this should not be an impediment to the assumption of the contractual obligations by North View. Some of the crew that will be required has already been contracted through Horsman Trucking Ltd. ("Horsman"), who has entered into a services subcontract with North View. In general, I accept the evidence of Donald P. Hayes who makes this statement in his July 2, 2009 Affidavit:

> At present there is no work available under the Teal Bill 13 Contract and no equipment is currently required. When logging recommences under the Contract, the Purchaser will be able to acquire equipment either directly or be able to subcontract out portions of the work (as is currently done by Hayes) and service the Contract without difficulty.
>
> There is currently a surplus of logging equipment on Vancouver Island. The most recent auction of equipment was held in June, 2009 by Ritchie Bros. in Duncan, BC. The sale prices at that recent Ritchie Bros.' auction were extremely low and any contractor on the Island will have no difficulty acquiring the necessary equipment at some of the lowest historic prices for that equipment.
>
> There is current an abundance of logging equipment from Coastal BC operations that has been returned to various leasing companies. I am aware of certain lessors that are now re-leasing this equipment without the requirement of a down payment by the new lessee. Essentially the new lessee simply makes payments based on the returned value of the equipment. This will make it very easy for any contractor or subcontractor to acquire any equipment needed to service a contract for logging or road building.

36 I am also satisfied that North View sets out a satisfactory explanation regarding equipment in its July 16, 2009 letter to Teal:

> I have made inquiries in the market as to the availability of equipment. Hayes has all of the equipment for sale that I would require to start the operations. I confirm that in the event of short notice from Teal that Hayes would rent or rent to purchase suitable equipment as required including a grapple yarder, log loaders,

back spar, cat etc.

Finning also has new and used inventory in stock. I am also aware of several contractors who are shut down and will likely have equipment for short term rent or rental purchase.

Pick up trucks are readily available for purchase or lease in the market and Hayes will sell me the industrial box liners required.

Until there is a logging plan and a start date, I have not tried to firm up equipment arrangements. Without the logging plan and a start date, I cannot be sure of the equipment actually required or the timing of that requirement.

37 Regarding the concern that North View is not a going concern, while it is clear that North View is an entity which is not presently operating, my review of the experience of the principals of North View allows me to conclude that the principals have sufficient experience to allow North View to be successful in performing the work that is provided by Teal under the Contract. The principal of North View has over 35 years of logging experience and worked as a subcontractor for Hayes between 2005 and 2008 on the work required under the Contract. As well, North View will have the assistance of the principals of Hayes, and has contracted with an experienced hauler to subcontract the hauling of timber to the dump operations.

38 I also accept the following evidence regarding the proposed operations of North View under the Contract which is set out in the July 24, 2009 Affidavit of Donald P. Hayes:

The contract will be operated as follows:

(a) Falling. The falling work under the contract is currently done by a sub contractor, Gemini, they had done the falling work for years, and will continue to do so for North View Timber Ltd. ("North View");

(b) Yarding. Mr. Horsman is one of the most experienced yarders on the coast and has done this work on this contract for Hayes. He will do this work;

(c) Loading. This work will be contracted out to an experienced loader. The loading takes place in close proximity to the yarding and can be supervised by the yarder, in this case Mr. Horsman;

(d) Hauling. The hauling will be subcontracted to Horsman Trucking Ltd, a well know and experienced hauler on the Island. I have know them for years and they have a good reputation.

39 I am satisfied that Teal should have no hesitation in concluding that the equipment, crew and expertise to undertake the work required under the Contract will be available to North View. In this regard, I am also mindful of the fact that, if North View fails to perform under the Contract, Hayes will be in a position to take back the Contract and then perform the logging required under the Contract. In the past, Teal was satisfied with the performance of Hayes under the Contract, and should have some solace that Hayes will be in a position to perform under the Contract if North View does not.

40 Regarding the concern of Teal that North View is not financially capable, I note that a $50,000.00 deposit has already been paid, that an agreement has been reached with Horsman to sell to Horsman the hauling subcontract for $400,000.00 so that the further $277,000.00 required at the date of closing will be available, that $100,000.00 will be set aside to meet capital requirements, and that preliminary discussions are underway with B.D.C. and Caterpillar Finance regarding financing once any logging plan proposed by Teal is known. In this regard, I am satisfied that the payments under the Contract must be made by Teal every two weeks, and I take into account the advice received from North View that its expenses need to be paid monthly so that the working capital that would otherwise be required to service this Contract is reduced.

41 Finally, Teal is concerned that North View has no "business plan". I am satisfied that this concern is answered in the July 16, 2009 letter from North View to Teal:

> I have not regularly prepared business plans. My practice is to study the logging plan, when I receive it and then determine the equipment and people that I need. I then closely supervise the production and all purchases to control the cash flow.
>
> I have had Mr. Donald P. Hayes assist me with the preparation of the Business Plan. Mr. Hayes is a Chartered Accountant and the President of Hayes Forest Services Limited, the current operator of the contract. This is a much more detailed plan than I could produce myself. I have reviewed it with Mr. Hayes and based on my knowledge I confirm that in my opinion the Business Plan reflects the economic conditions in the industry and uses reasonable assumptions concerning rates, costs, financing and working capital needs including the payment of the $3.00 per cubic meter promissory note to Hayes. I further confirm that I believe that the contract is viable at market rates.
>
> This Business Plan has not been independently reviewed but was developed in conjunction with Mr. Hayes who has operated this contract for over 20 years and is extremely knowledgeable in respect of this contract. Once the actual logging plan is provided, it will likely require material changes to the Business Plan.

42 As well, it should be obvious to Teal that it is difficult to put forward a "business plan" when

the 2009 and 2010 work allocated under the Contract is not known. While it is clear that North View does not have the present capacity or business plan in place to handle a cut of 125,000 cubic metres, it is also clear that there is no current work under the Contract and this yearly volume has not been required of Hayes for over three years.

43 In the context of leases, the Court must look at all of the circumstances to determine if consent has been reasonably withheld: *Lendorf Canadian Pension Properties Ltd. v. Davis Management Ltd.* (1987) 13 B.C.L.R. (2d) 367 (S.C.) at para. 51. The *Forest Act* and the *Timber Harvesting Regulations* require similar contracts to be assignable and puts the onus on licence holders such as Teal to justify their refusal to consent to any assignment. Taking into account all of the circumstances surrounding this question, I am satisfied that Teal has not shown that it is reasonable to withhold its consent. At the same time, I am satisfied that Hayes has met the burden of showing that a reasonable person would not have withheld consent.

44 In this regard, I have concluded that at least part of the refusal to provide consent was designed by Teal to achieve a collateral purpose that is wholly unconnected with the bargain between Teal and Hayes. In November 2008, Teal made an offer to purchase the Contract for $764,112.00. From this, I can conclude that Teal believes that there is significant value to it if the Contract cannot be performed by Hayes or if Teal can otherwise obtain the benefits of the Contract in order that they can be transferred to another operator. Teal has also provided an offer through 858 to purchase the Contract for $1,400,000.00. This is further evidence of the value to Teal of stopping a transfer of the Contract to North View in the hope that the Contract will revert to it by virtue of the inability or unwillingness of Hayes to perform under the Contract.

WHAT SHOULD BE MADE OF THE OFFER OF 858?

45 The offer of 858 was open for acceptance until August 11, 2009 and was directed to the attention of Hayes Forest Services Ltd. ("Offer"). It was a condition of the Offer that Horsman enter into a replaceable services sub-contract with 858 in the same form as the Horsman contract with North View. As at August 14, 2009, no confirmation had been received from Horsman that they were prepared to accept that stipulation. The purchase price under the Offer is $1,400,000, with $400,000 at the time of closing (being the amount that would be available to 858 under the Horsman contract) and with balance of the purchase price by a promissory note for $1,000,000.

46 In response to the concern raised by Hayes that Teal would be in a position to control the amount of work that would be available to 858 so that 858 would not be in a position to pay the balance due and owing under the Promissory Note quickly or at all, the following provision was inserted after the first draft of the Offer was forwarded to Hayes:

> 2.11 **Amount of Work Dispute.** Teal and the Purchaser agree that if, at any time before the Purchaser pays the Contract Purchase Price in full, the Vendor reasonably believes that Teal has failed to meet its obligation under Paragraph 2.05 of the Teal Contract, the Vendor may give notice (the "**Dispute Notice**") to

Teal and the Purchaser specifying in reasonable detail the particulars of the default, in which case a dispute is deemed to exist between the Vendor and Teal under this Agreement, which dispute, despite the reference in Paragraph 2.05 of the Teal Contract to resolving amount of work disputes in accordance with the Contract Regulation (as defined in the Teal Contract), will be resolved as follows:

(a) as soon as reasonably practicable after the notice is given, the Vendor and Teal will:

(i) cause their respective appropriate personnel with decision making authority to meet in an attempt to resolve the dispute through amicable negotiations; and

(ii) provide frank, candid and timely disclosure of all relevant facts, information and documents to facilitate those negotiations;

(b) if the dispute is not resolved by such negotiations within 15 days of the Vendor having given the Dispute Notice, either the Vendor or Teal may, within 30 days after the Dispute Notice was given, deliver a Notice (a "Mediation Notice") to the other party requiring the dispute to go to mediation, in which case the Vendor and Teal will attempt to resolve the dispute by structured negotiation with a mediator administered under the Commercial Mediation Rules of the British Columbia International Commercial Arbitration Centre before a mediator agreed upon by the Vendor and Teal or, failing agreement, appointed by the Centre;

(c) if:

(i) the dispute is not resolved within 14 days after the mediator has been agreed upon or appointed under Section 2.11(b); or

(ii) the mediation is terminated earlier as a result of a written notice by the mediator to the Vendor and Teal that the dispute is not likely to be resolved through mediation,

either the Vendor or Teal may, not more than 14 days after the conclusion of the period referred to in Section 2.1 1(c)(i) or the

receipt of the notice referred to in Section 2.11(c)(ii), as the case may be, commence arbitration proceedings by giving a notice of arbitration to the other party, in which case the dispute will be referred to and finally resolved by arbitration administered under the British Columbia International Commercial Arbitration Centre's Shorter Rules for Domestic Commercial Arbitration before an arbitrator agreed upon by the Vendor and Teal or, failing agreement, appointed by the Centre, and the decision of the arbitrator will be final and binding on the Vendor, the Purchaser and Teal, but will not be a precedent in any subsequent arbitration under this Section;

(d) pending resolution or other determination of the dispute under this Section, the Purchaser will continue to perform its obligations under the Teal Contract; and

(e) if, as a result of the resolution or other determination of the dispute under this Section, Teal allocates an additional amount of work to the Purchaser, the Purchaser will perform that additional amount of work in accordance with the terms of the Teal Contract.

47 Some of the objections to the Offer are summarized in the August 10, 2009 letter from counsel for Hayes to counsel for Teal:

> As you are aware our client has entered into a contract with North View Logging Ltd. to sell that contract to North View. Having done so Hayes is not in a position to enter into a second contract to sell the same contract.
>
> Apart from that problem, there are a number of other issues that make this offer problematic from Hayes' perspective, these include:
>
> 1. The proposed purchase price is substantially less than the North View offer, some $250,000. In addition, to obtain an extension of the closing of the transaction to North View, Hayes has had to agree to a break fee of $50,000 payable to North View if Hayes sells the contract to Teal. A copy of that agreement is enclosed;
> 2. The rate of payment on the Promissory Note is only $2 per M3 as opposed to the $3 per M3 to be paid by North View;
> 3. The Purchaser is a shell company incorporated on August 6, 2009 that appears to have no assets. It is proposed that the sale proceeds derived from the Horsman Trucking subcontract be used to fund the cash

component of the transaction, with the balance to be paid by the $2 per M3 payable under the Promissory Note. The Purchaser will not have any of its assets invested in this contract and is not at any financial risk. There is no consequence to the Purchaser simply walking away from its obligations and allowing Teal to cancel the underlying Bill 13 contract for non performance;

4. The only security proposed is from what appears to be a shell company and even that is limited to the underlying Bill 13 contract itself. If the Purchaser, a Teal nominee, defaults in performance, Teal will cancel the Bill 13 contract, and the "security" held by Hayes would vanish;
5. Payment under the promissory note is wholly dependent upon Teal allocating the amount of work that the holder of the Bill 13 contract is entitled to. An arm's length purchaser, such as North View, has a strong economic interest in enforcing its rights as against Teal to ensure that it receives the volume of work it is entitled to. The Purchaser proposed by Teal is a Teal nominee and will have no such economic interest. Teal has taken every step it can in the course of the CCAA proceedings to terminate the Bill 13 contract. We see no reason to expect that this attitude will change once both sides of the Bill 13 contract are in the control of Teal;
6. Teal can arbitrarily reduce and or delay the amount payable under the Promissory Note by allocating work that could or should be done by Hayes to other contractors working for Teal on TFL 46. It is doing so now;
7. There is no evidence of the ability of the Purchaser to do the work required under the contract, its finances, equipment or personnel.

48 Many of the objections raised by Hayes regarding the Offer parallel many of the objections raised by Teal regarding the North View offer. While Teal and 858 have common shareholders, none of the information that Teal required of North View is available to Hayes or the Court regarding the Offer of 858. If it is the position of Teal that the Court should approve the offer of 858 because it is reasonable to do so and is in the best interests of the creditors of Hayes to do so, then I conclude that Teal has not met the burden of showing that it is. In the context of whether withholding consent has been reasonable or not, a number of factors apply. If those factors are applied to the application of Teal, it is clear that a reasonable person would withhold consent and it is clear that approval of the offer of 858 would not be ordered. It is difficult for Teal to argue on one hand that a reasonable person would withhold consent for the proposed assignment to North View but, at the same time, the Court should approve the proposed transfer to 858, even though there is even less information available to allow the Court to reasonably assess the future contractual partner recommended by Teal. There is no information regarding the financial capability of 858. There is nothing which would allow the Court to satisfy itself as to the financial ability of 858 to meet its prospective obligations. As well, the Court is not in a position to approve offers where the offer continues to contain conditions precedent that have not been met. In this regard, the approval of Horsman to "transfer" its contract with Hayes to 858 so that 858 receives $400,000.00 remains an

unfulfilled condition.

49 There are also significant economic advantages to the creditors of Hayes to accept the North View offer and for the Court to make a finding that the consent of Teal has been unreasonably withheld so that the assignment of the Contract to North View should be approved. First, the offer of North View is $214,266.00 better. Second, the balance of the purchase price is paid off more quickly as the payment will be based on $3.00 per cubic metre, whereas the payment of the balance of the purchase price contemplated by 858 will be based on a payment of $2.00 per cubic metre. Third, if there is default, it is clear that the creditors of Hayes will benefit if there is a reversion of the Contract to Hayes. I cannot conclude that is the case with the Offer. Fourth, it may well be that Hayes will have to pay a $50,000.00 cancellation fee to Horsman if the Offer is approved by the Court.

50 It also should be noted that 858 is bringing none of its own money "to the table". Rather, all of the $400,000.00 that will be due on closing comes from the funds that would be available from Horsman if Horsman is prepared to enter into a similar subcontract with 858. As well, all payments of the $2.00 per cubic metre contemplated under the Offer are wholly dependent upon Teal allocating the amount of work that is contemplated under the Contract. North View has a stronger economic interest to enforce its rights against Teal to ensure that it receives the volume of work it is entitled to under the Contract whereas 858 has no such economic interest. As well, what is proposed under the Offer provides ample opportunity for the arbitration process and appeals therefrom to delay the question of the allocation of work to 858.

51 I am satisfied that Teal has unreasonably withheld its consent for the assignment of the Contract from Hayes to North View. Even if I had not reached that conclusion, I am satisfied that the advantages to the creditors of Hayes far outweigh any disadvantages so that I should exercise the discretion available to me under the *CCAA* to approve the assignment of the Contract despite the consent of Teal being reasonably withheld. The sale to North View Timber Ltd. of the replaceable stump to dump logging contract between Hayes Forest Services Limited and Teal Cedar Products Ltd. is approved. The application by Teal Cedar Products Ltd. to approve a sale of that contract to 858434 BC Ltd. is dismissed.

52 The parties will be at liberty to speak to the question of costs.

G.D. BURNYEAT J.

* * * * *

APPENDIX "A"

SCHEDULE "D"

DISPUTE RESOLUTION CAUSE

Timber Harvesting Contracts

Dispute Resolution

Where the Work performed by the Contractor under an agreement with the Company is carried out on lands managed by the Company under a Tree Farm Licence or Forest Licence, and where a dispute arises over a term, condition or obligation under the agreement which cannot be resolved amicably between the parties within 30 days of the dispute arising, the Company and the Contractor mutually agree that either party may invoke the following dispute resolution provisions:

(a) The parties may by agreement first attempt to resolve their dispute with the assistance of a single professionally qualified mediator. The mediator shall be chosen by agreement between the parties. In the event that the parties fail to agree on the choice of a mediator, then a mediator shall be chosen by a mutually agreed upon third party unrelated to the parties to this agreement.

(b) In the event that the mediator is unsuccessful in assisting the parties to resolve their dispute within 5 days of the commencement of the mediation, or either party wishes the dispute to proceed directly to arbitration, then either party may require by notice in writing that the. matter be referred to arbitration as provided for by the provisions of the Dispute Resolution Clause.

Where either party to the agreement has commenced an action in a court of competent jurisdiction regarding a term, condition or obligation under the agreement, and the action is in good standing, then the parties to the agreement shall not invoke or continue with the dispute resolution provisions of the agreement until such time as the court action has been finally concluded. Where a court issues a judgement in an action regarding a term, condition or obligation under the agreement and the judgement becomes final, then that judgement shall constitute the final resolution of the dispute between the parties.

Arbitration

The Company and the Contractor mutually agree that where a dispute is to be resolved by arbitration (the "Arbitration Proceeding"), it shall be so resolved by a

single arbitrator to be agreed on by the parties. If the parties are unable to agree on the choice of arbitrator then a single arbitrator shall be selected pursuant to the Commercial Arbitration Act, S.B.C. 1996, c. 3 as amended.

The Arbitration Proceeding shall be conducted in Vancouver British Columbia or such other place as the parties may agree in writing. The rules of procedure for the Arbitration Proceeding shall be those provided for in the Commercial Arbitration Act for domestic commercial arbitrations. as amended by the provisions of the Dispute Resolution Clause.

Each party shall only be entitled to two days to complete their submissions to the arbitrator. Each party shall have the right of reply to the submission of the other for one hour only. ....

The arbitrator shall hand down the arbitral award within 7 days of the completion of the submissions and reply of the parties.

Discovery

Each party shall be entitled to the following pre-arbitration "examination for discovery" rights, as that term is defined in the Rules of Court of the Supreme Court of British Columbia:

(a) discovery of all relevant documents pertaining directly to the issue or issues in dispute between the parties;
(b) discovery of one officer or representative of the other party;
(c) each party shall be allowed to discover the officer or representative of the other for no more than one day for each $50,000.00 in dispute to a maximum of three days, and where no amount has been specified, then each party shall only be allowed a maximum of two days of discovery of the officer or representative of the other.

Costs of the Dispute Resolution

Where a provision in the agreement has been referred to mediation or arbitration

by the Company or the Contractor, then any funds actually in dispute shall be deposited in an interest bearing trust account. Upon the resolution of the dispute, the funds and interest thereon shall be paid to the Company and the Contractor proportionately as agreed between the parties, or as directed by the arbitration award.

The Company and the Contractor shall pay all costs associated with the provision of mediation or arbitration services forthwith upon an invoice for these services being rendered, equally, except as provided for below.

The Company and the Contractor shall each bear their own costs in resolving the dispute between them, with the following exceptions:

(a) Where one party is found, on a balance of probabilities

  (i) not to have pursued its various rights and responsibilities under this agreement in good faith,
  (ii) not to have used all reasonable effort to resolve its dispute with the other through mediation with a minimum of delay and expense, or
  (iii) not to have used all reasonable effort to resolve its dispute with the other by the Arbitration Proceeding with a minimum of delay and expense,

  then the offending party shall pay the disbursements and one half of all other direct expense incurred by the other;

(b) Where both parties are found, on a balance of probabilities, to have acted in bad faith or made less than all reasonable effort to resolve their dispute, then each party shall bear its own direct costs and disbursements and shall share equally all costs associated with the conduct of the mediation and/or the Arbitration Proceeding; and
(c) For the purposes of sub-paragraphs (a) and (b) of this paragraph, the costs associated with the provision of mediation and arbitration services and the Conduct of the Arbitration Proceeding shall be considered a disbursement.

Any award or division of costs referred to herein shall constitute a liquidated debt

immediately due and payable by the one party to the other, and shall be satisfied to the extent possible by the indebted party to the other from the funds held in trust and referred to above.

Failure of Arbitration

Where the Contractor and the Company agree in writing, or where the arbitrator is unable to resolve the dispute, then the dispute shall be re-submitted for arbitration in accordance with the provisions of the Dispute Resolution Clause of the agreement.

Where the inability of the arbitrator to resolve the dispute arises out of the misconduct of one of the parties in the dispute or a party affiliated with one of the parties in the dispute, then the dispute shall be deemed to be settled in favour of the other party with that other party entitled to their full costs arising out of the dispute as a liquidated debt.

Indexed as:

Ontario v. Canadian Airlines Corp.

IN THE MATTER OF the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended
AND IN THE MATTER OF the Business Corporations Act (Alberta), S.A. 1981, c.B.-15, as amended, Section 185
AND IN THE MATTER OF Canadian Airlines Corporation and Canadian Airlines International Ltd.
Between
Her Majesty the Queen in Right of the Province of Ontario, applicant, and
Canadian Airlines Corporation and Canadian Airlines International Ltd., respondents

[2001] A.J. No. 1457

2001 ABQB 983

[2002] 3 W.W.R. 373

96 Alta. L.R. (3d) 1

98 Alta. L.R. (3d) 277

306 A.R. 124

29 C.B.R. (4th) 236

110 A.C.W.S. (3d) 238

Action No. 0001-05071

Alberta Court of Queen's Bench
Judicial District of Calgary

Romaine J.

Judgment: November 16, 2001.

(74 paras.)

Counsel:

Larry B. Robinson and Michael D. Aasen, for Her Majesty the Queen in Right of the Province of Ontario.
Chris Simard, for Canadian Airlines Corporation and Canadian Airlines International Ltd.
Sean Dunphy, for Air Canada.

REASONS FOR JUDGMENT

ROMAINE J.:--

INTRODUCTION

1 Her Majesty the Queen in Right of the Province of Ontario ("Ontario") seeks an order for the following relief:

a. a declaration that the portion of the debt owed by Canadian Airlines International Ltd. ("Canadian") to Ontario as secured by three letters of credit is not compromised by the Amended and Restated Plan of Compromise and Arrangement (the "Plan") filed by Canadian Airlines Corporation and Canadian Airlines International Ltd. on May 25, 2000;
b. in the alternative, a declaration that the Plan allows the tax liability secured by the letters of credit to be considered a secured claim and that Canadian is liable for the full amount thereof up to the face value of the letters of credit;
c. in the further alternative, an order varying the Plan to permit the tax liability secured by the letters of credit to be considered a secured claim and directing that Canadian is liable for the full amount thereof up to the value of the letters of credit.

FACTS

2 The relationship between the parties and the background to this application were set out succinctly by Paperny J. (as she then was) in an earlier, related application as follows:

> Canadian Airlines International Ltd. ("Canadian") has followed a practice of self-assessing its tax liabilities and has made instalment payments of tax under two Ontario statutes, the Retail Sales Tax Act and the Corporations Tax Act.

Pursuant to an ongoing auditing process, Ontario has assessed Canadian for taxes owing under these two statutes. The assessments date back as far as 1981. Following the assessments, Canadian filed eight notices of objection and appeals are ongoing. Canadian has provided Ontario with three separate letters of credit to secure the assessments under appeal. The letters of credit have been renewed at least once.

Ontario estimates the total assessments at approximately $2 million. This may be subject to adjustment due to ongoing audits and the failure of Canadian to have completed its 1999 and 2000 tax returns. Canadian has disputed these assessments from the outset and as stated in the affidavit of Nhan Le, Canadian's Director of Taxation, is of the view that its liability to Ontario for these taxes is contingent and negligible. In short, the tax liability of Canadian to Ontario has been in dispute for several years.

Canadian received court protection under the Companies' Creditors Arrangement Act on March 24, 2000.

Canadian included Ontario in its list of "Affected Unsecured Claims" and quantified Ontario's claim at zero. Contrary to paragraph 27 of the March 24, 2000 order, Ontario was not served with a copy.

Ontario did not receive a copy of the March 24, 2000 order until it received it as part of the voting package sent out in accordance with my April 7, 2000 order in these proceedings. The package was mailed on April 25, 2000, the last possible day under the terms of the April 7, 2000 order and arrived in the mail room of the Corporations Tax Branch of the Revenue Division of Ontario on May 2, 2000, three days before the Claims Bar Date set in that order. The Revenue Division has nine branches. According to the affidavit of Rosita Vinkovic, Senior Collections Officer for the Bankruptcy and Insolvency Unit in the Collections and Compliance Branch of the Ministry of Finance, the normal procedure is for insolvency related documents to be mailed directly to the Insolvency Unit, not to the Corporations Tax Branch. According to Ms. Vinkovic, a notice to this effect was published by the Minister of Finance in a 1997 newsletter of the Canadian Insolvency Practitioners' Association. . .

The voting package did not make its way to the Insolvency Unit until May 18,

2000. Despite extensive inquiries, Ms. Vinkovic has been unable to determine the reason for this delay. The collection officer in the Insolvency Unit that received the package on May 18, 2000 did not have an opportunity to review it in its entirety until May 23, 2000, the first business day after the long weekend (and the date that a second package was sent by the monitor to the Ministry of Finance public inquiry desk and directly routed to the Insolvency Unit).

As Senior Collections Officer, Ms. Vinkovic was assigned to handle the matter on May 25, 2000. She immediately noted the May 5, 2000 Claims Bar Date and a proof of claim along with copies of the letters of credit were faxed to the monitor that same day. The amount claimed was expressed as preliminary due to the ongoing audit, which was lengthy due to the extent of Canadian's operations and its failure to timely respond to requests for information and documents. The monitor initially advised Ms. Vinkovic that the claim would not be accepted as it was past the Claims Bar Date, but changed its position upon being advised of the related security.

On June 19, 2000, nearly one month later, Ontario received a letter from Canadian's counsel advising that its claim would not be accepted because it was submitted after the Claims Bar Date. Ms. Vinkovic was away on vacation from June 23, 2000 until July 10th. On her return on the 10th she read the June 19th letter and immediately sent a request for assistance to Joel Weintraub, Senior Legal Counsel in the Legal Services Branch. Mr. Weintraub contacted the Alberta firm that had handled a similar claim for the BC government and a request was sent to the Assistant Deputy Attorney General for Ontario to authorize the retention of outside counsel. Mr. Robinson advised that he was retained September 14, 2000 and immediately advised Canadian's counsel of his intention to bring [an application to extend time to file a proof of claim] but that it would take some time to prepare the necessary material and have it sworn. Ontario v. Canadian Airlines Corporation (2000), 276 A.R. 273 (Q.B.) paras. 2 - 9;

3 Paperny J. heard the application to extend time to file a proof of claim and granted leave to Ontario to file its claim on November 7, 2000. She found that in the circumstances, Ontario's delay in filing its claim was due to inadvertence and not an attempt to circumvent the CCAA process or gain an advantage over other creditors. She also found that Canadian had contributed to the delay by its conduct: Canadian failed to serve Ontario with the March 24, 2000 order, it did not mail the voting package until the last possible day, it mailed it to the wrong office and waited until the last day of the sanction hearing, nearly one month after receiving Ontario's claim, to notify Ontario that its claim was rejected. She found no prejudice to Canadian or Air Canada, the funder of the Plan as

they were specifically aware of the existence of Ontario's claim, and were, in fact, attempting to use the delay to avoid resolving the dispute with Ontario. Paperny J. found for these reasons it was not unfair to the funder of the Plan, Air Canada, to deal with Ontario's claim after the claims bar date.

4 The proof of claim faxed by Ontario to the monitor on May 25, 2000 divided Ontario's claim between an unsecured portion and a secured portion, and referred to a letter of credit. As it had been prepared in a hurry, the amount claimed was in error. Paperny J. allowed Ontario to file an amended claim and also allowed further amendments that may become necessary due to the late filing of Canadian's 1999 and 2000 tax returns. Ontario's amended claim is for $2,064,444.19. The three letters of credit lodged with Ontario total $1,248,324.84.

5 Canadian's position is that the effect of its Plan is that the debt due to Ontario, once quantified, is compromised in its entirety from $1.00 of proven claim to $0.14, as with all other Affected Unsecured Claims, and that the letters of credit only facilitate the payment of the reduced indebtedness. Ontario's position is that the only amount that is compromised by the Plan is the deficiency remaining after applying the amount of security represented by the letters of credit held by Ontario.

6 The Plan was approved at a meeting of affected creditors held on May 26, 2000, and was sanctioned by Paperny J. on June 27, 2000 after an extensive hearing that commenced on June 5, 2000. The last day of the hearing was June 19, 2000, the same day that Canadian advised Ontario that it was rejecting its claim as being out of time and not prepared in the proper form. Although there is no question that Canadian was aware of Ontario's claim and the provision of letters of credit, there is no reference to the letters of credit in the Plan or in the evidence that was put before the court in the sanction hearing.

ISSUES

7 The issues that arise in this application are as follows:

(1) What is the appropriate characterization of the letters of credit?
(2) What is the effect of the Plan on Ontario's claim and the letters of credit?
(3) If the Plan compromises the whole of Ontario's claim, should Ontario be granted relief from such compromise, in the form of an amendment to the Plan?

ANALYSIS

1. What is the appropriate characterization of the letters of credit?

8 The parties agreed that the letters of credit held by Ontario are not obligations that are compromised by the Plan: Meridian Developments Inc., Re (1984), 11 D.L.R. (4th) 576; Section 11.2 of the Companies Creditors Arrangement Act, R.C.C. 1985 c.C-36, as amended. However,

Canadian submitted that the Plan compromises the underlying debt, and the letters of credit operate only to facilitate the payment of Ontario's post-compromise debt and have no other effect on the nature of Ontario's claim. This interpretation of the nature of the letters of credit and the limitation of their effect is the expressed rationale for the inclusion of Ontario's claim in the "Affected Unsecured Claims" category and the lack of any reference to the letters of credit in the Plan that was put before the court for sanction.

9 Canadian submitted that such possession does not convert what it characterizes as an unsecured claim into some kind of secured claim. It argued that, since the letters of credit are not security interests in the assets of Canadian, but rather separate obligations between the relevant banks and Ontario, Ontario's claim is not secured.

10 I disagree with Canadian's characterization of the letters of credit and their effect on the nature of the relationship between Canadian and Ontario.

11 In suggesting that Ontario's claim is unsecured, Canadian appears to be including in the definition of "secured" the requirement that any security must be in the assets of Canadian. While that may be so in the context of the Plan drafted by Canadian, letters of credit are commonly used and recognized by the courts as a form of security: 885676 Ontario Ltd. (Trustee of) v. Frasmet Holdings Ltd. (1993), 17 C.B.R. (3d) 64 at para. 35 (Ont. Gen. Div.); Meridian Developments, supra, at pp. 585 and 587; Barclays Bank of Canada v. Canadian Commercial Bank (Liquidator of) (1999), 232 A.R. 235 (C.A.). As pointed out by Blair, J. in Frasmet, supra, at para. 27:

> [t]here is a fundamental difference between a letter of credit, which is a very specialized form of security, and a guarantee, which is not a form of security at all (except in a loose, non-legal sense of the term).

12 Wachowich J. (as he then was) recognized the distinction between the use of letters of credit as security and as guarantees at p. 585 of Meridian Developments:

> [Aspen Planners Ltd. v. Commerce Masonry & Forming Ltd. et al (1979), 100 D.L.R. (3d) 546], as do the English cases cited by counsel, exemplifies the more traditional use of the letter to guarantee payment in commercial transactions where goods and services are bought and sold.
>
> Here, however, a more novel use has been made of the letter of credit as a security device...

13 Kevin McGuinness, in his text The Law of Guarantee (Scarborough: Carswell, 1996) emphasizes the difference between the payment and security functions of letters of credit at 815:

> In the case of a traditional letter of credit...[it] provides a payment facilitating

> mechanism...Thus the letter of credit is not intended as a security for payment...
>
> In contrast, a stand-by credit is not furnished as a means of making payment, but as a method of providing security against the possibility of default.

Although Canadian agreed that the letters of credit it posted are "standby" (or security) letters of credit, it attempts to characterize them as simply payment devices. I do not agree.

14 While counsel for Air Canada also submitted that a letter of credit is basically a guarantee, that is not how it was characterized in Frasmet, supra and Meridian, supra and properly so, since an irrevocable standby letter of credit such as those held by Ontario represents the equivalent of cash, the advance of which is subject to the satisfaction of certain conditions.

15 The legislation under which the tax is payable to Ontario and the letters of credit were posted confirm that the letters of credit were provided as security. The Corporations Tax Act, R.S.O. 1990, c. C-40, as amended by S.O. 1994, c. 14, s. 39(1) provides in s. 81 that:

> Every corporation shall pay, immediately on receipt of a notice of assessment or reassessment or of a statement of account in respect of a taxation year, any part of the tax, interest, penalties and any other amounts then unpaid in respect of the taxation year, whether or not an objection to or an appeal from an assessment in respect of the taxation year is outstanding.

16 Section 103 of that Act provides that the Minister may accept security in lieu of this immediate payment:

> The Minister may, if he or she considers it advisable, accept security for the payment of taxes by a corporation by way of a mortgage or other charge of any kind upon the property of the corporation or of any other person, or by way of a guarantee of the payment of the taxes by another person.

17 The Retail Sales Tax Act, R.S.O. 1990, c. R-31, as amended by S.O. 1994, c. 13, ss. 13, 14(2), 15(3), S.O. 1999, C. 9, s. 186 contains similar provisions for the immediate payment of assessed tax notwithstanding an objection by the taxpayer in ss. 18-20. Section 37(2) provides that "[w]here the Minister considers it advisable to do so, the Minister may accept security for the payment of taxes in any form that the Minister considers satisfactory".

18 In short, although Ontario's claim may not have been characterized as "secured" by Canadian in the Plan, the letters of credit provide Ontario with a form of security, albeit subject to certain conditions.

19 The letters of credit require Ontario to provide either a drawing certificate stating that the

amount being drawn is "due and payable in accordance with the provisions of the [Ontario Retail Sales] Act" and remains unpaid, or a written demand stating that the amount demanded is "payable and the taxpayer has failed to pay it." The parties agreed that until decisions have been rendered in the tax appeals, no amounts are payable, and Ontario is therefore precluded from drawing on the letters of credit until that time. Canadian submitted that the effect of this agreed-upon forbearance by Ontario is that the underlying debt is subject, not only to potential reduction by virtue of the tax appeals in Ontario, but also to reduction by compromise in the CCAA proceedings. To hold otherwise, Canadian suggested, flies in the face of the explicit wording of the letters of credit and is an attempt to improve Ontario's pre-CCAA entitlement.

20 A finding that the requirement to provide a written confirmation of the amount of debt owing prior to drawing on a letter of credit renders the underlying debt subject to compromise through CCAA proceedings would undermine the commercial purpose of such instruments and frustrate their objectives. It would render any security provided by a letter of credit meaningless in the very situation it has been obtained to alleviate. As stated by Blair J. in Frasmet, supra at para. 36:

> In the case at bar, the stated purpose of the letter of credit is to secure Standford's obligations under the lease. It can scarcely be gain-said that an event which is sure to impair a tenant's ability to honour its obligations under the lease is its bankruptcy. Why should Frasmet, which had obtained for itself a stand-by letter of credit as collateral security in connection with the lease transaction, be precluded from calling upon that security when the very kind of situation for which security is most likely necessary arises? In my view, in the circumstances of this case, it should not be so precluded.

21 In Frasmet, supra, while the tenant's bankruptcy terminated its continuing obligations to pay rent, Blair J. found that there were other obligations under the lease that arose upon default, including accelerated rent, damages arising out of the breach and the landlord's right to recoup capital expenditures on leasehold improvements made at the outset of the lease. Blair J. allowed the landlord to draw upon the letter of credit, stating at para. 40 that:

> [w]hile the bankruptcy of Stanford and the subsequent disclaimer of the lease by the Trustee may release the Tenant and its Trustee from those obligations, they cannot in my opinion, deprive the landlord from having resort to the security for which it bargained in order to protect itself in the case of the very kind of eventuality which has occurred.

22 Similarly, in 366604 Alberta Ltd.(Trustee of) v. Pensionfund Properties Ltd. (1996), 39 C.B.R. (3d) 134 (Alta. Q.B.), aff'd (1998), 7 C.B.R. (4th) 42 (Alta. C.A.), Smith J. found that the bankruptcy of a tenant did not affect the right of a landlord to call on a letter of credit issued as security for the repayment of a cash inducement. Smith J. found that the landlord was entitled to call on the letter of credit "irrespective of any dispute arising as to entitlement to the fund." (p.137). A

letter of credit is "a form of security which may be called upon by the secured creditor when the event for which the security has been given occurs, without regard to the circumstances existing between the parties to the underlying transaction": Frasmet, para. 35.

23 That insolvency is irrelevant to a letter of credit is reflected in s. 11.2 of the CCAA:

> No order may be made under section 11 staying or restraining any action, suit or proceeding against a person, other than a debtor company in respect of which an application has been made under this Act, who is obligated under a letter of credit or guarantee in relation to the company.

24 Canadian submitted that, as the provision of a letter of credit involves three separate contracts (Meridian Developments, supra at 586), it is necessary that I determine the terms of the contract between Ontario and Canadian. Canadian suggested that, based on the specific wording of the letters of credit, I should find that one term of such contract is that Ontario could not call on the letters of credit as long as they were kept current and until the final amount of tax debt owing by Canadian to Ontario was determined. Canadian then submitted that I should take an additional step and find that Ontario's forbearance is subject, not only to the result of the tax appeals, but to reduction of the claims pursuant to compromise in these proceedings. The argument is that, since Ontario has by its forbearance waived its right to immediate payment of the tax assessed, it has somehow without more left itself open to reduction of its claim through the Plan.

25 The answer to this argument again lies with the nature of the letters of credit and the nature of Canadian's obligation to the taxing authorities. Had Ontario not accepted the letters of credit from Canadian, Canadian would have been obliged to pay the entire amount of tax assessed pending the outcome of its appeals of the assessments, resulting in no debt to be compromised. Forbearance by Ontario in recognition of the possibility that Canadian's appeals of the assessments may be successful is not the equivalent of acceptance of the risk of Canadian's intervening insolvency. As set out by Lazar Sarna in the text Letters of Credit: The Law and Current Practice at p. 5-25 (quoted in 366604 Alberta Ltd. (Trustee of) v. Pensionfund Properties Ltd., supra at para. 11 (Q.B.):

> . . .[O]ne of the fundamental commercial reasons for the use of the letter of credit mechanism is to secure anticipated payments in a manner which would not rely upon the will, status or financial faith of the applicant.

26 I cannot find that Ontario's forbearance in accepting the letters of credit in lieu of cash was a waiver of anything other than an immediate right to be paid. Its forbearance is to delay such right until after the appeals have been concluded, for the amount determined to be payable on appeal. There is no evidence of any greater forbearance, either in the letters of credit or otherwise before me, and certainly no evidence that, in accepting the letters of credit, Ontario agreed to have its claims treated as unsecured. The nature of the letters of credit dictates the opposite conclusion, as does Ontario's response to that characterization when it finally became aware of how it was being treated under the Plan.

27 Canadian also sought to draw a distinction between Ontario's claim and other secured claims by noting that this is not a case in which Canadian has committed an act of default under a security agreement such that Ontario would be in a position to enforce its security rights. Ontario must still wait for the outcome of the tax appeals before drawing on the letters of credit. However, the fact that no immediate enforcement rights of Ontario are being compromised by the Plan does not convert the nature of Ontario's interest from a secured claim to an unsecured claim.

28 Canadian submitted that Ontario is seeking relief from the terms of its own letters of credit, in that it is asking to change the terms of the bargain it struck with Canadian upon acceptance of the letters of credit. I reject that submission and find the converse; Ontario is asking that the bargain be honoured. Ontario did not ask for any amendment to the letters of credit, but for recognition of the secured nature of part of its claim. Ontario argued that once that question is settled, the letters of credit can be exercised in due course after the appeals have been concluded and any difficulty arising from the necessity of making representations in a draw-down certificate or written demand will be resolved.

29 For the reasons discussed, I find that a portion of Ontario's claim is indeed secured, and that there was no implied agreement between Ontario and Canadian that the debt underlying the secured portion of the claims could be compromised by intervening events other than the tax appeals.

30 Despite this, there is no reference to the letters of credit anywhere in the Plan, nor any suggestion that Ontario's claim may be anything other than entirely unsecured. It is clear that Canadian had full knowledge of the letters of credit, and of the position taken by Ontario in its May 25, 2000 form of claim, that it was secured for part of its claim.

31 The court sanctioning the Plan did not have knowledge of Ontario's position, or the form of security that distinguished Ontario's claim from other, apparently unsecured claims in the same category. It is clear that the court proceeded on the assumption that Ontario's claim was completely unsecured, on the basis of an aggressive characterization of the letters of credit by Canadian. The question then becomes, what effect does the Plan have on Ontario's claim and the letters of credit? Specifically, it must be determined whether an interpretation of the Plan which disregards the security arrangements made between these parties should be adopted.

2. What is the effect of the Plan on Ontario's claim and the letters of credit?

32 After court approval of a CCAA plan, an application for directions may be made if a difficulty arises in its interpretation or application: Horizon Village Corp., Canada (Re) (1991), 8 C.B.R. (3d) 25 (Alta. Q.B.).

33 In that case, Wachowich J. (as he then was) was asked to interpret a court-sanctioned plan with respect to a federal tax rebate that had arisen in favour of the debtor company. The court-appointed manager sought a declaration that the rebate formed part of the estate of the debtor company. A secured creditor argued that it was entitled to the rebate because it held an assignment

of the rebate as collateral security. Wachowich J. found in favour of the secured creditor.

34 He stated that as a starting point in such applications, the court must always keep in mind the purpose and effect of the CCAA: para. 5. He referred to the wide scope of the legislation in granting protection to debtor companies and enabling them to continue carrying on business. Commensurate with the court's protection of debtors under the CCAA, Wachowich J. noted, is the court's desire not to prejudice creditors: para. 7, quoting from NsC Diesel Power Inc., Re (1990), 79 C.B.R. (N.S.) 1 (T.D.) at p. 6: "[the CCAA] was, in my view, never intended to disadvantage any group which, but for the Act, would have enjoyed rights and priorities vis-à-vis the debtor or the debtor's assets."

35 Wachowich J. found that the plan before him did not expressly refer to either the secured creditor's collateral security interest in the rebate, nor to the rebate itself. The rebate was not a source of funds contemplated by the plan. He considered, however, that the collateral security interest or the rebate might be impliedly included in the plan. He held that the court will be reluctant to imply terms which will alter the legal relationship between parties, but will do so if the purposes of the CCAA and any plan made under the CCAA will be defeated without such implied terms. He concluded that there were no implied inclusions in regard to the rebate, specifically rejecting that the rebate was impliedly caught by the plan's use of the words "proceeds of sale" or "funds generated".

36 The aim of minimizing prejudice to creditors embodied in the CCAA is a reflection of the cardinal principle of insolvency law: that relative entitlements created before insolvency are preserved: R. Goode, Principles of Corporate Insolvency Law, 2nd ed. (London: Sweet & Maxwell, 1997) at 54. While the CCAA may qualify this principle, it does so only when it is consistent with the purpose of facilitating debtor reorganization and ongoing survival, and in the spirit of what is fair and reasonable.

37 Paperny J. (as she then was) also discussed the purpose of the CCAA in Re Canadian Airlines Corp., (2000), 265 A.R. 201 (Q.B.), aff'd [2000] A.J. No. 1028 (C.A.), online: (AJ) (C.A.), leave refused [2001] S.C.C.A. No. 60. At para. 95, she stated that the purpose of the CCAA is to facilitate the reorganization of debtor companies for the benefit of a broad range of constituents.

38 Paperny J. also noted at para. 95 that, in dealing with applications under the CCAA, the court has a wide discretion to ensure the objectives of the CCAA are met. At para. 94, she identified guidance for the exercise of this discretion in Olympia & York Developments Ltd. v. Royal Trust Co. (1993), 17 C.B.R. (3d) 1 (Ont. Gen. Div.) at p. 9 as follows:

> "Fairness" and "reasonableness" are, in my opinion, the two keynote concepts underscoring the philosophy and workings of the Companies' Creditors Arrangement Act. Fairness is the quintessential expression of the court's equitable jurisdiction - although the jurisdiction is statutory, the broad discretionary powers given to the judiciary by the legislation which make its exercise an exercise in equity - and "reasonableness" is what lends objectivity to

the process.

39 In addition to the purposes of the CCAA and the principles which guide the court's role in proceedings under that statute, the overall purpose and intention of the plan in question will also be considered by the court when faced with disputes in interpretation: Lindsay v. Transtec Canada Ltd. (1994), 28 C.B.R. (3d) 110 (BCSC), aff'd 31 C.B.R. (3d) 157 (BCCA)

40 With these guiding principles in mind, I now turn to the interpretation of the Plan.

41 As referenced above, Canadian submitted that the Plan must be interpreted as compromising the entirety of Ontario's claim, not just the portion remaining after the application of letters of credit. Its position is summarized in a letter sent by its counsel to Ontario's counsel, Exhibit "C" to the affidavit of Ontario's deponent, Susan Scarlett:

> ...We note that, in Canadian's...Plan, ..., approved by the Order of Madam Justice M.S. Paperny dated June 27, 2000, all Affected Unsecured Creditors (i.e. holders of Affected Unsecured Claims- art. 1.1) are to receive $0.14 for each $1.00 of Proven Unsecured Claim (arts. 1.1, 5.1(a)). "Affected Unsecured Claims" is defined in art. 1.1 as "all Claims listed in Part I of the Affected Unsecured Claims List or all Claims of any Person listed in Part II of the Affected Unsecured Claims List...". Your client is covered by each alternative branch in that definition. Listed at para. 2 of Part I of the Unsecured Claims List is "Claims in respect of any Tax Claims including, without limitation, those Claims listed on Part "II" to this Schedule "B". As well, Ontario is a person listed in Part II of the Affected Unsecured Claims List. The definition of "Tax Claim" (at art. 1.1 of the Plan) includes the following words:
>
>> "Tax Claims" means any and all Claims for Taxes by any...provincial...authority, agency or government (including, without limitation, any and all Claims for Taxes by ...Her Majesty the Queen in right of any province or territory of Canada...) ... in respect of any taxation year or period ending on or before the Effective Date...
>
> Thus, the entirety of your client's claim is an Affected Unsecured Claim, and your client will receive in payment thereof, $0.14 per $1.00 of Proven Claim.

42 Ontario suggested that the Plan should be interpreted as including the secured portion of its claim in the "Noteholders Claims List" under the Plan, which is characterized as secured. It pointed out that the Plan defines the "Noteholders Claims List" as "the list of Affected Secured Note Claims attached hereto as Schedule "C", as amended or supplemented from time to time as provided in the Creditors' Meetings Order". From that language, Ontario submitted that it is clear that the list of

Noteholders was not intended to be complete or final. It also suggested that the secured portion of Ontario's claim could be considered to be an "unknown" claim in accordance with the definition of "Claims" under the Plan, and that, therefore, the addition of its claim to the Noteholders Claims List would not offend the Plan as sanctioned.

43 I disagree with Canadian's suggestion that its interpretation is the only or most reasonable interpretation of the Plan. I also do not find the interpretation suggested by Ontario to be persuasive. I do agree, however, with Ontario's position as reflected in the first ground of relief sought in this application, as paraphrased at the outset of these reasons: the Plan only compromises the balance of Ontario's claim after the letters of credit are applied. In my view, the language of the Plan, the general concept of the Plan as a whole and the purpose and philosophy of the CCAA support this result.

44 Although the Plan is capable of the interpretation that Canadian suggested, I find that interpretation should not be adopted in view of the purpose of the CCAA and the whole of the Plan itself. Specifically:

a. The Plan makes no express reference to the letters of credit. Implying that the treatment of Ontario's claim is entirely unsecured is not necessary to avoid defeating the purpose of the CCAA and the Plan. Canadian has not suggested nor provided any evidence that the compromise of the entirety of Ontario's claim is required for its ongoing survival, or formed an integral part of the whole of the Plan.
b. Not only is there is no evidence or suggestion that interpreting the Plan in the manner Ontario proposed would be prejudicial to Canadian or Air Canada, there is no evidence of prejudice to Canadian's creditors, nor can there be any suggestion of damage to the integrity of the Plan.
c. While certainly the alteration of legal relationships between creditors and debtors is a necessary incident of CCAA plans, the court also endeavours to minimize to the extent possible prejudice to creditors: Horizon Village Corp., Canada (Re), supra. Canadian's interpretation is inconsistent with this goal.
d. The premise of Canadian's position is that the Plan compromises only the underlying debt to Ontario and leaves intact the letters of credit, which are mere payment devices. This wholly disregards the reality of the security Canadian granted to Ontario pre-CCAA to avoid immediate payment of assessed tax, as well as the entire concept of the Plan, described below. This technical approach is to be discouraged in CCAA proceedings: Lindsay v. Transtec Canada Ltd., supra at para. 26 (BCSC).
e. Disregarding the letters of credit in Canadian's insolvent circumstances is wholly inconsistent with the rationale of these particular security devices. Letters of credit are obtained to secure payments in a manner that does not

rely on the financial position of the applicant. As recognized in s. 11.2 of the CCAA, letters of credit are designed to operate outside and not be subject to the compromises typically involved in insolvency.

f. Compromising the entirety of Ontario's claim, which in effect deprives Ontario of much of the value of its security, is inconsistent with the general concept of the Plan. This was to compromise the claims of certain of Canadian's unsecured creditors to the extent of 86 cents per dollar of proven claims (with no cap on total proven unsecured claims) and to compromise the claims of Affected Secured Noteholders to the extent of 3 cents per dollar of proven claims and allowing those secured creditors to receive the unsecured dividend on the deficiency.

g. Canadian's interpretation results in anomalous treatment of a secured creditor and tax claimant under the Plan. It treats a secured creditor as an unsecured creditor in compromising its entire claim at 14 cents on the dollar, while only the deficiency portion of the other secured creditors under the Plan (Affected Secured Noteholders) are treated in this fashion. Further, there is no evidence that any other secured creditor is included in the Affected Unsecured Creditors list, except for Ontario and the Affected Secured Noteholders (and then only to the extent of the deficiency). Similarly, there is no evidence that any other tax claimant was secured but deprived of that security by having the entirety of its claim compromised.

For these reasons and the reasons that follow, Canadian's interpretation is not fair and reasonable.

45 As noted, I am not persuaded by Ontario's suggested interpretation of the Plan. It would be a strained interpretation to include Ontario's secured claim with those of the Affected Secured Noteholders. It is not consistent with the overall concept of the Plan, as described above. It also appears that it is no longer possible to amend the Noteholders Claims List, since the power to do so expired on May 15, 2000.

46 However, the Plan can and should be interpreted as excluding secured claims from compromise as "Affected Unsecured Claims". Rather, the only secured claims compromised under the terms of the Plan are those of the Affected Secured Noteholders. These notes represented a principal debt to Canadian of US$ 175,000,000.00 with a provision that could increase the obligation to US $190,000,000.00. It is obvious why the compromise of those secured claims was integral to the success of the Plan and the ability of Canadian to carry on business.

47 While the Plan's definition of "Claim" is broad and refers to both unsecured and secured claims, the way the Plan was drafted requires that the term "Claim" be used in relation to both the secured (the "Affected Secured Note Claims") and the unsecured (the "Affected Unsecured Claims") claims. These two categories constitute the classification of compromised claims under the Plan (Section 5.1). It is true that "Tax Claims" are included within the definition of "Affected

Unsecured Claims" and arguably the use of the word "Claims" in conjunction with "Tax" could incorporate a compromise of a secured claim. That result, however, amounts to including the whole of an apparently isolated secured claim, which is not an Affected Secured Note Claim, in a group of unsecured claims. There is no evidence before me to suggest that there are any other creditors in the Affected Unsecured Claims List that hold security, except for Ontario and creditors holding Senior Secured Notes, to the extent of any deficiency only. There is no other reference in the Plan that would suggest that the Affected Unsecured Creditors include secured claims.

48 The interpretation of the Plan to exclude compromise of secured claims except for those of Affected Secured Noteholders is consistent with the purposes of the CCAA, as well as the Plan itself. The letters of credit are not Canadian's property and there is no evidence or suggestion that their intended use by Ontario will operate to defeat any aspect of the Plan, nor to prejudice Canadian's ongoing operations. The purpose of the CCAA to facilitate reorganization and ongoing survival of debtor companies is honoured. Honouring Ontario's secured claim is consistent with the general concept of compromising only the claims of unsecured creditors and Affected Secured Noteholders in the Plan.

49 Interpretation of the Plan in this way does not result in an enhancement of Ontario's rights or special treatment under the Plan. It honours the clear security arrangements made prior to the CCAA proceedings and treats the deficiency in a manner identical to the unsecured claims of all affected creditors.

50 Canadian emphasized in its written submissions that it was not compromising a secured claim in its proposed treatment of Ontario under the Plan. Not only did Canadian reject Ontario as a secured creditor, it stressed that the only compromise was of the underlying debt to Ontario. In substance, however, what Canadian hopes to achieve from its suggested interpretation is the effective disregard of Ontario's security. If Canadian had intended to compromise a secured claim within the Affected Unsecured Claims category, this should have been expressed clearly within the terms of the Plan, Ontario should have been expressly notified in a timely fashion, and the court should have been alerted to this anomalous treatment in the sanction hearing. Canadian did none of these things. It now relies on an interpretation of the language of the Plan to support its purported compromise of the whole of Ontario's claim without regard to its security. While I appreciate that CCAA proceedings necessarily change debtor-creditor relationships, this must be done clearly and fairly. Under the circumstances, the court cannot condone the change Canadian is seeking vis-à-vis Ontario's claim.

51 In summary, the evidence is clear that the letters of credit were granted by Canadian well prior to the March 24, 2000 stay order. Ontario's secured claim is not mentioned in the Plan, and the security would be effectively stripped of its value by the application of the Plan as proposed by Canadian, in a fashion that is aberrant to the treatment of any other creditor under the Plan and inconsistent with its general concept. This cannot be right and can be avoided by a reasonable interpretation of the Plan that is consistent with the general concepts of both the CCAA and the

Plan.

52 This conclusion is strengthened by the role that Canadian played in the delay surrounding the submission of Ontario's claim, discussed further below.

3. Should Ontario be granted relief from the complete compromise of its claim under the Plan, in the form of an amendment to the Plan?

53 If I was unable to interpret the Plan in a manner which compromises only the unsecured portion of Ontario's claim, I would in any event have considered it appropriate to direct an amendment to the terms of the Plan to effect this result.

54 The Ontario Court of Appeal considered the question of whether the court has jurisdiction to amend a plan of arrangement in Algoma Steel Corp. v. Royal Bank of Canada (1992), 11 C.B.R.(3d) 11, leave refused (1992), 10 O.R.(3d) xv (SCC)

55 In that case, the plan of arrangement had been voted upon by creditors and sanctioned by the court, subject to the outcome of the appeal. The court found that, generally speaking, a plan of arrangement is consensual and the result of agreement, and that a plan found to be fair and reasonable ought not be amended by the court unless jurisdiction is found in the CCAA and there are compelling reasons to do so. The court also found that, generally speaking, the court ought not interfere by amendment in situations where to do so would prejudice the interests of the company or the creditors. In the facts of the Algoma situation, the court found that an amendment would be insignificant and technical as far as other creditors were concerned, and allowed the plan to be amended.

56 Sections 6 and 7 of the CCAA deal with the authority of the court to sanction a plan of arrangement, and to alter or modify its terms. Section 7 provides that, when an amendment is proposed at any time after meetings of creditors have been summoned, the court may adjourn those meetings or may direct that no adjournment of the meetings or convening of additional meetings is necessary if the court is of the opinion that the creditors or shareholders are not adversely affected by the amendment proposed. Section 7 also provides that any arrangement so altered or modified may be sanctioned under section 6. The Plan was in fact amended pursuant to the authority of Section 7 in this manner by Paperny, J. Section 6 and 7 offer no guidance on whether a court-sanctioned plan may be subsequently amended.

57 As mentioned, the CCAA confers broad discretion on the court and is to be afforded a large and liberal interpretation: Re Canadian Airlines Corp., supra at para 95 (Q.B); Chef Ready Foods Ltd. v. Hongkong Bank of Canada (1990), 51 B.C.L.R. (2d) 84 (C.A.). It is silent, however, on many procedural issues. Given the lack of legislative guidance, the courts have used the basic purpose of the CCAA as a guide to its application and the exercise of its discretion in disposing of applications under the Act: Re Canadian Airlines Corp., supra at para. 95. The keynote concepts of fairness and reasonableness have been recognized as the driving force behind the CCAA and the

court's interpretation and application of the Act: Re Canadian Airlines Corp. at para. 95, Olympia & York Developments Ltd. v. Royal Trust Co., supra at p. 9.

58 I have already described that the purposes of the CCAA are honoured in the interpretation of the Plan that would compromise only the unsecured portion of Ontario's claim. Those purposes are equally honoured in an amendment to the Plan to achieve this result. Further, the concepts of fairness and reasonableness are also recognized in such an amendment, in contrast to the existing effect of the Plan if my interpretation were not possible.

59 It would not be fair to Ontario, given the pre-existing arrangements made with Canadian to secure the payment of tax and the process by which it found itself faced with Canadian's attempt to compromise the entirety of its claim (discussed further below), to allow Canadian to succeed in this regard. Moreover, it is not unfair to either Canadian or Air Canada to allow an amendment to effect the result that only the deficiency portion of Ontario's claim is compromised as an unsecured claim. Canadian and Air Canada were well aware of the letters of credit and that Ontario had submitted a form of claim that recognized this security. There is no evidence or assertion of unfairness to any other party.

60 It would similarly not be reasonable to deprive Ontario of its security, as I found would be the effective result if Canadian's interpretation of the Plan were to prevail. While Canadian argued that the security itself is not compromised, that argument does not recognize the reality that if the letters of credit are to be treated as the simple payment mechanisms that Canadian asserted they were, their value is essentially reduced, cent for cent, in a manner identical to unsecured claims under the Plan. Ultimately, the letters of credit would be deprived of their value by Ontario's treatment under the Plan. This is not a reasonable result in view of the whole of the Plan and the anomalous treatment Canadian would have the court inflict on Ontario's secured claim.

61 The CCAA authorizes the court to amend a plan in appropriate circumstances, where there are compelling reasons to do so. Although the Act does not expressly state that such amendment could take place after the Plan is sanctioned, as pointed out in Algoma, supra there is no reason to suggest that the CCAA "contemplates a role for the court as a mere rubber stamp or one that is simply administrative rather than judicial." (p.103). While the circumstances justifying an amendment after a sanction hearing ought to be truly exceptional, in recognition of the potential violence done to the laudable goal of commercial certainty, there is no reason why subsequent amendments should be conclusively foreclosed in every case, without examination of the particular circumstances.

62 Are there compelling circumstances in this case that would justify a subsequent amendment? Ontario submitted that there are, in that it would be unfair to compel Ontario to be bound by the unilateral characterization of its claim by Canadian.

63 The process established by the April 7, 2000 order setting out the claims procedure was unique, in that it allowed Canadian to list its creditors under categories reflecting its opinion of their status. A creditor that did not agree with Canadian's characterization of the nature or amount of its

claim was required to file a Dispute Notice.

64 In Ontario's case, for the reasons set out in Paperny J.'s findings of fact, the claims bar date intervened. Ontario filed a Dispute Notice on the basis of a partially secured claim. Ontario did not become aware that Canadian was rejecting its claim as being out of time until the last day evidence was presented at the sanction hearing, and no evidence of Ontario's position was presented to the court at the hearing.

65 While Ontario must bear some responsibility for its systemic internal delays, and while it would have been prudent for Ontario to have been represented at the hearing or to have followed-up its Dispute Notice to ensure that Canadian was in agreement with its claim, it was not aware of the position Canadian would take with respect to the validity of its claim until after the time it would have had an opportunity to appear at the sanction hearing. I note that in Canadian's June 19, 2000 letter to Ontario, it did not suggest that it was also taking the position that the security would not be honoured as originally intended by the parties. This was only raised after Canadian failed to have Ontario's claim barred in the late claim application.

66 Ontario never had a realistic opportunity to present its position to the court before the Plan was sanctioned, and the court was completely unaware of any issue involving the nature of Ontario's claim. It must surely never be the case that a creditor in CCAA proceedings is deprived of the opportunity to present its submissions on the nature and amount of its claim by reasons of procedural irregularities that do not arise from a lack of diligence or good faith. The wide scope and protection offered by the CCAA should not be allowed to operate to disadvantage or prejudice creditors without a fair hearing of their concerns and submissions.

67 This is not a situation, as in Re: Airbus Enterprises Inc. (1993), 22 C.B.R. (3rd) 80 (Ont. Gen. Div.), where the creditor had several opportunities to make submissions to the court and to appeal its classification and failed to pursue these options. While it is true that Ontario was aware of its proposed classification under the Plan, and also aware of the sanction hearing at which classification was to be approved, it had taken action to place its position on classification before the monitor and Canadian by filing its Dispute Notice. At the least, it was entitled to assume that, if Canadian disagreed with its position, it would give Ontario notice prior to the conclusion of the sanction hearing. It was not Ontario that was "lying in the weeds" in this case, delaying in the hopes of gaining an advantage.

68 There is no prejudice to other creditors if the Plan is amended as sought by Ontario. As was the case in Algoma, supra, the letters of credit are not the property of Canadian and there is no evidence or suggestion that there will be any prejudice or impairment of operations as a result of drawing on the letters of credit. Both Canadian and Air Canada were aware of Ontario's claim, and cannot be said to be prejudiced except to the extent that they disagree with the characterization of the claim. Paperny, J. specifically found no prejudice in the late claim application and also found that Canadian and Air Canada were attempting to use the delay to avoid resolving the dispute with

Ontario. As I have stated previously, this is not an attempt by Ontario to improve its pre-insolvency rights, but merely to enforce them.

69 Canadian submitted that Ontario's request for amendment of the Plan is a procedurally improper method of attacking the sanction order. The Canadian process was unusual in that the classification of creditors was approved in the sanction order, and not previously. Canadian submitted that Ontario should have appealed the sanction order as it was the order approving the classification, relying on Re: Keddy Motor Inns (1992), 13 C.B.R. (3d) 245 (NSCA).

70 The rationale of that case is that, while the proper procedure for attacking a classification order is by way of appeal from that order and not a subsequent sanction order, because of the overall supervisory duty of the court to ensure fairness of a plan, the court can intervene in the subsequent appeal of the sanction order "if necessary to avert substantial injustice" (para. 21). In Re: Keddy Motor Inns, supra, the court found the circumstances did not warrant intervention.

71 Shortly before the sanction order was issued, Ontario was advised by Canadian that its claim would not be accepted because it was submitted after the claims bar date. Ontario's next step was to pursue its application for extension of time to file a proof of claim. It was successful in that application, and filed its amended claim, continuing to assert secured status. The decision of Paperny J. allowing Ontario's application does not restrict Ontario to making its claim as an "Affected Unsecured Creditor". In fact, in the decision, Paperny J. refers several times to the letters of credit as "security" for the assessments under appeal. It is arguable that, had Ontario chosen to appeal the sanction order because of the classification of its claim, it would have faced the objection that it lacked status as its claim was time-barred. The process followed by Ontario is not a collateral attack on the sanction order, but the logical outcome of the procedure followed to re-establish its claim.

72 Canadian also submitted that Ontario's classification as an "Affected Unsecured Creditor" is appropriate because it is in the same classification as other Tax Claimants, citing the principle of "commonality of interest" as enunciated by Forsyth, J. in Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd. (1988), 72 C.B.R. (N.S.) 20 (Alta. Q.B.). This is not, however, a case of a secured creditor attempting to be distinguished from other secured creditors, but of a secured creditor attempting to be characterized as secured. The distinction between a secured claim and an unsecured claim is surely sufficient to overcome the "commonality of interest" test.

73 Were it necessary, I would direct that the Plan be amended to provide that the portion of Ontario's claim that is secured by the letters of credit not be compromised.

CONCLUSION

74 In conclusion, I find that the Plan compromises only the unsecured portion of Ontario's claim. If I was unable to make that finding, I would have found compelling reasons in these very unusual circumstances for the court to take the extraordinary step of amending the Plan, even after its

sanction. To do otherwise would be to allow Ontario to be prejudiced by a process that was flawed in its operation with respect to Ontario's claim. Canadian and Air Canada were aware both of Ontario's claim and its characterization of its security and there is no prejudice to either of them in the interpretation I have found, nor the amendment to effect it, if necessary. Canadian did not suggest nor is there any evidence of prejudice to the other creditors arising from this interpretation or amendment.

ROMAINE J.

cp/i/nc/qlrds

Case Name:
Canadian Red Cross Society (Re)

IN THE MATTER OF The Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36
AND IN THE MATTER OF a plan of arrangement of the Canadian Red Cross Society/la Société Canadienne de la Croix-Rouge
Re: The Canadian Red Cross Society/la Société Canadienne de la Croix Rouge

[2002] O.J. No. 2567

[2002] O.T.C. 438

35 C.B.R. (4th) 43

114 A.C.W.S. (3d) 794

Court File No. 98-CL-002970

Ontario Superior Court of Justice

Blair J.

Heard: May 28, 2002.
Judgment: June 28, 2002.

(24 paras.)

Practice -- Persons who can sue or be sued -- Individuals and corporations, status or standing -- Class or representative actions, damages -- Applicable law.

Motion by the trustee for directions as to the governing law respecting issues relating to the eligibility of persons to claim under the HIV Fund. The amended plan of compromise and arrangement of the Canadian Red Cross Society was approved by its creditors and sanctioned by the Court. The principal thrust of the Plan was to make available from the assets of the Society a fund of money to meet the claims of various groups of persons who contracted HIV from certain blood products supplied by the Society. The Plan contained a provision that it was to be governed by and

construed in accordance with the laws of Ontario and the federal laws of Canada. The referee designated under the Plan was responsible for determining whether and to what extent individuals infected with HIV blood from products at various times could apply to the fund for compensation. His responsibilities gave him the power to decide whether limitation periods had expired, to determine whether claimants had already released the Red Cross and to assess damages. The trustee of the Plan sought directions as to the governing law respecting issues relating to the eligibility of persons to claim under the fund.

HELD: Motion allowed. The law of Ontario applied. The policy reasons for applying the law of one jurisdiction were to minimize the costs of assessing claims and to avoid inequality of treatment between claimants and uncertainty as to the amount of the fund required to compensate claimants.

Counsel:

Risa Kirshblum, for the trustee under the Plan.
Harvey T. Strosberg, Q.C., for claimants, J.A.M and D.L.M.
Dawna J. Ring, Q.C., for various HIV claimants, previously Court Appointed Representative for Persons Secondarily Infected with HIV.
Danielle Joel, for the Yang and Kerekes families.
Kenneth Arenson, for four families of claimants.

BLAIR J.:--

Background

1 The Amended Plan of Compromise and Arrangement of the Canadian Red Cross Society [the "Society"], dated July 31, 2000, was approved by its creditors and sanctioned by the Court. The principal thrust of the Plan is to make available from the assets of the Society a Fund of money to meet the claims of various groups of persons who contracted HIV from certain blood products supplied by the Society. By its terms, the Honourable Peter Cory is appointed the Trustee under the Plan.

2 On this motion, the Trustee moves for directions as to the governing law respecting issues relating to the eligibility of persons to claim under the HIV Fund. Earlier, I ruled that this was a question for the Court to determine, rather than the Referee who is named under the Plan to assess the claims.

3 The Honourable Robert Montgomery is the Referee now designated under the Plan. His responsibility is to determine whether and to what extent individuals infected with HIV from blood

products at various times can apply to the HIV Fund for compensation. The process for doing so is set out in Section 5.10 of the Plan, which gives the Referee the power to decide whether limitation periods have expired, to determine whether claimants have already released the Red Cross, and to assess damages.

4 The Referee's award as to damages is final, and is to be satisfied solely out of the HIV Fund.

5 The underlying problem giving rise to this motion for directions is that in making those determinations, the Referee will have to know what governing law applies to such matters as:

a) the limitation period applicable to each claimant; and,
b) whether certain claimants fall into the category of family members who would otherwise be eligible to claim for their relative's infection pursuant to family law legislation in the various Provinces.

6 The results for individual claimants may differ, depending upon the applicable choice of law and the jurisdiction in which their claims may have been asserted in the first place against the Red Cross prior to the Companies' Creditors Arrangement Act,[1] ("CCAA") Order of July 20, 1998. While time limitations are not dissimilar across the country of those HIV Claimants still alive, they vary for the estates for those who have died. In a number of Provinces, the discoverability rule applies to estate claims (see Burt v. Lelacheur (2000), 189 D.L.R. (4th) 193 (N.S.C.A.), leave to appeal to S.C.C. refused, [2000] S.C.C.A. No. 505), whereas in Ontario, the Court of Appeal had ruled that it does not (see Waschkowski v. Hopkinson Estate (2000), 47 O.R. (3d) 370 (C.A.)).[2] At the same time, Ontario law is more favourable than that of other Provinces in terms of the scope of categories of family law members who are entitled to make Family Law Act types of claims against the HIV Fund.

7 The opening provisions of Section 5.10 of the Plan and paragraph (a) thereof stipulate that:

> The fund established under paragraph 5.05(c) shall be available to satisfy HIV Claims in accordance with the terms hereof. As a condition of Plan Implementation the Plaintiffs in the Listed HIV Claims shall execute a release fully and finally releasing the Society and all Plan Participants from their respective HIV Claims, in exchange for their entitlement hereunder. The release shall include an undertaking not to pursue any other party unless on a several basis. HIV Claimants may apply to the Referee within 4 months following the Plan Implementation Date for a determination of damages with respect to their respective HIV Claim. Any references held hereunder shall be conducted on the following terms:
>
> (a) The Referee shall decide whether limitation periods had expired prior to July 20, 1998 and no award or payment under this Plan shall be made to an

> HIV Claimant where the Referee decides that the limitation period in respect of such Claim had expired prior to July 20, 1998.

8 Section 8.09 of the Plan is the general provision dealing with the law governing the Plan. It provides that:

> This Plan shall be governed by and construed in accordance with the laws of the Province of Ontario and the federal laws of Canada applicable therein. Any questions as to the interpretation or application of this Plan and all proceedings taken in connection with this Plan and its provisions shall be subject to the exclusive jurisdiction of the Court.

9 As the affidavit filed in support of the Trustee's motion for directions notes:

> Some may therefore argue that the law of Ontario should apply in all respects to all claims regardless of factors such as the place of residence of the claimant or the place where the claimant received the blood transfusion which resulted in the HIV infection with respect to which the claimant is seeking recovery from the Fund. Others may argue that the issues outlined above do not, for the purposes of "choice of law", fall within the purview of s. 8.09 of the Plan and that a determination of choice of law must be made.

10 Hence, the motion for directions.

Analysis

11 I have concluded that the proper law governing the issues of limitation periods, categories of family members entitled to claim, and the quantum of damages those deemed eligible will be entitled to receive, is the law of Ontario. My reasons for arriving at that conclusion follow.

12 When interpreting a Court approved CCAA Plan, the Court must keep in mind "the purposes of the CCAA and the principles which guide the court's role in proceedings under that statute [as well as] the overall purpose and intention of the plan in question": Ontario v. Canadian Airline Corp. (2001), 29 C.B.R. (4th) 236 at 243 (Alta. Q.B.), per Romaine J. See also, Lindsay v. Transtec Canada Ltd. (1994), 28 C.B.R. (3d) 110 (B.C.S.C.), aff'd (1995), 31 C.B.R. (3d) 157 (B.C.C.A.). This gives rise to the "fairness and reasonableness" considerations, and the general aim of minimizing the prejudice to creditors, that underlie such proceedings: Olympia & York Developments v. Royal Trust Co. (1993), 17 C.B.R. (3d) 75 (Ont. Gen. Div.); Ontario v. Canadian Airlines Corp., supra.

13 In addition, however, since a Plan of Compromise and Arrangement is in substance a contract, sanctioned by the Court, principles of contractual interpretation must also be applied.

14 The purpose of the CCAA, in broad terms, is to enable companies that would otherwise be lost to the community through bankruptcy to continue to operate if they can work out a satisfactory arrangement with their creditors. This benefits the company, the creditors, and the community as a whole. In this case, the Canadian Red Cross was able to make such an arrangement - after two years of exceedingly complex negotiations and court proceedings - and to continue to operate its non-blood-supply-related community activities, while at the same time establishing a Fund towards satisfying the claims of various groups of blood infected claimants, including the HIV Claimants.

15 Article 5 of the Plan contains the provisions of the compromise dealing with the treatment of Transfusion Claimants and HIV Claimants. Article 5.01 - a statement of general considerations in this regard - opens with these words:

> For the purposes of this Plan, the Transfusion Claimants and the HIV Claimants shall receive the treatment provided in this Article on account of their Transfusion Claims and HIV Claims, respectively, and, on the Plan Implementation Date, all Transfusion Claims and HIV Claims shall be compromised, as against the Society and the Plan Participants, in accordance with the terms hereof. [Emphasis added.]

16 Thus, the rights of the Claimants flow from the compromise, as sanctioned by the Court on the basis of the CCAA principles outlined above.

17 In this case, the language of the compromise - as voted on and accepted by the HIV Claimants - is clear: the Plan "shall be governed by and construed in accordance with the laws of the Province of Ontario and the federal laws of Canada applicable therein" (i.e. in Ontario): Article 8.09.

18 There are sound policy reasons why the law of one jurisdiction should apply in a situation such as this. The HIV Fund is limited, and it is important to minimize the costs of assessing Claims. One law, applicable to all Claims - although perhaps cutting adversely against some Claimants in some respects, in comparison to their pre-insolvency positions - accomplishes this goal more effectively. One law, applicable to all Claims, avoids inequality of treatment as between claimants and uncertainty as to the amount of the HIV Fund required to compensate Claimants. As Mr. Strosberg noted, any participant who objected to the application of the law of Ontario in respect of all claims under the Plan could have voiced that objection and proposed an amendment to the Plan, or voted to defeat the Plan, during the approval and sanctioning phase. None did so.

19 On behalf of her Claimants, Ms. Ring argued very skillfully that the purpose of the Plan as a whole is to make the HIV Fund available to all persons in Canada affected with HIV, who had an outstanding claim against the Canadian Red Cross on July 20, 1998 - the date upon which the Red Cross was initially given CCAA protection. Accordingly, she submits, the proper law applying to those claims should be the law of the jurisdiction that would have governed had the claim been commenced before that date.

20 Ms. Ring stresses what she submits is the claim-specific wording of Article 5.10(a) of the Plan cited above. She notes that the Referee is to decide "whether limitation periods had expired prior to July 20, 1998" and that no award is to be made to "an" HIV Claimant where the limitation period "in respect of such Claim" had expired. The clause refers to limitation periods (plural), the argument goes, and does not specifically state that only Ontario's time limitation period applies. Therefore, the language of the general governing law provisions of Article 8.09 should not override the specific provisions of Article 5.10(a).

21 Having regard to the terms of the Plan as a whole, however, I do not think that Article 5.10(a) can be given such a specific interpretation. There are a large number of HIV Claims to be dealt with. Hence the reference to "limitation periods" in the plural. However, the determination is to be made in relation to Claims where a limitation period issue arises. Hence the reference to "in respect of such Claim". If Article 5.10(a) were viewed as an exception to the general governing law provision of the Plan, the parties could easily have said so, and those voting on the Plan could easily have ensured that it did or - as noted above - voted against the Plan.

22 The rights of the HIV Claimants now flow from the Amended Plan of Compromise and Arrangement, not from what their respective positions may have been in terms of suing the Canadian Red Cross before insolvency.

23 I agree that the effect of interpreting the Plan to apply Ontario law to the issues in question is to apply Ontario law retroactively to all claims across Canada. This has possibly adverse implications in the case of certain individual claims; but it has possibly beneficial implications for other individual claims. In any event, I am satisfied on reading the Plan as a whole and considering the underlying purposes and principles of the CCAA and principles of contractual interpretation, that that is precisely what was intended by the negotiators of the Plan and by those who approved it by their votes.

Conclusion

24 Accordingly, an Order is granted directing that the law of Ontario and the federal laws of Canada applicable therein govern issues relating to eligibility of persons to claim under the HIV Fund, including but not necessarily limited to applicable limitation periods and categories of family members entitled to claim, and the quantum those deemed eligible will receive.

BLAIR J.

cp/ci/e/nc/qlhcc/qlhcs

1 R.S.C. 1985, c. C-36.

2 Mr. Arenson has indicated that he will be challenging the application of the Waschkowski ruling to the circumstances of these Claims, in a proceeding to be dealt with later.

** Preliminary Version **

Case Name:

Bhasin v. Hrynew

Harish Bhasin, carrying on business as Bhasin & Associates, Appellant;
v.
Larry Hrynew and Heritage Education Funds Inc. (formerly known as Allianz Education Funds Inc., formerly known as Canadian American Financial Corp. (Canada) Limited), Respondents.

[2014] S.C.J. No. 71

[2014] A.C.S. no 71

2014 SCC 71

2014 CSC 71

[2014] 3 S.C.R. 494

[2014] 3 R.C.S. 494

[2014] 11 W.W.R. 641

245 A.C.W.S. (3d) 832

27 B.L.R. (5th) 1

379 D.L.R. (4th) 385

4 Alta. L.R. (6th) 219

464 N.R. 254

20 C.C.E.L. (4th) 1

2014 CarswellAlta 2046

2014EXP-3530

J.E. 2014-1992

EYB 2014-244256

File No.: 35380.

Supreme Court of Canada

Heard: February 12, 2014;
Judgment: November 13, 2014.

Present: McLachlin C.J. and LeBel, Abella, Rothstein, Cromwell, Karakatsanis and Wagner JJ.

(112 paras.)

Appeal From:

ON APPEAL FROM THE COURT OF APPEAL FOR ALBERTA

Contracts -- Performance and discharge -- Performance -- Termination -- By notice -- Appeal by Bhasin from judgment setting aside decision holding Can-Am and Hrynew liable for civil conspiracy towards Bhasin allowed in part -- Can-Am had misled Bhasin before exercising non-renewal clause of Bhasin's enrollment director's agreement, and Hrynew, Bhasin's competitor, had intentionally induced breach of contract -- It was appropriate to recognize new common law duty of honest performance that applied to all contracts as manifestation of general organizing principle of good faith -- Can-Am had acted dishonestly so was liable -- Court of Appeal was correct in finding there could be no liability for Hrynew, competitor agency, for inducing breach of contract.

Appeal by Bhasin from a judgment of the Alberta Court of Appeal setting aside a decision that found Can-Am and Hrynew liable for civil conspiracy towards Bhasin. Can-Am marketed education savings plans to investors through retail dealers, known as enrollment directors, such as Bhasin. The enrollment director's agreement between Can-Am and Bhasin provided that the contract would automatically renew at the end of its three year term unless one of the parties gave notice to the contrary. Hrynew, another enrollment director, was a competitor of Bhasin and repeatedly proposed a merger of their agencies, which Bhasin refused. Can-Am appointed Hrynew as provincial trading officer (PTO) to conduct compliance reviews and audits. Bhasin objected to having Hrynew review his confidential business records. Can-Am repeatedly misled Bhasin by telling him that Hrynew, as

PTO, was under an obligation to treat the information confidentially. It also responded equivocally when Bhasin asked in August 2000 whether the merger was a "done deal", while it had indicated to the Alberta Securities Commission earlier that year that its planned restructuring included Bhasin working for Hrynew's agency. After Bhasin continued to refuse to allow Hrynew to audit his records, Can-Am gave notice that it would not renew the 1998 agreement. At the expiry of the contract term, Bhasin lost the value in his business in his assembled workforce. Bhasin sued Can-Am and Hrynew. The trial judge found Can-Am was in breach of the implied term of good faith, Hrynew had intentionally induced breach of contract, and both Can-Am and Hrynew were liable for civil conspiracy. The Court of Appeal allowed the appeal and dismissed Bhasin's lawsuit.

Held: Appeal allowed in part. Good faith performance of contracts was a general organizing principle of the common law of contract, and there was a common law duty to act honestly in the performance of contractual obligations. Parties were generally required to perform their contractual duties honestly and reasonably and not capriciously or arbitrarily. In carrying out his or her own performance of the contract, a party was to have appropriate regard to the legitimate contractual interests of the contracting partner. The notion of "appropriate regard" for the other party's interests required that a party not seek to undermine those interests in bad faith. Unlike fiduciary duties, good faith performance did not engage duties of loyalty to the other contracting party or a duty to put the interests of the other contracting party first. The application of the organizing principle of good faith to particular situations was to be developed where the existing law was found to be wanting and where the development could occur incrementally in a way that was consistent with the structure of the common law of contract and gave due weight to the importance of private ordering and certainty in commercial affairs. The principle of good faith was to be applied in a manner consistent with the fundamental commitments of the common law of contract which generally placed great weight on the freedom of contracting parties to pursue their individual self-interest. It could not be used as a pretext for scrutinizing the motives of contracting parties. The objection to Can-Am's conduct in this case did not fit within any of the existing situations or relationships in which duties of good faith had been found to exist. It was appropriate to recognize a new common law duty that applied to all contracts as a manifestation of the general organizing principle of good faith: a duty of honest performance whereby parties were required to be honest with each other in relation to the performance of their contractual obligations and not lie or mislead the other party about one's contractual performance. In this case, the trial judge concluded that Can-Am acted dishonestly with Bhasin throughout the period leading up to its exercise of the non-renewal clause, both with respect to its own intentions and with respect to Hrynew's role as PTO. The trial judge's detailed findings amply supported this overall conclusion. Can-Am was liable for damages calculated on the basis of what Bhasin's economic position would have been had Can-Am fulfilled its duty. Bhasin was entitled to damages in the amount of $87,000. The Court of Appeal was correct in finding that there could be no liability for inducing breach of contract or unlawful means conspiracy. As such, it followed that the claims against Hrynew were rightly dismissed.

Statutes, Regulations and Rules Cited:

Civil Code of Lower Canada,

Civil Code of Quebec, S.Q. 1991, c. 64, art. 6, art. 7, art. 1375

Franchises Act, R.S.A. 2000, c. F-23, s. 7

Restatement (Second) of Contracts (1981), s. 205

Uniform Commercial Code (2012), s. 1-201(b)(20), s. 1-302, s. 1-304

Subsequent History:

NOTE: This document is subject to editorial revision before its reproduction in final form in the Canada Supreme Court Reports.

Court Catchwords:

Contracts -- Breach -- Performance -- Non-renewal provision -- Duty of good faith -- Duty of honest performance -- Agreement governing relationship between company and retail dealer providing for automatic contract renewal at end of three-year term unless parties giving six months' written notice to contrary -- Company deciding not to renew dealership agreement -- Retail dealer lost value of business and majority of sales agents solicited by competitor agency -- Retail dealer suing company and competitor agency -- Whether common law requiring new general duty of honesty in contractual performance -- Whether company breaching that duty.

Damages -- Quantum -- Contracts -- Breach -- Performance -- Non-renewal provision -- Duty of good faith -- Duty of honest performance -- Agreement governing relationship between company and retail dealer providing for automatic contract renewal at end of three-year term unless parties giving six months' written notice to contrary -- Company deciding not to renew dealership agreement -- Retail dealer lost value of business and majority of sales agents solicited by competitor agency -- Retail dealer suing company and competitor agency -- What is appropriate measure of damages.

Court Summary:

C markets education savings plans to investors through retail dealers, known as enrollment directors, such as B. An enrollment director's agreement that took effect in 1998 governed the relationship between C and B. The term of the contract was three years. The applicable provision provided that the contract would automatically renew at the end of the three year term unless one of the parties gave six months' written notice to the contrary.

H was another enrollment director and was a competitor of B. H wanted to capture B's lucrative niche market and previously approached B to propose a merger of their agencies on numerous

occasions. He also actively encouraged C to force the merger. B had refused to participate in such a merger. C appointed H as the provincial trading officer ("PTO") to review its enrollment directors for compliance with securities laws after the Alberta Securities Commission raised concerns about compliance issues among C's enrollment directors. The role required H to conduct audits of C's enrollment directors. B objected to having H, a competitor, review his confidential business records.

During C's discussions with the Commission about compliance, it was clear that C was considering a restructuring of its agencies in Alberta that involved B. In June 2000, C outlined its plans to the Commission and they included B working for H's agency. None of this was known by B. C repeatedly misled B by telling him that H, as PTO, was under an obligation to treat the information confidentially. It also responded equivocally when B asked in August 2000 whether the merger was a "done deal". When B continued to refuse to allow H to audit his records, C threatened to terminate the 1998 Agreement and in May 2001 gave notice of non-renewal under the Agreement. At the expiry of the contract term, B lost the value in his business in his assembled workforce. The majority of his sales agents were successfully solicited by H's agency.

B sued C and H. The trial judge found C was in breach of the implied term of good faith, H had intentionally induced breach of contract, and both C and H were liable for civil conspiracy. The Court of Appeal allowed the appeal and dismissed B's lawsuit.

Held: The appeal with respect to C should be allowed and the appeal with respect to H dismissed. The trial judge's assessment of damages should be varied to $87,000 plus interest.

Canadian common law in relation to good faith performance of contracts is piecemeal, unsettled and unclear. Two incremental steps are in order to make the common law more coherent and more just. The first step is to acknowledge that good faith contractual performance is a general organizing principle of the common law of contract which underpins and informs the various rules in which the common law, in various situations and types of relationships, recognizes obligations of good faith contractual performance. The second step is to recognize, as a further manifestation of this organizing principle of good faith, that there is a common law duty which applies to all contracts to act honestly in the performance of contractual obligations. Taking these two steps will put in place a duty that is just, that accords with the reasonable expectations of commercial parties and that is sufficiently precise that it will enhance rather than detract from commercial certainty.

There is an organizing principle of good faith that parties generally must perform their contractual duties honestly and reasonably and not capriciously or arbitrarily. An organizing principle states in general terms a requirement of justice from which more specific legal doctrines may be derived. An organizing principle therefore is not a free-standing rule, but rather a standard that underpins and is manifested in more specific legal doctrines and may be given different weight in different situations. It is a standard that helps to understand and develop the law in a coherent and principled way.

The organizing principle of good faith exemplifies the notion that, in carrying out his or her own

performance of the contract, a contracting party should have appropriate regard to the legitimate contractual interests of the contracting partner. While "appropriate regard" for the other party's interests will vary depending on the context of the contractual relationship, it does not require acting to serve those interests in all cases. It merely requires that a party not seek to undermine those interests in bad faith. This general principle has strong conceptual differences from the much higher obligations of a fiduciary. Unlike fiduciary duties, good faith performance does not engage duties of loyalty to the other contracting party or a duty to put the interests of the other contracting party first.

This organizing principle of good faith manifests itself through the existing doctrines about the types of situations and relationships in which the law requires, in certain respects, honest, candid, forthright or reasonable contractual performance. Generally, claims of good faith will not succeed if they do not fall within these existing doctrines. However, this list is not closed. The application of the organizing principle of good faith to particular situations should be developed where the existing law is found to be wanting and where the development may occur incrementally in a way that is consistent with the structure of the common law of contract and gives due weight to the importance of private ordering and certainty in commercial affairs.

The approach of recognizing an overarching organizing principle but accepting the existing law as the primary guide to future development is appropriate in the development of the doctrine of good faith. Good faith may be invoked in widely varying contexts and this calls for a highly context-specific understanding of what honesty and reasonableness in performance require so as to give appropriate consideration to the legitimate interests of both contracting parties.

The principle of good faith must be applied in a manner that is consistent with the fundamental commitments of the common law of contract which generally places great weight on the freedom of contracting parties to pursue their individual self-interest. In commerce, a party may sometimes cause loss to another -- even intentionally -- in the legitimate pursuit of economic self-interest. Doing so is not necessarily contrary to good faith and in some cases has actually been encouraged by the courts on the basis of economic efficiency. The development of the principle of good faith must be clear not to veer into a form of *ad hoc* judicial moralism or "palm tree" justice. In particular, the organizing principle of good faith should not be used as a pretext for scrutinizing the motives of contracting parties.

The objection to C's conduct in this case does not fit within any of the existing situations or relationships in which duties of good faith have been found to exist. It is appropriate to recognize a new common law duty that applies to all contracts as a manifestation of the general organizing principle of good faith: a duty of honest performance, which requires the parties to be honest with each other in relation to the performance of their contractual obligations.

Under this new general duty of honesty in contractual performance, parties must not lie or otherwise knowingly mislead each other about matters directly linked to the performance of the contract. This does not impose a duty of loyalty or of disclosure or require a party to forego advantages flowing

from the contract; it is a simple requirement not to lie or mislead the other party about one's contractual performance. Recognizing a duty of honest performance flowing directly from the common law organizing principle of good faith is a modest, incremental step.

This new duty of honest performance is a general doctrine of contract law that imposes as a contractual duty a minimum standard of honesty in contractual performance. It operates irrespective of the intentions of the parties, and is to this extent analogous to equitable doctrines which impose limits on the freedom of contract, such as the doctrine of unconscionability. However, the precise content of honest performance will vary with context and the parties should be free in some contexts to relax the requirements of the doctrine so long as they respect its minimum core requirements.

The duty of honest performance should not be confused with a duty of disclosure or of fiduciary loyalty. A party to a contract has no general duty to subordinate his or her interest to that of the other party. However, contracting parties must be able to rely on a minimum standard of honesty from their contracting partner in relation to performing the contract as a reassurance that if the contract does not work out, they will have a fair opportunity to protect their interests.

In this case, the trial judge did not make a reversible error by adjudicating the issue of good faith. C breached the 1998 Agreement when it failed to act honestly with B in exercising the non-renewal clause. The trial judge concluded that C acted dishonestly with B throughout the period leading up to its exercise of the non-renewal clause, both with respect to its own intentions and with respect to H's role as PTO. The trial judge's detailed findings amply support this overall conclusion.

C is liable for damages calculated on the basis of what B's economic position would have been had C fulfilled its duty. While the trial judge did not assess damages on that basis given the different findings in relation to liability, the trial judge made findings that permit this Court to do so. These findings permit damages to be assessed on the basis that if C had performed the contract honestly, B would have been able to retain the value of his business rather than see it, in effect, expropriated and turned over to H. It is clear from the findings of the trial judge and from the record that the value of the business around the time of non-renewal was $87,000. B is entitled to damages in the amount of $87,000. The Court of Appeal was correct in finding that there could be no liability for inducing breach of contract or unlawful means conspiracy. As such, it follows that the claims against H were rightly dismissed.

Cases Cited

Referred to: *Aleyn v. Belchier* (1758), 1 Eden. 132, 28 E.R. 634; *Mills v. Mills* (1938), 60 C.L.R. 150; *Mellish v. Motteux* (1792), Peake. 156, 170 E.R. 113; *Carter v. Boehm* (1766), 3 Burr. 1905, 97 E.R. 1162; *Herbert v. Mercantile Fire Ins. Co.* (1878), 43 U.C.Q.B. 384; *Gateway Realty Ltd. v. Arton Holdings Ltd.* (1991), 106 N.S.R. (2d) 180, aff'd (1992), 112 N.S.R. (2d) 180; *McDonald's Restaurant of Canada Ltd. v. British Columbia* (1997), 29 B.C.L.R. (3d) 303; *Crawford v. Agricultural Development Board (N.B.)* (1997), 192 N.B.R. (2d) 68; *Transamerica Life Canada Inc.*

v. ING Canada Inc. (2003), 68 O.R. (3d) 457; *Mesa Operating Limited Partnership v. Amoco Canada Resources Ltd.* (1994), 149 A.R. 187; *Barclays Bank PLC v. Metcalfe & Mansfield Alternative Investments VII Corp.*, 2013 ONCA 494, 365 D.L.R. (4th) 15; *R. v. Salituro*, [1991] 3 S.C.R. 654; *Bow Valley Husky (Bermuda) Ltd. v. Saint John Shipbuilding Ltd.*, [1997] 3 S.C.R. 1210; *Watkins v. Olafson*, [1989] 2 S.C.R. 750; *Hill v. Church of Scientology of Toronto*, [1995] 2 S.C.R. 1130; *R.W.D.S.U., Local 558 v. Pepsi-Cola Canada Beverages (West) Ltd.*, 2002 SCC 8, [2002] 1 S.C.R. 156; *British Columbia v. Imperial Tobacco Canada Ltd.*, 2005 SCC 49, [2005] 2 S.C.R. 473; *Grant v. Torstar Corp.*, 2009 SCC 61, [2009] 3 S.C.R. 640; *Interfoto Picture Library Ltd. v. Stiletto Visual Programmes Ltd.*, [1989] 1 Q.B. 433; *London Drugs Ltd. v. Kuehne & Nagel International Ltd.*, [1992] 3 S.C.R. 299; *Machtinger v. HOJ Industries Ltd.*, [1992] 1 S.C.R. 986; *Schuler A.G. v. Wickman Machine Tool Sales Ltd.*, [1974] A.C. 235; *CivicLife.com Inc. v. Canada (Attorney General)* (2006), 215 O.A.C. 43; *Dynamic Transport Ltd. v. O.K. Detailing Ltd.*, [1978] 2 S.C.R. 1072; *Mitsui & Co. (Canada) Ltd. v. Royal Bank of Canada*, [1995] 2 S.C.R. 187; *Mason v. Freedman*, [1958] S.C.R. 483; *Honda Canada Inc. v. Keays*, 2008 SCC 39, [2008] 2 S.C.R. 362; *Wallace v. United Grain Growers Ltd.*, [1997] 3 S.C.R. 701; *Fidler v. Sun Life Assurance Co. of Canada*, 2006 SCC 30, [2006] 2 S.C.R. 3; *702535 Ontario Inc. v. Lloyd's London, Non-Marine Underwriters* (2000), 184 D.L.R. (4th) 687; *Whiten v. Pilot Insurance Co.*, 2002 SCC 18, [2002] 1 S.C.R. 595; *Andrusiw v. Aetna Life Insurance Co. of Canada* (2001), 289 A.R. 1; *Martel Building Ltd. v. Canada*, 2000 SCC 60, [2000] 2 S.C.R. 860; *M.J.B. Enterprises Ltd. v. Defence Construction (1951) Ltd.*, [1999] 1 S.C.R. 619; *Tercon Contractors Ltd. v. British Columbia (Transportation and Highways)*, 2010 SCC 4, [2010] 1 S.C.R. 69; *Yam Seng Pte Ltd. v. International Trade Corporation Ltd.*, [2013] EWHC 111, [2013] 1 All E.R. (Comm.) 1321; *Mid Essex Hospital Services NHS Trust v. Compass Group UK and Ireland Ltd.*, [2013] EWCA Civ 200 (BAILII); *Renard Constructions (ME) Pty Ltd. v. Minister for Public Works* (1992), 26 N.S.W.L.R. 234; *Burger King Corp. v. Hungry Jack's Pty Ltd.*, [2001] NSWCA 187 (AustLII); *R. v. Jones*, [1994] 2 S.C.R. 229; *R. v. Hart*, 2014 SCC 52, [2014] 2 S.C.R. 544; *Peel (Regional Municipality) v. Canada*, [1992] 3 S.C.R. 762; *A.I. Enterprises Ltd. v. Bram Enterprises Ltd.*, 2014 SCC 12, [2014] 1 S.C.R. 177; *Bank of America Canada v. Mutual Trust Co.*, 2002 SCC 43, [2002] 2 S.C.R. 601; *Greenberg v. Meffert* (1985), 50 O.R. (2d) 755; *Shelanu Inc. v. Print Three Franchising Corp.* (2003), 64 O.R. (3d) 533; *GEC Marconi Systems Pty Ltd. v. BHP Information Technology Pty Ltd.*, [2003] FCA 50 (AustLII); *Bank of Montreal v. Kuet Leong Ng*, [1989] 2 S.C.R. 429; *Kirke La Shelle Co. v. Armstrong Co.*, 263 N.Y. 79 (1933); *National Bank of Canada v. Soucisse*, [1981] 2 S.C.R. 339; *Houle v. Canadian National Bank*, [1990] 3 S.C.R. 122; *Bank of Montreal v. Bail Ltée*, [1992] 2 S.C.R. 554; *United Roasters, Inc. v. Colgate-Palmolive Co.*, 649 F.2d 985 (1981); *Ryan v. Moore*, 2005 SCC 38, [2005] 2 S.C.R. 53; *Maracle v. Travellers Indemnity Co. of Canada*, [1991] 2 S.C.R. 50; *Parna v. G. & S. Properties Ltd.*, [1971] S.C.R. 306; *Bruno Appliance and Furniture, Inc. v. Hryniak*, 2014 SCC 8, [2014] 1 S.C.R. 126; *LeMesurier v. Andrus* (1986), 54 O.R. (2d) 1; *Shell Oil Co. v. Marinello*, 294 A.2d 253 (1972), aff'd 307 A.2d 598 (1973); *Atlantic Richfield Co. v. Razumic*, 390 A.2d 736 (1978); *J.H. Westerbeke Corp. v. Onan Corp.*, 580 F.Supp. 1173 (1984); *Pitney-Bowes, Inc. v. Mestre*, 517 F.Supp. 52 (1981), cert. denied, 464 U.S. 893 (1983); *Agribrands Purina Canada Inc. v. Kasamekas*, 2011 ONCA 460, 106 O.R. (3d) 427.

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History and Disposition:

APPEAL from a judgment of the Alberta Court of Appeal (Côté and Paperny JJ.A. and Belzil J. (*ad hoc*)), 2013 ABCA 98, 84 Alta. L.R. (5th) 68, 544 A.R. 28, 567 W.A.C. 28, 362 D.L.R. (4th) 18, 12 B.L.R. (5th) 175, [2013] 11 W.W.R. 459, [2013] A.J. No. 395 (QL), 2013 CarswellAlta 822, setting aside a decision of Moen J., 2011 ABQB 637, 526 A.R. 1, 96 B.L.R. (4th) 73, [2012] 9 W.W.R. 728, [2011] A.J. No. 1223 (QL), 2011 CarswellAlta 1905. Appeal allowed in part.

Counsel:

Neil Finkelstein, *Brandon Kain*, *John McCamus* and *Stephen Moreau*, for the appellant.

Eli S. Lederman, *Jon Laxer* and *Constanza Pauchulo*, for the respondents.

The judgment of the Court was delivered by

CROMWELL J.:--

I. Introduction

1 The key issues on this appeal come down to two, straightforward questions: Does Canadian common law impose a duty on parties to perform their contractual obligations honestly? And, if so, did either of the respondents breach that duty? I would answer both questions in the affirmative. Finding that there is a duty to perform contracts honestly will make the law more certain, more just and more in tune with reasonable commercial expectations. It will also bring a measure of justice to the appellant, Mr. Bhasin, who was misled and lost the value of his business as a result.

II. Facts and Judicial History

Overview and Issues

2 The appellant, Mr. Bhasin, through his business Bhasin & Associates, was an enrollment director for Canadian American Financial Corp. ("Can-Am") beginning in 1989. The relationship between Mr. Bhasin and Can-Am soured in 1999 and ultimately Can-Am decided not to renew the dealership agreement with him. The litigation leading to this appeal ensued.

3 Can-Am markets education savings plans ("ESPs") to investors through retail dealers, known as enrollment directors, such as Mr. Bhasin. It pays the enrollment directors compensation and bonuses for selling ESPs. The enrollment directors are in effect small business owners and the success of their businesses depends on them building a sales force. It took Mr. Bhasin approximately 10 years to build his sales force, but his business thrived and Can-Am gave him numerous awards and prizes recognizing him as one of their top enrollment directors in Canada: 2011 ABQB 637, 526 A.R. 1, at paras. 51, 238 and 474.

4 An enrollment director's agreement that took effect in 1998 governed the relationship between

Can-Am and Mr. Bhasin. (That Agreement replaced a previous agreement of an indefinite term that had governed their relationship since the outset in 1989.) The Agreement was a commercial dealership agreement, not a franchise agreement. There was no franchise fee and it was not covered by the statutory duty of fair dealing such as that provided for in s. 7 of the *Franchises Act*, R.S.A. 2000, c. F-23.

5 That said, there were some features of the 1998 Agreement that are similar to provisions typically found in franchise agreements. Mr. Bhasin was obliged to sell Can-Am investment products exclusively and owed it a fiduciary duty. Can-Am owned the client lists, was responsible for branding and implemented central policies that applied to all enrollment directors: see cls. 4.1, 5.2, 5.3 and 4.7. Mr. Bhasin could not sell, transfer, or merge his operation without Can-Am's consent, which was not to be withheld unreasonably: see cls. 4.5 and 11.4.

6 The term of the contract was three years. Clauses 8.3 and 8.4 allowed termination on short notice for misconduct or other cause. Clause 3.3 -- the provision at the centre of this case -- provided that the contract would automatically renew at the end of the three-year term unless one of the parties gave six months' written notice to the contrary.

7 Mr. Hrynew, one of the respondents and another enrollment director, was a competitor of Mr. Bhasin and there was considerable animosity between them: trial reasons, at para. 461. The trial judge found, in effect, that Mr. Hrynew pressured Can-Am not to renew its Agreement with Mr. Bhasin and that Can-Am dealt dishonestly with Mr. Bhasin and ultimately gave in to that pressure.

8 When Mr. Hrynew moved his agency to Can-Am from one of its competitors many years before the events in question, Can-Am promised him that he would be given consideration for mergers that would take place and he in fact merged with other agencies in Calgary after joining Can-Am: trial reasons, at para. 238. He was in a strong position with Can-Am because he had the largest agency in Alberta and a good working relationship with the Alberta Securities Commission which regulated Can-Am's business: para. 284.

9 Mr. Hrynew wanted to capture Mr. Bhasin's lucrative niche market around which he had built his business: trial reasons, at para. 303. Mr. Hrynew personally approached Mr. Bhasin to propose a merger of their agencies on numerous occasions: para. 238. He also actively encouraged Can-Am to force the merger and made "veiled threats" that he would leave if no merger took place: para. 282; see also paras. 251 and 287. The trial judge found that the proposed "merger" was in effect a hostile takeover of Mr. Bhasin's agency by Mr. Hrynew: para. 240. Mr. Bhasin steadfastly refused to participate in such a merger: para. 247.

10 The Alberta Securities Commission raised concerns about compliance issues among Can-Am's enrollment directors. In late 1999, the Commission required Can-Am to appoint a single provincial trading officer ("PTO") to review its enrollment directors for compliance with securities laws: trial reasons, at paras. 149, 152 and 160. Can-Am appointed Mr. Hrynew to that position in September of that year. The role required him to conduct audits of Can-Am's enrollment directors.

Mr. Bhasin and Mr. Hon, another enrollment director, objected to having Mr. Hrynew, a competitor, review their confidential business records: paras. 189-196.

11 Can-Am became worried that the Commission might revoke its licence and, in 1999 and 2000, it had many discussions with the Commission about compliance. During those discussions, it was clear that Can-Am was considering a restructuring of its agencies in Alberta that involved Mr. Bhasin. In June 2000, Can-Am outlined its plans to the Commission and they included Mr. Bhasin working for Mr. Hrynew's agency. The trial judge found that this plan had been formulated before June 2000: trial reasons, at para. 256. None of this was known by Mr. Bhasin: paras. 243-46.

12 In fact, Can-Am repeatedly misled Mr. Bhasin by telling him that Mr. Hrynew, as PTO, was under an obligation to treat the information confidentially and that the Commission had rejected a proposal to have an outside PTO, neither of which was true: trial reasons at para. 195. It also responded equivocally when Mr. Bhasin asked in August 2000 whether the merger was a "done deal": para. 247. When Mr. Bhasin continued to refuse to allow Mr. Hrynew to audit his records, Can-Am threatened to terminate the 1998 Agreement and in May 2001 gave notice of non-renewal under the Agreement: paras. 207-11.

13 At the expiry of the contract term, Mr. Bhasin lost the value in his business in his assembled workforce. The majority of his sales agents were successfully solicited by Mr. Hrynew's agency. Mr. Bhasin was obliged to take less remunerative work with one of Can-Am's competitors.

14 Mr. Bhasin sued Can-Am and Mr. Hrynew. Moen J. in the Alberta Court of Queen's Bench found that it was an implied term of the contract that decisions about whether to renew the contract would be made in good faith. The court held that the corporate respondent was in breach of the implied term of good faith, Mr. Hrynew had intentionally induced breach of contract, and the respondents were liable for civil conspiracy.

15 The trial judge found that Can-Am acted dishonestly with Mr. Bhasin throughout the events leading up to the non-renewal: it misled him about its intentions with respect to the merger and about the fact that it had already proposed the new structure to the Commission; it did not communicate to him that the decision was already made and final, even though he asked; and it did not communicate with him that it was working closely with Mr. Hrynew to bring about a new corporate structure with Hrynew's being the main agency in Alberta. The trial judge also found that, had Can-Am acted honestly, Mr. Bhasin could have "governed himself accordingly so as to retain the value in his agency": para. 258.

16 The Alberta Court of Appeal allowed the respondents' appeal and dismissed Mr. Bhasin's lawsuit. The court found his pleadings to be insufficient and held that the lower court erred by implying a term of good faith in the context of an unambiguous contract containing an entire agreement clause: 2013 ABCA 98, 84 Alta. L.R. (5th) 68.

17 The appeal raises four issues:

(a) Did Mr. Bhasin properly plead breach of the duty of good faith?
(b) Did Can-Am owe Mr. Bhasin a duty of good faith? If so, did it breach that duty?
(c) Are the respondents liable for the torts of inducing breach of contract or civil conspiracy?
(d) If there was a breach, what is the appropriate measure of damages?

III. Analysis

A. *Did Mr. Bhasin Properly Plead Breach of the Duty of Good Faith?*

18 The Court of Appeal held that Mr. Bhasin had not properly pleaded the good faith issue and that the trial judge had therefore erred in considering it. Mr. Bhasin contests this conclusion, while the respondents support it. I agree with Mr. Bhasin.

19 The allegations in the statement of claim clearly put the questions of improper purpose and dishonesty in issue. These facts are sufficient to put Can-Am's good faith in issue. The question of whether this conduct amounted to a breach of the duty of good faith is a legal conclusion that did not need to be pleaded separately. The defendants did not move to strike the pleadings or seek particulars of the allegation of wrongful termination in the statement of claim. Good faith was a live issue that was fully canvassed in a lengthy trial: A.F., at paras. 92-94. Written submissions by both parties at trial referred to the good faith issue and even in his opening at trial, Mr. Bhasin's counsel raised the issue of good faith.

20 The trial judge held that any deficiency in the pleadings did not cause prejudice to the respondents: paras. 23 and 48. This is an assessment she was uniquely positioned to make and her conclusion ought to be treated with deference on appeal. The good faith issue was fully argued in and addressed by the Court of Appeal and has been fully argued on the merits in this Court.

21 In my view, the trial judge did not make a reversible error by adjudicating the issue of good faith and we should address the merits of that issue.

B. *Did Can-Am Owe Mr. Bhasin a Duty of Good Faith?*

(1) Decisions and Positions of the Parties

(a) *Decisions*

22 The trial judge accepted Mr. Bhasin's position that there was a duty of good faith in this case and that it had been breached. In brief, her reasoning was as follows.

23 First, the trial judge decided that the 1998 Agreement was a type of agreement which as a matter of law requires good faith performance. She recognized that the 1998 Agreement did not fall within any of the existing categories of contract, such as employment, insurance and franchise agreements, which have been held to require good faith performance. She concluded, however, that the Agreement was analogous to a franchise or employment contract, and so by analogy to these cases, she implied a term of good faith performance as a matter of law. The contract was not balanced from its inception and the relationship placed the enrollment director in a position of inherent and predictable vulnerability: paras. 67-86.

24 Second and in the alternative, the trial judge held that a term of good faith performance should be implied based on the intentions of the parties in order to give business efficacy to the agreement. She concluded that "[w]hen one considers the whole of the relationship ... it is clear that the parties had to operate in good faith and there was a requirement of fairness between them. In other words, good faith was necessary to give business efficacy to the whole 1998 Agreement": para. 101.

25 The 1998 Agreement contained an "entire agreement clause" stating that there were no "agreements, express, implied or statutory, other than expressly set out" in it: cl. 11.2. The trial judge held, however, that this clause did not preclude the implication of a duty of good faith. The parties, she reasoned, cannot rely on exclusion clauses to avoid contractual obligations where there is an imbalance of power and that courts refuse to let parties shelter under entire agreement clauses where it would be unjust or inequitable to do so: paras. 116-18.

26 Turning to the issue of breach, the trial judge found that Can-Am had breached the agreement, first by requiring Mr. Bhasin to submit to an audit by Mr. Hrynew and to provide the latter with access to his business records, and second by exercising the non-renewal clause in a dishonest and misleading manner and for an improper purpose. The non-renewal clause was not intended to permit Can-Am to force a merger of the Bhasin and Hrynew agencies, but that was the purpose for which Can-Am exercised this power: para. 261. The trial judge also found both respondents liable for unlawful means conspiracy and found Mr. Hrynew liable for inducing Can-Am's breach of its contract with Mr. Bhasin.

27 The Court of Appeal reversed and held that there had been no breach of contract. The duty of good faith in employment contracts could not be extended by analogy to other types of contract. In any event, the duty of good faith in the employment context is limited to the manner of termination and does not include reasons for non-renewal: C.A. reasons, at paras. 27 and 31. Nor was this a circumstance in which a term could be implied because it was so obvious it was not thought necessary to mention or was necessary to make the contract work: para. 32. Even if there were an implied duty of good faith in this case, the impugned conduct concerned the non-renewal of a contract, which occurs on expiry, unlike a termination clause: para. 31.

28 Moreover, the Court of Appeal held that a term cannot be implied where it goes against an express term of the contract. Here, the parties did not intend a perpetual contract, since they

included a term allowing either party to unilaterally trigger its expiration prior to the end of each three-year term. The trial judge's approach was inconsistent with the non-renewal provision of the contract. The motive for triggering expiration was not restricted under the Agreement. The implication of a term of good faith also violated the entire agreement clause. The court held that the evidence of assurances given by Can-Am as to how the non-renewal power would be exercised fell afoul of the parol evidence rule and should not have been considered. Since the Court of Appeal held there was no breach of contract, the basis for the claims in unlawful means conspiracy and inducing breach of contract also disappeared.

(b) *Positions of the Parties*

29 Mr. Bhasin advances two related positions on appeal. His broad submission is that the Court should recognize a general duty of good faith in contract. The duty arises where the agreement gives the defendant the power to unilaterally defeat a legitimate contractual objective of the plaintiff and it does not clearly allow the defendant to exercise its power without regard for that objective: A.F., at para. 51. This duty of good faith prevents conduct which, while consonant with the letter of a contract, exhibits dishonesty, ill will, improper motive or similar departures from reasonable business expectations. Mr. Bhasin contends that common law in Canada is increasingly isolated as other jurisdictions embrace a greater role for good faith in contract law: A.F., at paras. 27-32. The recognition of a general duty of good faith would constitute an incremental advance in the law, given the numerous specific situations that already give rise to a duty of good faith. Mr. Bhasin relies on the findings of the trial judge that the respondents improperly and dishonestly used its non-renewal right to compel Mr. Bhasin to merge with his competitor. Mr. Bhasin contends that the respondents had no legitimate business reason for not renewing the contract. He also says that the entire agreement clause should be construed narrowly, and that express language is needed for such a clause to derogate from a duty of good faith: A.F., at para. 83.

30 Mr. Bhasin's second position, emphasized in oral argument, is that the Court should at least recognize a duty of honest performance of contractual obligations: transcript, at pp. 8, 10 and 24. Mr. Bhasin relies on the trial judge's findings that Can-Am acted dishonestly towards Mr. Bhasin throughout the period leading up to the non-renewal. It repeatedly lied to him about the nature of the organizational changes required by the Alberta Securities Commission, the nature of the audits that were to be carried out by Mr. Hrynew, and was dishonest about its intention to force him out: trial reasons, at paras. 195, 221, 246-47 and 267.

31 Unsurprisingly, the respondents see things very differently. While they accept that good faith plays a role in Canadian contract law, they submit that this role is much more modest than Mr. Bhasin suggests. They say that such a duty arises only in certain classes of contract, such as employment contracts, and in contracts involving discretionary powers: R.F., at para. 52. In the employment context, the duty applies only to the manner in which a contract is terminated. The contract in this case was negotiated between commercial parties to whom the policy considerations underlying employment law doctrine do not apply. Mr. Bhasin is alleging a right to a perpetual, or

at least indefinite, contract with the respondents. The contract in this case could not be said to be discretionary, because it provided simply that on six months notice either party could terminate the Agreement. The respondents submit that there is no ambiguity in the wording of the non-renewal clause of the contract and so there is no basis for implying other terms or for relying on extrinsic evidence of the parties' intentions. The entire agreement clause specifically precluded the implication of any terms other than the express terms of the contract.

(2) Analysis

(a) *Overview*

32 The notion of good faith has deep roots in contract law and permeates many of its rules. Nonetheless, Anglo-Canadian common law has resisted acknowledging any generalized and independent doctrine of good faith performance of contracts. The result is an "unsettled and incoherent body of law" that has developed "piecemeal" and which is "difficult to analyze": Ontario Law Reform Commission ("OLRC?), *Report on Amendment of the Law of Contract* (1987), at p. 169. This approach is out of step with the civil law of Quebec and most jurisdictions in the United States and produces results that are not consistent with the reasonable expectations of commercial parties.

33 In my view, it is time to take two incremental steps in order to make the common law less unsettled and piecemeal, more coherent and more just. The first step is to acknowledge that good faith contractual performance is a general organizing principle of the common law of contract which underpins and informs the various rules in which the common law, in various situations and types of relationships, recognizes obligations of good faith contractual performance. The second is to recognize, as a further manifestation of this organizing principle of good faith, that there is a common law duty which applies to all contracts to act honestly in the performance of contractual obligations.

34 In my view, taking these two steps is perfectly consistent with the Court's responsibility to make incremental changes in the common law when appropriate. Doing so will put in place a duty that is just, that accords with the reasonable expectations of commercial parties and that is sufficiently precise that it will enhance rather than detract from commercial certainty.

(b) *Good Faith as a General Organizing Principle*

(i) Background

35 The doctrine of good faith traces its history to Roman law and found acceptance in earlier English contract law. For example, Lord Northington wrote in *Aleyn v. Belchier* (1758), 1 Eden 132, 28 E.R. 634, at p. 138, cited in *Mills v. Mills* (1938), 60 C.L.R. 150 (H.C.A.), at p. 185, that "[n]o point is better established than that, a person having a power, must execute it *bona fide* for the end designed, otherwise it is corrupt and void." Similarly, Lord Kenyon wrote in *Mellish v. Motteux*

(1792), Peake 156, 170 E.R. 113, "in contracts of all kinds, it is of the highest importance that courts of law should compel the observance of honesty and good faith": p. 157. In *Carter v. Boehm* (1766), 3 Burr. 1905, 97 E.R. 1162, at p. 1910, Lord Mansfield stated that good faith is a principle applicable to all contracts: see also *Herbert v. Mercantile Fire Ins. Co.* (1878), 43 U.C.Q.B. 384 (Ont.); R. Powell, "Good Faith in Contracts" (1956), 9 Curr. Legal Probs. 16.

36 However, these broad pronouncements have been, for the most part, restricted by subsequent jurisprudence to specific types of contracts and relationships, such as insurance contracts, leaving unclear the role of the broader principle of good faith in the modern Anglo-Canadian law of contracts: *Chitty on Contracts* (31st ed. 2012), at para. 1-039; W. P. Yee, "Protecting Parties' Reasonable Expectations: A General Principle of Good Faith" (2001), 1 *O.U.C.L.J.* 195, at p. 195; E. P. Belobaba, "Good Faith in Canadian Contract Law", in *Special Lectures of the Law Society of Upper Canada 1985 -- Commerical Law: Recent Developments and Emerging Trends* (1985), 73, at p. 75. One leading Canadian contracts scholar went so far as to say that the common law has taken a "kind of perverted pride" in the absence of any general notion of good faith, as if accepting that notion "would be admitting to the presence of some kind of embarrassing social disease": J. Swan, "Whither Contracts: A Retrospective and Prospective Overview", in *Special Lectures of the Law Society of Upper Canada 1984 -- Law in Transition: Contracts* (1984), 125, at p. 148.

37 This Court has not examined whether there is a general duty of good faith contractual performance. However, there has been an active debate in other courts and among scholars for decades over whether there is, or should be, a general or "stand-alone" duty of good faith in the performance of contracts. Canadian courts have reached different conclusions on this point.

38 Some suggest that there is a general duty of good faith: *Gateway Realty Ltd. v. Arton Holdings Ltd.* (1991), 106 N.S.R. (2d) 180 (S.C. (T.D.)), aff'd on narrower grounds (1992), 112 N.S.R. (2d) 180 (S.C. (App. Div.)); *McDonald's Restaurant of Canada Ltd. v. British Columbia* (1997), 29 B.C.L.R. (3d) 303 (C.A.), at para. 99; *Crawford v. Agricultural Development Board (N.B.)* (1997), 192 N.B.R. (2d) 68 (C.A.), at paras. 7-8. They see a broad role for good faith as an implied term in all contracts that establishes minimum standards of acceptable commercial behaviour. As Kelly J. put it in *Gateway Realty*, at para. 38:

> The law requires that parties to a contract exercise their rights under that agreement honestly, fairly and in good faith. This standard is breached when a party acts in a bad faith manner in the performance of its rights and obligations under the contract. "Good faith? conduct is the guide to the manner in which the parties should pursue their mutual contractual objectives. Such conduct is breached when a party acts in "bad faith? -- a conduct that is contrary to community standards of honesty, reasonableness or fairness.

39 Other courts are of the view that there exists no such general duty of good faith in all contracts: *Transamerica Life Canada Inc. v. ING Canada Inc.* (2003), 68 O.R. (3d) 457 (C.A.), at

para. 54; *Mesa Operating Limited Partnership v. Amoco Canada Resources Ltd.* (1994), 149 A.R. 187 (C.A.), at paras. 15-19, *per* Kerans J.A., *dubitante*; *Barclays Bank PLC v. Metcalfe & Mansfield Alternative Investments VII Corp.*, 2013 ONCA 494, 365 D.L.R. (4th) 15, at para. 131; see G. R. Hall, *Canadian Contractual Interpretation Law* (2nd ed. 2012), at pp. 338-46. The detractors of such a general duty of good faith have accepted a limited role for good faith in certain contexts but have held that it would create commercial uncertainty and undermine freedom of contract to recognize a general duty of good faith that would permit courts to interfere with the express terms of a contract.

40 This Court ought to develop the common law to keep in step with the "dynamic and evolving fabric of our society" where it can do so in an incremental fashion and where the ramifications of the development are "not incapable of assessment": *R. v. Salituro*, [1991] 3 S.C.R. 654, at p. 670; *Bow Valley Husky (Bermuda) Ltd. v. Saint John Shipbuilding Ltd.*, [1997] 3 S.C.R. 1210, at para. 93; see also *Watkins v. Olafson*, [1989] 2 S.C.R. 750, at pp. 760-64; *Hill v. Church of Scientology of Toronto*, [1995] 2 S.C.R. 1130, at para. 85; *R.W.D.S.U., Local 558 v. Pepsi-Cola Canada Beverages (West) Ltd.*, 2002 SCC 8, [2002] 1 S.C.R. 156; *British Columbia v. Imperial Tobacco Canada Ltd.*, 2005 SCC 49, [2005] 2 S.C.R. 473; *Grant v. Torstar Corp.*, 2009 SCC 61, [2009] 3 S.C.R. 640, at para. 46. This is even more appropriate where, as here, what is contemplated is not the reversal of some settled rule, but a development directed to bringing greater certainty and coherence to a complex and troublesome area of the common law.

41 As I see it, the developments that I propose are desirable as a result of several considerations. First, the current Canadian common law is uncertain. Second, the current approach to good faith performance lacks coherence. Third, the current law is out of step with the reasonable expectations of commercial parties, particularly those of at least two major trading partners of common law Canada -- Quebec and the United States: see, e.g., Hall, at p. 347. While the developments which I propose will not completely address these problems, they will bring a measure of coherence and predictability to the law and will bring the law closer to what reasonable commercial parties would expect it to be.

(ii) Survey of the Current State of the Common Law

42 Anglo-Canadian common law has developed a number of rules and doctrines that call upon the notion of good faith in contractual dealings; it is a concept that underlies many elements of modern contract law: S. M. Waddams, *The Law of Contracts* (2010), at para. 550; J. D. McCamus *The Law of Contracts* (2nd ed. 2012), at pp. 835-38; OLRC, at p. 165; Belobaba, at pp. 75-76; J. F. O'Connor, *Good Faith in English Law* (1990), at pp. 17-49; J. Steyn, "Contract Law: Fulfilling the Reasonable Expectations of Honest Men" (1997), 113 *Law Q. Rev.* 433. The approach, not unfairly, has been characterized as developing "piecemeal solutions in response to demonstrated problems": *Interfoto Picture Library Ltd. v. Stiletto Visual Programmes Ltd.*, [1989] 1 Q.B. 433 (C.A.), at p. 439, *per* Bingham L.J. (as he then was). Thus we see, for example, that good faith notions have been applied to particular types of contracts, particular types of contractual provisions and particular

contractual relationships. It also underlies doctrines that explicitly deal with fairness in contracts, such as unconscionability, and plays a role in interpreting and implying contractual terms. The difficulty with this "piecemeal" approach, however, is that it often fails to take a consistent or principled approach to similar problems. A brief review of the current landscape of good faith will show the extent to which this is the case.

43 Considerations of good faith are apparent in doctrines that expressly consider the fairness of contractual bargains, such as unconscionability. This doctrine is based on considerations of fairness and preventing one contracting party from taking undue advantage of the other: G. H. L. Fridman, *The Law of Contract in Canada* (6th ed. 2011), at pp. 329-30; E. Peden, "When Common Law Trumps Equity: the Rise of Good Faith and Reasonableness and the Demise of Unconscionability" (2005), 21 *J.C.L.* 226; Belobaba, at p. 86; S. M. Waddams, "Good Faith, Unconscionability and Reasonable Expectations" (1995), 9 J.C.L. 55.

44 Good faith also plays a role in the law of implied terms, particularly with respect to terms implied by law. Terms implied by law redress power imbalances in certain classes of contracts such as employment, landlord-lessee, and insurance contracts: *London Drugs Ltd. v. Kuehne & Nagel International Ltd.*, [1992] 3 S.C.R. 299, at p. 457, *per* McLachlin J.; see also *Machtinger v. HOJ Industries Ltd.*, [1992] 1 S.C.R. 986, *per* McLachlin J., concurring. The implication of terms plays a functionally similar role in common law contract law to the doctrine of good faith in civil law jurisdictions by filling in gaps in the written agreement of the parties: *Chitty on Contracts,* at para. 1-051. In *Mesa Operating*, the Alberta Court of Appeal implied a term that a power of pooling properties for the purpose of determining royalty payments be exercised reasonably. The court implied this term in order to give effect to the intentions of the parties rather than as a requirement of good faith, but Kerans J.A. stated that "[t]he rule that governs here can, therefore, be expressed much more narrowly than to speak of good faith, although I suspect it is in reality the sort of thing some judges have in mind when they speak of good faith": para. 22. Many other examples may be found in Waddams, *The Law of Contracts*, at paras. 499-506.

45 Considerations of good faith are also apparent in contract interpretation: *Chitty on Contracts,* at para. 1-050; Hall, at p. 347. The primary object of contractual interpretation is of course to give effect to the intentions of the parties at the time of contract formation. However, considerations of good faith inform this process. Parties may generally be assumed to intend certain minimum standards of conduct. Further, as Lord Reid observed in *Schuler A.G. v. Wickman Machine Tool Sales Ltd.*, [1974] A.C. 235 (H.L.), at p. 251, "[t]he more unreasonable the result the more unlikely it is that the parties can have intended it". As A. Swan and J. Adamski put it, the duty of good faith "is not an externally imposed requirement but inheres in the parties' relation": *Canadian Contract Law* (3rd ed. 2012), at ss. 8.134 to 8.146.

46 Good faith also appears in numerous contexts in a more explicit form. The concept of "good faith" is used in hundreds of statutes across Canada, including statutory duties of good faith and fair dealing in franchise legislation and good faith bargaining in labour law: S. K. O'Byrne, "Good Faith

in Contractual Performance: Recent Developments " (1995), 74 *Can. Bar Rev.* 70, at p. 71.

47 There have been many attempts to bring a measure of coherence to this piecemeal accretion of appeals to good faith: see, among many others, McCamus, at pp. 835-68; S. K. O'Byrne, "The Implied Term of Good Faith and Fair Dealing: Recent Developments" (2007), 86 *Can. Bar. Rev.* 193, at pp. 196-204; Waddams, *The Law of Contracts*, at paras. 494-508; R. S. Summers, "?Good Faith' in General Contract Law and the Sales Provisions of the Uniform Commercial Code? (1968), 54 Va. L. Rev. 195; S. J. Burton, "Breach of Contract and the Common Law Duty to Perform in Good Faith? (1980), 94 Harv. L. Rev. 369. By way of example, Professor McCamus has identified three broad types of situations in which a duty of good faith performance of some kind has been found to exist: (1) where the parties must cooperate in order to achieve the objects of the contract; (2) where one party exercises a discretionary power under the contract; and (3) where one party seeks to evade contractual duties (pp. 840-56; *CivicLife.com Inc. v. Canada (Attorney General)* (2006), 215 O.A.C. 43, at paras. 49-50).

48 While these types of cases overlap to some extent, they provide a useful analytical tool to appreciate the current state of the law on the duty of good faith. They also reveal some of the lack of coherence in the current approach. It is often unclear whether a good faith obligation is being imposed as a matter of law, as a matter of implication or as a matter of interpretation. Professor McCamus notes:

> Although the line between the two types of implication is difficult to draw, it may be realistic to assume that implied duties of good faith are likely, on occasion at least, to slide into the category of legal incidents rather than mere presumed intentions. Certainly, it would be difficult to defend the implication of terms on each of the cases considered here on the basis of the traditional business efficiency or officious bystander test. In the control of contractual discretion cases, for example, it may be more realistic to suggest that the implied limitation on the exercise of the discretion is intended to give effect to the "reasonable expectations of the parties. ? [pp. 865-66]

49 The first type of situation (contracts requiring the cooperation of the parties to achieve the objects of the contract) is reflected in the jurisprudence of this Court. In *Dynamic Transport Ltd. v. O.K. Detailing Ltd.*, [1978] 2 S.C.R. 1072, the parties to a real estate transaction failed to specify in the purchase-sale agreement which party was to be responsible for obtaining planning permission for a subdivision of the property. By law, the vendor was the only party capable of obtaining such permission. The Court held that the vendor was under an obligation to use reasonable efforts to secure the permission, or as Dickson J. put it, "[t]he vendor is under a duty to act in good faith and to take all reasonable steps to complete the sale": p. 1084. It is not completely clear whether this duty was imposed as a matter of law or was implied based on the parties' intentions: see p. 1083; see also *Gateway Realty* and *CivicLife.com.*

50 *Mitsui & Co. (Canada) Ltd. v. Royal Bank of Canada*, [1995] 2 S.C.R. 187, is an example of the second type of situation (exercise of contractual discretion). The lease of a helicopter included an option to buy at the "reasonable fair market value of the helicopter as established by Lessor": para. 2. This Court held, at para. 34, that, "[c]learly, the lessor is not in a position, by virtue of clause 32, to make any offer that it may feel is appropriate. It is contractually bound to act in good faith to determine the reasonable fair market value of the helicopters, which is the price that the parties had initially agreed would be the exercise price of the option." The Court did not discuss the basis for implying the term, but suggested that in the absence of a reasonableness requirement, the option would be a mere agreement to agree and thus would be unenforceable, which means that the implication of the term was necessary to give business efficacy to the agreement.

51 This Court's decision in *Mason v. Freedman*, [1958] S.C.R. 483, falls in the third type of situation in which a duty of good faith arises (where a contractual power is used to evade a contractual duty). In that case, the vendor in a real estate transaction regretted the bargain he had made. He then sought to repudiate the contract by failing to convey title in fee simple because he claimed his wife would not provide a bar of dower. The issue was whether he could take advantage of a clause permitting him to repudiate the transaction in the event that he was "unable or unwilling" to remove this defect in title even though he had made no efforts to do so by trying to obtain the bar of dower. Judson J. held that the clause did not "enable a person to repudiate a contract for a cause which he himself has brought about" or permit "a capricious or arbitrary repudiation": p. 486. On the contrary, "[a] vendor who seeks to take advantage of the clause must exercise his right reasonably and in good faith and not in a capricious or arbitrary manner": p. 487.

52 The jurisprudence is not always very clear about the source of the good faith obligations found in these cases. The categories of terms implied as a matter of law, terms implied as a matter of intention and terms arising as a matter of interpretation sometimes are blurred or even ignored, resulting in uncertainty and a lack of coherence at the level of principle.

53 Apart from these types of situations in which a duty of good faith arises, common law Canadian courts have also recognized that there are classes of relationships that call for a duty of good faith to be implied by law.

54 For example, this court confirmed that there is a duty of good faith in the employment context in *Honda Canada Inc. v. Keays*, 2008 SCC 39, [2008] 2 S.C.R. 362. Mr. Keays was diagnosed with chronic fatigue syndrome and was frequently absent from work. Honda grew concerned with the frequency of the absences. It ordered Mr. Keays to undergo an examination by a doctor chosen by the employer, required him to provide a doctor's note for any absences, and discouraged him from retaining outside counsel. The majority held that in all employment contracts there was an implied term of good faith governing the manner of termination. In particular, the employer should not engage in conduct that is "unfair or is in bad faith by being, for example, untruthful, misleading or unduly insensitive" when dismissing an employee: para. 57, citing *Wallace v. United Grain Growers Ltd.*, [1997] 3 S.C.R. 701, at para. 98. Good faith in this context did not extend to the

employer's reasons for terminating the contract of employment because this would undermine the right of an employer to determine the composition of its workforce: *Wallace*, at para. 76.

55 This Court has also affirmed the duty of good faith which requires an insurer to deal with its insured's claim fairly, both with respect to the manner in which it investigates and assesses the claim and to the decision whether or not to pay it: *Fidler v. Sun Life Assurance Co. of Canada*, 2006 SCC 30, [2006] 2 S.C.R. 3, at para. 63, citing *702535 Ontario Inc. v. Lloyd's London, Non-Marine Underwriters* (2000), 184 D.L.R. (4th) 687 (Ont. C.A.), at para. 29. The breach of this duty may support an award of punitive damages: *Whiten v. Pilot Insurance Co.*, 2002 SCC 18, [2002] 1 S.C.R. 595. This duty of good faith is also reciprocal: the insurer must not act in bad faith when dealing with a claim, which is typically made by someone in a vulnerable situation, and the insured must act in good faith by disclosing facts material to the insurance policy (para. 83, citing *Andrusiw v. Aetna Life Insurance Co. of Canada* (2001), 289 A.R. 1 (Q.B.), at paras. 84-85, *per* Murray J.).

56 This Court has also recognized that a duty of good faith, in the sense of fair dealing, will generally be implied in fact in the tendering context. When a company tenders a contract, it comes under a duty of fairness in considering the bids submitted under the tendering process, as a result of the expense incurred by parties submitting these bids: *Martel Building Ltd. v. Canada*, 2000 SCC 60, [2000] 2 S.C.R. 860, at para. 88; see also *M.J.B. Enterprises Ltd. v. Defence Construction (1951) Ltd.*, [1999] 1 S.C.R. 619; *Tercon Contractors Ltd. v. British Columbia (Transportation and Highways)*, 2010 SCC 4, [2010] 1 S.C.R. 69, at paras. 58-59; A. C. McNeely, *Canadian Law of Competitive Bidding and Procurement* (2010), at pp. 245-54.

57 Developments in the United Kingdom and Australia point to enhanced attention to the notion of good faith, mitigated by reluctance to embrace it as a stand-alone doctrine. Good faith in contract performance has received increasing prominence in English law, despite its "traditional ... hostility" to the concept: *Yam Seng Pte Ltd. v. International Trade Corporation Ltd.*, [2013] EWHC 111, [2013] 1 All E.R. (Comm.) 1321 (Q.B.), at para. 123, citing E. McKendrick, *Contract Law* (9th ed. 2011), at pp. 221-22; see also *Chitty on Contracts*, at para. 1-039. In *Yam Seng*, Leggatt J. held that a number of specific duties embodying good faith can be implied according to the presumed intentions of the parties according to the traditional approach for implying terms: para. 131. Leggatt J. identified a number of these implied duties, including honesty, fidelity to the parties' bargain, cooperation, and fair dealing: paras. 135-50. Leggatt J. stated that "[a] paradigm example of a general norm which underlies almost all contractual relationships is an expectation of honesty. That expectation is essential to commerce, which depends critically on trust": para. 135; see D. Campbell, "Good Faith and the Ubiquity of the 'Relational' Contract'" (2014), 77 *Mod. L. Rev.* 475. The Court of Appeal considered the *Yam Seng* decision in *Mid Essex Hospital Services NHS Trust v. Compass Group UK and Ireland Ltd.*, [2013] EWCA Civ 200 (BAILII), where it confirmed that good faith was not a general principle of English law, but that it could be an implied term in certain categories of cases: paras. 105 and 150.

58 Australian courts have also moved towards a greater role for good faith in contract

performance: *Cheshire and Fifoot's Law of Contract*, (9th Australian ed. 2008), at 10.43 to 10.47. The duty of good faith in its modern form was recognized by Priestley J.A. in *Renard Constructions (ME) Pty Ltd. v. Minister for Public Works* (1992), 26 N.S.W.L.R. 234 (C.A.). There is no generally applicable duty of good faith, but one will be implied into contracts in certain circumstances. The duty of good faith can be implied as a matter of law or as a matter of fact, although the cases are not always clear on the basis on which the term is being implied. Australian courts have taken a broad view of what constitutes good faith: see, e.g., *Burger King Corp. v. Hungry Jack's Pty Ltd.*, [2001] NSWCA 187 (AustLII). The law of good faith performance in Australia is still developing and remains unsettled: E. Peden, "Good faith in the performance of contract law" (2004), 42: 9 *L.S.J.* 64, at p. 64. However, it is clear that the duty of good faith requires adherence to standards of honest conduct: A. Mason, "Contract, Good Faith and Equitable Standards in Fair Dealing" (2000), 116 *Law Q. Rev.* 66, at p. 76; *Burger King*, at paras. 171 and 189.

(iii) The Way Forward

59 This selective survey supports the view that Canadian common law in relation to good faith performance of contracts is piecemeal, unsettled and unclear: Belobaba; O'Byrne, "Good Faith in Contractual Performance", at p. 95; B. J. Reiter, "Good Faith in Contracts? (1983), 17 Val. U.L. Rev. 705, at pp. 711-12. It also shows that in Canada, as well as in the United Kingdom and Australia, there is increasing attention to the notion of good faith, particularly in the area of contractual performance. Opponents of any general obligation of good faith prefer the traditional, organic development of solutions to address particular problems as they arise: see, e.g., M. G. Bridge, "Does Anglo-Canadian Contract Law Need a Doctrine of Good Faith?" (1984), 9 *Can. Bus. L.J.* 385; D. Clark, "Some Recent Developments in the Canadian Law of Contracts" (1993), 14 *Advocates' Q.* 435, at pp. 436 and 440. However, foreclosing some incremental development of the law at the level of principle would go beyond what prudent caution requires and evidence an almost "perverted pride" -- to use Swan's term -- in the law's failings.

60 Commercial parties reasonably expect a basic level of honesty and good faith in contractual dealings. While they remain at arm's length and are not subject to the duties of a fiduciary, a basic level of honest conduct is necessary to the proper functioning of commerce. The growth of longer term, relational contracts that depend on an element of trust and cooperation clearly call for a basic element of honesty in performance, but, even in transactional exchanges, misleading or deceitful conduct will fly in the face of the expectations of the parties: see Swan and Adamski, at s.1.24.

61 The fact that commercial parties expect honesty on the part of their contracting partners can also be seen from the fact that it was the American Bar Association's Section of Corporation, Banking and Business Law that urged the adoption of "honesty in fact" in the original drafting of the Uniform Commercial Code ("U.C.C.?): E. A. Farnsworth, "Good Faith Performance and Commercial Reasonableness Under the Uniform Commercial Code? (1963), 30 *U. Chicago L. Rev.* 666, at p. 673. Moreover, empirical research suggests that commercial parties do in fact expect that their contracting parties will conduct themselves in good faith: see, e.g., S. Macaulay,

"Non-contractual Relations in Business: A Preliminary Study" (1963), 28 *Am. Soc. Rev.* 55, at p. 58; H. Beale and T. Dugdale, "Contracts Between Businessmen: Planning and the Use of Contractual Remedies" (1975), 2 *Brit. J. Law. & Soc.* 45, at pp. 47-48; S. Macaulay, "An Empirical View of Contract", [1985] Wis. L. Rev. 465; V. Goldwasser and T. Ciro, "Standards of Behaviour in Commercial Contracting" (2002), 30 *A.B.L.R.* 369, at pp. 372-77. It is, to say the least, counterintuitive to think that reasonable commercial parties would accept a contract which contained a provision to the effect that they were not obliged to act honestly in performing their contractual obligations.

62 I conclude from this review that enunciating a general organizing principle of good faith and recognizing a duty to perform contracts honestly will help bring certainty and coherence to this area of the law in a way that is consistent with reasonable commercial expectations.

(iv) Towards an Organizing Principle of Good Faith

63 The first step is to recognize that there is an organizing principle of good faith that underlies and manifests itself in various more specific doctrines governing contractual performance. That organizing principle is simply that parties generally must perform their contractual duties honestly and reasonably and not capriciously or arbitrarily.

64 As the Court has recognized, an organizing principle states in general terms a requirement of justice from which more specific legal doctrines may be derived. An organizing principle therefore is not a free-standing rule, but rather a standard that underpins and is manifested in more specific legal doctrines and may be given different weight in different situations: see, e.g., *R. v. Jones*, [1994] 2 S.C.R. 229, at p. 249; *R. v. Hart*, 2014 SCC 52, [2014] 2 S.C.R. 544, at para. 124; R. M. Dworkin, "Is Law a System of Rules?", in R. M. Dworkin, ed., *The Philosophy of Law* (1977), 38, at p. 47. It is a standard that helps to understand and develop the law in a coherent and principled way.

65 The organizing principle of good faith exemplifies the notion that, in carrying out his or her own performance of the contract, a contracting party should have appropriate regard to the legitimate contractual interests of the contracting partner. While "appropriate regard" for the other party's interests will vary depending on the context of the contractual relationship, it does not require acting to serve those interests in all cases. It merely requires that a party not seek to undermine those interests in bad faith. This general principle has strong conceptual differences from the much higher obligations of a fiduciary. Unlike fiduciary duties, good faith performance does not engage duties of loyalty to the other contracting party or a duty to put the interests of the other contracting party first.

66 This organizing principle of good faith manifests itself through the existing doctrines about the types of situations and relationships in which the law requires, in certain respects, honest, candid, forthright or reasonable contractual performance. Generally, claims of good faith will not succeed if they do not fall within these existing doctrines. But we should also recognize that this list

is not closed. The application of the organizing principle of good faith to particular situations should be developed where the existing law is found to be wanting and where the development may occur incrementally in a way that is consistent with the structure of the common law of contract and gives due weight to the importance of private ordering and certainty in commercial affairs.

67 This approach is consistent with that taken in the case of unjust enrichment. McLachlin J. (as she then was) outlined the approach in *Peel (Regional Municipality) v. Canada*, [1992] 3 S.C.R. 762, at pp. 786 and 788:

> This case presents the Court with the difficult task of mediating between, if not resolving, the conflicting views of the proper scope of the doctrine of unjust enrichment. It is my conclusion that we must choose a middle path; one which acknowledges the importance of proceeding on general principles but seeks to reconcile the principles with the established categories of recovery .... .
>
> ...
>
> The tri-partite principle of general application which this Court has recognized as the basis of the cause of action for unjust enrichment is thus seen to have grown out of the traditional categories of recovery. It is informed by them. It is capable, however, of going beyond them, allowing the law to develop in a flexible way as required to meet changing perceptions of justice.

68 The flexible approach that was taken in *Peel* recognizes that "[a]t the heart of the doctrine of unjust enrichment, whether expressed in terms of the traditional categories of recovery or general principle, lies the notion of restoration of a benefit which justice does not permit one to retain": p. 788. In that case, this Court further developed the law through application of an organizing principle without displacing the existing specific doctrines. This is what I propose to do with regards to the organizing principle of good faith.

69 The approach of recognizing an overarching organizing principle but accepting the existing law as the primary guide to future development is appropriate in the development of the doctrine of good faith. Good faith may be invoked in widely varying contexts and this calls for a highly context-specific understanding of what honesty and reasonableness in performance require so as to give appropriate consideration to the legitimate interests of both contracting parties. For example, the general organizing principle of good faith would likely have different implications in the context of a long-term contract of mutual cooperation than it would in a more transactional exchange: Swan and Adamski, at s. 1.24; B. Dixon, "Common law obligations of good faith in Australian commercial contracts -- a relational recipe" (2005), 33 *A.B.L.R.* 87.

70 The principle of good faith must be applied in a manner that is consistent with the fundamental commitments of the common law of contract which generally places great weight on the freedom of contracting parties to pursue their individual self-interest. In commerce, a party may

sometimes cause loss to another -- even intentionally -- in the legitimate pursuit of economic self-interest: *A.I. Enterprises Ltd. v. Bram Enterprises Ltd.*, 2014 SCC 12, [2014] 1 S.C.R. 177, at para. 31. Doing so is not necessarily contrary to good faith and in some cases has actually been encouraged by the courts on the basis of economic efficiency: *Bank of America Canada v. Mutual Trust Co.*, 2002 SCC 43, [2002] 2 S.C.R. 601, at para. 31. The development of the principle of good faith must be clear not to veer into a form of *ad hoc* judicial moralism or "palm tree? justice. In particular, the organizing principle of good faith should not be used as a pretext for scrutinizing the motives of contracting parties.

71 Tying the organizing principle to the existing law mitigates the concern that any general notion of good faith in contract law will undermine certainty in commercial contracts. In my view, this approach strikes the correct balance between predictability and flexibility.

(v) Should There Be a New Duty?

72 In my view, the objection to Can-Am's conduct in this case does not fit within any of the existing situations or relationships in which duties of good faith have been found to exist. The relationship between Can-Am and Mr. Bhasin was not an employment or franchise relationship. Classifying the decision not to renew the contract as a contractual discretion would constitute a significant expansion of the decided cases under that type of situation. After all, a party almost always has some amount of discretion in how to perform a contract. It would also be difficult to say that a duty of good faith should be implied in this case on the basis of the intentions of the parties given the clear terms of an entire agreement clause in the Agreement. The key question before the Court, therefore, is whether we ought to create a new common law duty under the broad umbrella of the organizing principle of good faith performance of contracts.

73 In my view, we should. I would hold that there is a general duty of honesty in contractual performance. This means simply that parties must not lie or otherwise knowingly mislead each other about matters directly linked to the performance of the contract. This does not impose a duty of loyalty or of disclosure or require a party to forego advantages flowing from the contract; it is a simple requirement not to lie or mislead the other party about one's contractual performance. Recognizing a duty of honest performance flowing directly from the common law organizing principle of good faith is a modest, incremental step. The requirement to act honestly is one of the most widely recognized aspects of the organizing principle of good faith: see Swan and Adamski, at s. 8.135; O'Byrne, "Good Faith in Contractual Performance", at p. 78; Belobaba; *Greenberg v. Meffert* (1985), 50 O.R (2d) 755 (C.A.), at p. 764; *Gateway Realty*, at para. 38, *per* Kelly J.; *Shelanu Inc. v. Print Three Franchising Corp.* (2003), 64 O.R. (3d) 533 (C.A.), at para. 69. For example, the duty of honesty was a key component of the good faith requirements which have been recognized in relation to termination of employment contracts: *Wallace*, at para. 98; *Honda Canada*, at para. 58.

74 There is a longstanding debate about whether the duty of good faith arises as a term implied as

a matter of fact or a term implied by law: see *Mesa Operating*, at paras. 15-19. I do not have to resolve this debate fully, which, as I reviewed earlier, casts a shadow of uncertainty over a good deal of the jurisprudence. I am at this point concerned only with a new duty of honest performance and, as I see it, this should not be thought of as an implied term, but a general doctrine of contract law that imposes as a contractual duty a minimum standard of honest contractual performance. It operates irrespective of the intentions of the parties, and is to this extent analogous to equitable doctrines which impose limits on the freedom of contract, such as the doctrine of unconscionability.

75 Viewed in this way, the entire agreement clause in cl. 11.2 of the Agreement is not an impediment to the duty arising in this case. Because the duty of honesty in contractual performance is a general doctrine of contract law that applies to all contracts, like unconscionability, the parties are not free to exclude it: see *CivicLife.com*, at para. 52.

76 It is true that the Anglo-Canadian common law of contract has been reluctant to impose mandatory rules not based on the agreement of the parties, because they are thought to interfere with freedom of contract: see *Gateway Realty*, *per* Kelly J.; O'Byrne, "Good Faith in Contractual Performance", at p. 95; Farnsworth, at 677-78. As discussed above, however, the duty of honest performance interferes very little with freedom of contract, since parties will rarely expect that their contracts permit dishonest performance of their obligations.

77 That said, I would not rule out any role for the agreement of the parties in influencing the scope of honest performance in a particular context. The precise content of honest performance will vary with context and the parties should be free in some contexts to relax the requirements of the doctrine so long as they respect its minimum core requirements. The approach I outline here is similar in principle to that in s. 1-302(b) of the U.C.C. (2012):

> The obligations of good faith, diligence, reasonableness and care ... may not be disclaimed by agreement. The parties, by agreement, may determine the standards by which the performance of those obligations is to be measured if those standards are not manifestly unreasonable.

78 Certainly, any modification of the duty of honest performance would need to be in express terms. A generically worded entire agreement clause such as cl. 11.2 of the Agreement does not indicate any intention of the parties to depart from the basic tenets of honest performance: see *GEC Marconi Systems Pty Ltd. v. BHP Information Technology Pty Ltd.*, [2003] FCA 50 (AustLII), at para. 922, *per* Finn J.; see also O'Byrne, "Good Faith in Contractual Performance", at p. 96.

79 Two arguments are typically raised against an increased role for a duty of good faith in the law of contract: see Bridge, Clark, and Peden, "When Common Law Triumphs Equity: the Rise of Good Faith and Reasonableness and the Demise of Unconscionability". The first is that "good faith" is an inherently unclear concept that will permit *ad hoc* judicial moralism to undermine the certainty of commercial transactions. The second is that imposing a duty of good faith is inconsistent with the basic principle of freedom of contract. I do not have to decide here whether or not these points are

valid in relation to a broad, generalized duty of good faith. However, they carry no weight in relation to adopting a rule of honest performance.

80 Recognizing a duty of honesty in contract performance poses no risk to commercial certainty in the law of contract. A reasonable commercial person would expect, at least, that the other party to a contract would not be dishonest about his or her performance. The duty is also clear and easy to apply. Moreover, one commentator points out that given the uncertainty that has prevailed in this area, cautious solicitors have long advised clients to take account of the requirements of good faith: W. Grover, "A Solicitor Looks at Good Faith in Commercial Transactions", in *Special Lectures of the Law Society of Upper Canada 1985 -- Commercial Law: Recent Developments and Emerging Trends* (1985), 93, at pp. 106-7. A rule of honest performance in my view will promote, not detract from, certainty in commercial dealings.

81 Any interference by the duty of honest performance with freedom of contract is more theoretical than real. It will surely be rare that parties would wish to agree that they may be dishonest with each other in performing their contractual obligations.

82 Those who fear that this modest step would create uncertainty or impede freedom of contract may take comfort from experience of the civil law of Quebec and the common and statute law of many jurisdictions in the United States.

83 The *Civil Code of Québec* recognizes a broad duty of good faith which extends to the formation, performance and termination of a contract and includes the notion of the abuse of contractual rights: see arts. 6, 7 and 1375. While this is not the place to expound in detail on good faith in the Quebec civil law, it is worth noting that good faith is seen as having two main aspects. The first is the subjective aspect, which is concerned with the state of mind of the actor, and addresses conduct that is, for example, malicious or intentional. The second is the objective aspect which is concerned with whether conduct is unacceptable according to the standards of reasonable people. As J.-L. Baudouin and P.-G. Jobin explain, [TRANSLATION] "a person can be in good faith (in the subjective sense), that is, act without malicious intent or without knowledge of certain facts, yet his or her conduct may nevertheless be contrary to the requirements of good faith in that it violates objective standards of conduct that are generally accepted in society": *Les obligations* (7th ed. 2013), by P.-G. Jobin and N. Vézina, at para. 132. The notion of good faith includes (but is not limited to) the requirement of honesty in performing the contract: *ibid.*, at para. 161; *Bank of Montreal v. Kuet Leong Ng*, [1989] 2 S.C.R. 429, at p. 436.

84 In the United States, s. 1-304 of the U.C.C. provides that "[e]very contract or duty within the Uniform Commercial Code imposes an obligation of good faith in its performance and enforcement." The U.C.C. has been enacted by legislation in all 50 states. While the provisions of the U.C.C. apply only to commercial contracts, s. 205 of the *Restatement (Second) of Contracts* (1981) provides for a general duty of good faith in all contracts. This provision of the *Restatement* has been followed by courts in the vast majority of states. The notion of "good faith" in the

Restatement substantially followed the definition proposed by Robert Summers in an influential article, where he proposed that "good faith" is best understood as an "excluder" of various categories of bad faith conduct: p. 206; see s. 205, comment a. The general definition of "good faith" in the U.C.C. is also quite broad, encompassing honesty and adherence to "reasonable commercial standards": s. 1-201(b)(20). This definition was originally limited to "honesty in fact", that is, a duty of honesty in performance, and was only later expanded: A. D. Miller and R. Perry, "Good Faith Performance" (2013), 98 Iowa L. Rev. 689, at pp. 719-20. Honesty in performance is also a key component of "good faith? under the *Restatement*: s. 205, comments a and d.

85 Experience in Quebec and the United States shows that even very broad conceptions of the duty of good faith have not impeded contractual activity or contractual stability: see, e.g., J. Pineau, "La discrétion judiciaire a-t-elle fait des ravages en matière contractuelle?", in *La réforme du Code civil, cinq ans plus tard* (1998), 141. It is also worth noting that in both the United States and Quebec, judicial developments preceded legislative action in codifying good faith. In the United States, courts had recognized the existence of a general duty of good faith before the promulgation of the U.C.C.: see, e.g., *Kirke La Shelle Co. v. Armstrong Co.*, 263 N.Y. 79 (1933). Similarly, though there was no express provision of "good faith" in the *Civil Code of Lower Canada*, the Court implied such a general duty from more specific provisions of the *Code*: see *National Bank of Canada v. Soucisse*, [1981] 2 S.C.R. 339; *Houle v. Canadian National Bank*, [1990] 3 S.C.R. 122; *Bank of Montreal v. Bail Ltée*, [1992] 2 S.C.R. 554. The duty of good faith was subsequently included in the revisions leading to the enactment of the *Civil Code of Québec*.

86 The duty of honest performance that I propose should not be confused with a duty of disclosure or of fiduciary loyalty. A party to a contract has no general duty to subordinate his or her interest to that of the other party. However, contracting parties must be able to rely on a minimum standard of honesty from their contracting partner in relation to performing the contract as a reassurance that if the contract does not work out, they will have a fair opportunity to protect their interests. That said, a dealership agreement is not a contract of utmost good faith (*uberrimae fidei*) such as an insurance contract, which among other things obliges the parties to disclose material facts: *Whiten*. But a clear distinction can be drawn between a failure to disclose a material fact, even a firm intention to end the contractual arrangement, and active dishonesty.

87 This distinction explains the result reached by the court in *United Roasters, Inc. v. Colgate-Palmolive Co.*, 649 F.2d 985 (4th Cir. 1981). The terminating party had decided in advance of the required notice period that it was going to terminate the contract. The court held that no disclosure of this intention was required other than what was stipulated in the notice requirement. The court stated:

> ... there is very little to be said in favor of a rule of law that good faith requires one possessing a right of termination to inform the other party promptly of any decision to exercise the right. A tenant under a month-to-month lease may decide in January to vacate the premises at the end of September. It is hardly to be

> suggested that good faith requires the tenant to inform the landlord of his decision soon after January. Though the landlord may have found earlier notice convenient, formal exercise of the right of termination in August will do. [pp. 989-90]

United Roasters makes it clear that there is no unilateral duty to disclose information relevant to termination. But the situation is quite different, as I see it, when it comes to actively misleading or deceiving the other contracting party in relation to performance of the contract.

88 The duty of honest performance has similarities with the existing law in relation to civil fraud and estoppel, but it is not subsumed by them. Unlike promissory estoppel and estoppel by representation, the contractual duty of honest performance does not require that the defendant intend that his or her representation be relied on and it is not subject to the uncertainty around whether estoppel can be used to found an independent cause of action: *Ryan v. Moore*, 2005 SCC 38, [2005] 2 S.C.R. 53, at para. 5; *Maracle v. Travellers Indemnity Co. of Canada*, [1991] 2 S.C.R. 50; Waddams, *The Law of Contracts*, at paras. 195-203; B. MacDougall, *Estoppel* (2012), at pp. 142-44. As for the tort of civil fraud, breach of the duty of honest contractual performance does not require the defendant to intend that the false statement be relied on and breach of it supports a claim for damages according to the contractual rather than the tortious measure: see, e.g., *Parna v. G. & S. Properties Ltd.*, [1971] S.C.R. 306, cited with approval in *Bruno Appliance and Furniture, Inc. v. Hryniak*, 2014 SCC 8, [2014] 1 S.C.R. 126, at para. 19.

89 Mr. Bhasin, supported by many judicial and academic authorities, has argued for wholesale adoption of a more expansive duty of good faith in contrast to the modest, incremental change that I propose: A.F., at para. 51; Summers, at p. 206; Belobaba; *Gateway Realty*. In many of its manifestations, good faith requires more than honesty on the part of a contracting party. For example, in *Dynamic Transport*, this Court held that good faith in the context of that contract required a party to take reasonable steps to obtain the planning permission that was a condition precedent to a sale of property. In other cases, the courts have required that discretionary powers not be exercised in a manner that is "capricious" or "arbitrary": *Mason, at p. 487*; *LeMesurier v. Andrus* (1986), 54 O.R. (2d) 1 (C.A.), at p. 7. In other contexts, this Court has been reluctant to extend the requirements of good faith beyond honesty for fear of causing undue judicial interference in contracts: *Wallace*, at para. 76.

90 It is not necessary in this case to define in general terms the limits of the implications of the organizing principle of good faith. This is because it is unclear to me how any broader duty would assist Mr. Bhasin here. After all, the contract was subject to non-renewal. It is a considerable stretch, as I see it, to turn even a broadly conceived duty of good faith exercise of the non-renewal provision into what is, in effect, a contract of indefinite duration. This in my view is the principal difficulty in the trial judge's reasoning because, in the result, her decision turned a three year contract that was subject to an express provision relating to non-renewal into a contract of roughly nine years' duration. As the Court of Appeal pointed out, in my view correctly, "[t]he parties did not

intend or presume a perpetual contract, as they contracted that either party could unilaterally cause it to expire on any third anniversary": para. 32. Even if there were a breach of a broader duty of good faith by forcing the merger, Can-Am's contractual liability would still have to be measured by reference to the least onerous means of performance, which in this case would have meant simply not renewing the contract. Since no damages flow from this breach, it is unnecessary to decide whether reliance on a discretionary power to achieve a purpose extraneous to the contract and which undermined one of its key objectives might call for further development under the organizing principle of good faith contractual performance.

91 I note as well that, even in jurisdictions that embrace a broader role for the duty of good faith, plaintiffs have met with only mixed success in alleging bad faith failure to renew a contract. Some cases have treated non-renewal as equivalent to termination and thus subject to a duty of good faith: *Shell Oil Co. v. Marinello*, 294 A.2d 253 (N.J. Super. Ct. 1972), aff'd, 307 A.2d 598 (N.J., 1973); *Atlantic Richfield Co. v. Razumic*, 390 A.2d 736 (Pa. 1978), at pp. 741-42. Other courts have seen non-renewal as fundamentally different, especially where the express terms of the contract contemplate the expiry of contractual obligations and leave no room for any sort of duty to renew: *J. H. Westerbeke Corp. v. Onan Corp.*, 580 F.Supp. 1173 (D. Mass. 1984), at p. 1184; *Pitney-Bowes, Inc. v. Mestre*, 517 F.Supp. 52 (S.D. Fla. 1981), cert. denied, 464 U.S. 893 (1983).

92 I conclude that at this point in the development of Canadian common law, adding a general duty of honest contractual performance is an appropriate incremental step, recognizing that the implications of the broader, organizing principle of good faith must be allowed to evolve according to the same incremental judicial approach.

93 A summary of the principles is in order:

(1) There is a general organizing principle of good faith that underlies many facets of contract law.

(2) In general, the particular implications of the broad principle for particular cases are determined by resorting to the body of doctrine that has developed which gives effect to aspects of that principle in particular types of situations and relationships.

(3) It is appropriate to recognize a new common law duty that applies to all contracts as a manifestation of the general organizing principle of good faith: a duty of honest performance, which requires the parties to be honest with each other in relation to the performance of their contractual obligations.

(3) Application

94 The trial judge made a clear finding of fact that Can-Am "acted dishonestly toward Bhasin in exercising the non-renewal clause": para. 261; see also para. 271. There is no basis to interfere with that finding on appeal. It follows that Can-Am breached its duty to perform the Agreement honestly.

95 The immediate dispute in this case centred on the non-renewal clause contained in cl. 3.3 of

the 1998 Agreement which Mr. Bhasin entered into in November 1998. It provided that the Agreement was for a three-year term and would be automatically renewed unless one of the parties gave notice to the contrary at least six months before the end of the initial or any renewed term:

> 3.3 The term of this Agreement shall be for a period of three years from the date hereof (the "Initial Term") and thereafter shall be automatically renewed for successive three year periods (a "Renewal Term"), subject to earlier termination as provided for in section 8 hereof, unless either [Can-Am] or the Enrollment Director notifies the other in writing at least six months prior to expiry of the Initial Term or any Renewal Term that the notifying party desires expiry of the Agreement, in which event the Agreement shall expire at the end of such Initial Term or Renewal Term, as applicable.

96 The factual matrix in which the judge made her finding of dishonest performance is complicated and I will only outline it in very broad terms in order to put that finding in context. There were two main interrelated story lines.

97 The first concerns Mr. Hrynew's persistent attempts to take over Mr. Bhasin's market through a merger -- in effect a takeover by him of Mr. Bhasin's agency. The second concerns the difficulties, beginning in early April 1999, that Can-Am was having with the Alberta Securities Commission, which regulated its business and its enrollment directors in Alberta. The Commission insisted that Can-Am appoint a full-time employee to be a PTO responsible for compliance with Alberta securities law. Can-Am ultimately appointed Mr. Hrynew, with the result that he would audit his competitor agencies, including Mr. Bhasin's, and therefore have access to their confidential business information. Mr. Bhasin's refusal to allow Mr. Hrynew access to this information led to the final confrontation with Can-Am and its giving notice of non-renewal in May 2001. Can-Am, for its part, wanted to force a merger of the Bhasin agency under the Hrynew agency, effectively giving Mr. Bhasin's business to Mr. Hrynew. It was in the context of this situation that the trial judge made her findings of dishonesty on the part of Can-Am.

98 The trial judge concluded that Can-Am acted dishonestly with Mr. Bhasin throughout the period leading up to its exercise of the non-renewal clause, both with respect to its own intentions and with respect to Mr. Hrynew's role as PTO. Her detailed findings amply support this overall conclusion.

99 By early 2000, Can-Am was considering a significant reorganization of its activities in Alberta; by June of that year, it sent an organizational chart to the Commission showing that Mr. Bhasin's agency was to be merged under Mr. Hrynew's. But it had said nothing of this to Mr. Bhasin: trial reasons, at paras. 167-68. The trial judge found that these representations made by Can-Am to the Commission were clearly false if, as she concluded, they intended to refer to Mr. Bhasin: para. 246. She also found that Can-Am, by June 2000, was fearful that the Commission was going to pull its licence in Alberta and that it was prepared to do whatever it could to forestall that

possibility. "However, it was not dealing honestly with [Mr.] Bhasin about the realities of the situation as [it] saw them": para. 246.

100 In August 2000, Mr. Bhasin first heard of Can-Am's merger plans for him during a meeting with Can-Am's regional vice-president. But when questioned about Can-Am's intentions with respect to the merger, the official "equivocated" and did not tell him the truth that from Can-Am's perspective this was a "done deal". The trial judge concluded that the official was "not honest with [Mr.] Bhasin" at that meeting: para. 247.

101 When Mr. Bhasin complained about Mr. Hrynew's conflict of interest in being both auditor and competitor, Can-Am in effect blamed the Commission, claiming that the Commission had rejected its proposal to appoint a third party PTO. This was not truthful. Can-Am failed to mention that it had proposed to appoint a non-resident of Alberta who was clearly not qualified according to the Commission's criteria or that it had decided to appoint Mr. Hrynew even though he did not meet the Commission's criteria either: trial reasons, at paras. 195 and 221. It also misrepresented -- repeatedly -- to Mr. Bhasin that Mr. Hrynew was bound by duties of confidentiality and segregation of activities in the course of an audit, when in fact there was no such requirement. Can-Am did not even finalize its PTO contract with Mr. Hrynew until March 2001 and, notwithstanding its assurances to Mr. Bhasin, it failed to include such a provision in the contract: paras. 190-221. As the trial judge found, Can-Am "could not possibly have missed this honestly in the PTO agreement, given that [Mr. Bhasin's] very protests about [Mr.] Hrynew's appointment as PTO were about confidentiality and segregation of activities": para. 221. The judge also found that Can-Am repeated these "lies" about Mr. Hrynew's supposed obligations of confidentiality even after the PTO agreement, without these protections, had been signed: para. 204.

102 Can-Am pushed on with the requirement that Mr. Hrynew audit Mr. Bhasin's agency as if it were required to do so by the Commission even though it had arranged to have one of its employees conduct the audit of Mr. Hrynew's agency: trial reasons, at para. 198.

103 As the trial judge found, this dishonesty on the part of Can-Am was directly and intimately connected to Can-Am's performance of the Agreement with Mr. Bhasin and its exercise of the non-renewal provision. I conclude that Can-Am breached the 1998 Agreement when it failed to act honestly with Mr. Bhasin in exercising the non-renewal clause.

C. *Liability for Civil Conspiracy and Inducing Breach of Contract*

104 In light of this conclusion, I agree with the Court of Appeal's rejection of Mr. Bhasin's claims based on the torts of inducing breach of contract and unlawful means conspiracy.

105 The trial judge specifically found that Mr. Hrynew did not encourage Can-Am to act dishonestly in its dealings with Mr. Bhasin and that Can-Am's dishonest conduct was not fairly attributable to Mr. Hrynew: paras. 271 and 287. It follows that Mr. Hrynew did not induce Can-Am's breach of its contractual duty of honest performance.

106 The trial judge dismissed the claim for conspiracy to injure and there is no basis to interfere with that finding. However, the trial judge held the respondents liable for unlawful means conspiracy, with the unlawful means being the breach of contract and inducing breach of contract: para. 326. Because, in light of my conclusions, the only relevant breach of contract in this case is the breach of the duty of honest performance and there was no inducement of breach of contract, the only relevant unlawful means pertained to Can-Am alone and not Mr. Hrynew. Accordingly, there can be no liability for civil conspiracy: see *Agribrands Purina Canada Inc. v. Kasamekas*, 2011 ONCA 460, 106 O.R. (3d) 427, at para. 43.

107 I therefore agree with the result reached by the Court of Appeal that there could be no liability for inducing breach of contract or unlawful means conspiracy: para. 36. It follows that the claims against Mr. Hrynew were rightly dismissed.

D. *What Is the Appropriate Measure of Damages?*

108 I have concluded that Can-Am's breach of contract consisted of its failure to be honest with Mr. Bhasin about its contractual performance and, in particular, with respect to its settled intentions with respect to renewal. It is therefore liable for damages calculated on the basis of what Mr. Bhasin's economic position would have been had Can-Am fulfilled that duty. While the trial judge did not assess damages on that basis given her different findings in relation to liability, she made findings that permit this Court to do so.

109 The trial judge specifically held that but for Can-Am's dishonesty, Mr. Bhasin could have acted so as to "retain the value in his agency": paras. 258-59. In reaching this conclusion, the trial judge was well aware of the difficulties that Mr. Bhasin would have in selling his business given the "almost absolute controls" that Can-Am had on enrollment directors and that it owned the "book of business": para. 402. She also heard evidence and made findings about what the value of the business was, taking these limitations into account. These findings, in my view, permit us to assess damages on the basis that if Can-Am had performed the contract honestly, Mr. Bhasin would have been able to retain the value of his business rather than see it, in effect, expropriated and turned over to Mr. Hrynew.

110 It is clear from the findings of the trial judge and from the record that the value of the business around the time of non-renewal was $87,000. The defendant's expert at trial valued Mr. Bhasin's business as of 2001 (the time of non-renewal) as approximately $87,000. While there is some confusion in the record about the date of evaluation and the relevance of discount rates, I am persuaded that the trial judge found that the business was worth $87,000 at the time that the Agreement expired and that she made this finding fully alive to the difficulties standing in the way of a sale of the business given the contractual arrangements between Can-Am and its enrollment directors: see, e.g., para. 451. In addition, we have had no suggestion in argument that this figure should be reassessed. In fact, the defendants, as appellants before the Court of Appeal, submitted to that court that if damages were payable, they should be assessed at the value of the business at the

time of the expiry of the Agreement and noted that the trial judge had accepted the evidence of their expert witness, Mr. Bailey, that the value was $87,000.

111 I conclude therefore that Mr. Bhasin is entitled to damages in the amount of $87,000.

IV. Disposition

112 I would allow the appeal with respect to Can-Am and dismiss the appeal with respect to Mr. Hrynew. I would vary the trial judge's assessment of damages to $87,000 plus interest. Mr. Bhasin should have his costs throughout as against Can-Am. There should be no costs at any level in favour of or against Mr. Hrynew.

Appeal allowed in part.

Solicitors:

Solicitors for the appellant: McCarthy Tétrault, Toronto.

Solicitors for the respondents: Lenczner Slaght Royce Smith Griffin, Toronto.

Case Name:

1578838 Ontario Inc. v. Bank of Nova Scotia

Between
1578838 Ontario Inc., Plaintiff, and
The Bank of Nova Scotia, Scotia Mortgage Corporation, Joe McGrath, Roman Bruchkowsky and Debra Merritt, Defendants
And between
The Bank of Nova Scotia and Scotia Mortgage Corporation, Plaintiffs by Counterclaim, and
1578838 Ontario Inc. and Rosa Bufalino, Defendants to the Counterclaim

[2011] O.J. No. 2577

2011 ONSC 3482

6 R.P.R. (5th) 332

2011 CarswellOnt 4313

Welland Court File No. 1616/10

Ontario Superior Court of Justice

J.R. Henderson J.

Heard: May 27, 2011.
Judgment: June 7, 2011.

(56 paras.)

Court Summary:

Issues dealt with as identified by the Judge releasing the decision:

- The Bank took a five year mortgage on plaintiff's 52 unit townhouse complex in the amount of $1.4 million in 2005. The Bank chose not to consent to a proposed conversion of the complex to a condominium

corporation in 2008.

- When the mortgage came due in full in 2010, the plaintiff refused to pay out the mortgage and kept possession of the property. Then, the plaintiff sued the Bank for breach of its duty to act in good faith. The Bank counterclaimed on the mortgage.
- The Bank's motion for summary judgment on the mortgage was allowed. The plaintiff's request for a stay of the judgment was dismissed.
- The Bank's motion for summary dismissal of the claim against it of failing to act in good faith was dismissed, and that matter will proceed to trial.

Counsel:

Margaret A. Hoy, for the Plaintiff.

David S. Ward, for the Defendants The Bank of Nova Scotia and Scotia Mortgage Corporation.

No one appearing for the Defendants Joe McGrath, Roman Bruchkowsky and Debra Merritt.

David S. Ward, for the Plaintiffs by Counterclaim.

Margaret A. Hoy, for Defendant to the Counterclaim 1578838 Ontario Inc.

No one appearing for Rosa Bufalino.

DECISION ON MOTION

J.R. HENDERSON J.:--

INTRODUCTION

1 This is my decision on two motions; one motion brought by the defendants The Bank of Nova Scotia and Scotia Mortgage Corporation (collectively called "the Bank"), and the other motion brought by the plaintiff 1578838 Ontario Inc. ("157").

2 The claim against the defendants McGrath, Bruchkowsky and Merritt has been discontinued, and the Bank's counterclaim has not yet been served on Rosa Bufalino. Therefore, the individuals named in the title of proceedings were not parties to these motions.

3 There are two aspects to the Bank's motion. First, the Bank requests summary judgment on its

counterclaim against 157 regarding a mortgage on the property known as 100-304 Brownleigh Avenue, Welland, Ontario ("the mortgaged property"). The Bank submits that the full amount of the mortgage was due on October 1, 2010 and has not yet been paid.

4 Second, the Bank requests summary dismissal of 157's claim against the Bank. 157 claims that the Bank committed the torts of inducing breach of contract, and interfering with economic relations, and failed to fulfill its contractual obligation to act in good faith regarding a request to change the use of the mortgaged property.

5 At this point in time the Statement of Claim does not contain an allegation that the Bank failed to fulfill its contractual obligation to act in good faith, but 157 has a pending motion requesting an amendment to that effect. For the purposes of this motion I have assumed that 157's motion to amend has been allowed and the pleadings have been amended as requested, without prejudice to the Bank's right to contest the motion to amend when it is eventually heard.

6 157's motion today is for an interlocutory injunction prohibiting the Bank from interfering with the tenants residing on the mortgaged property, and prohibiting the Bank from taking any steps to enforce the terms of the mortgage.

BACKGROUND

7 The mortgaged property is a 52-unit townhouse complex in Welland, Ontario, that was at all material times owned by 157. 157 operated a townhouse rental business on the mortgaged property, rented out the 52 townhouse units to residential tenants, and collected the rents from the tenants.

8 The mortgage is a commercial mortgage dated September 26, 2005 between 157 as mortgagor/chargor, and the Bank as mortgagee/chargee in the amount of $1,425,000.00. The mortgage has a five-year term and provides for monthly payments of $10,000.00 on the first day of every month, with the balance of the mortgage payable in full on October 1, 2010.

9 The mortgage includes the following terms:

> 13. CHANGE OF USE OR OWNERSHIP
>
> THE CHARGOR covenants and agrees that it will not change or permit to be changed the use of the said lands without prior written consent of the Chargee ...
>
> THE CHARGOR covenants and agrees with the Chargee that in the event of any change of ownership ... of the Chargor including ... transfer or sale of the property, or part thereof ("Transfer") without the Chargee's prior written consent, at the Chargee's option all or part of the monies secured with accrued interest

thereon shall forthwith become due and payable ...

33. CONSENT OF CHARGEE

WHEREVER the Chargor is required by this Charge to obtain the consent or approval of the Chargee, it is agreed that ... the Chargee may give or withhold its consent or approval for any reason that it may see fit in its sole and absolute discretion ...

10 In August 2008, Charlie Bufalino ("Bufalino"), an officer and director of 157, discussed a possible sale of the mortgaged property to a third party with the Real Estate Lending Manager of the Bank, Debra Merritt ("Merritt"). Merritt informed Bufalino that, pursuant to the terms of the mortgage, the mortgage could be paid out in full at any time prior to the expiry of the term provided that 157 paid the appropriate penalty, which was approximately three months interest. No specific request was made of the Bank by 157 at that time.

11 On September 12, 2008, 157 sent a copy of an agreement of purchase and sale to Merritt. The agreement, dated April 14, 2008, was for the sale of the mortgaged property from 157 to Canadian Equity Builders ("CEB"). The purchase price was $3,725,000.00 and the agreement was to close on October 30, 2008, which was later extended to November 6, 2008. The agreement did not include a term that the Bank's consent was a condition of the sale, and the Bank did not participate in the negotiation of the agreement. The agreement contemplated the conversion of the mortgaged property to condominiums, and 157 agreed to cooperate with CEB in CEB's application for a condominium registration.

12 On approximately October 15, 2008 Merritt was asked by the lawyers for CEB to consent to a postponement of the Bank's mortgage in favour of a site plan agreement, and to consent to a proposed condominium registration application.

13 In response to this request, Merritt consulted with two of her superiors in the Real Estate Lending Department, Joe McGrath ("McGrath") and Roman Bruchkowsky ("Bruchkowsky"). Thereafter, on October 29, 2008 Merritt advised the lawyers for CEB that the Bank would not consent to the postponement of the mortgage or to the condominium conversion.

14 On November 4, 2008 the lawyer for 157 advised Merritt that the agreement of purchase and sale was scheduled to close on November 6, 2008, and he asked for a discharge statement from the Bank so that the mortgage could be paid out on closing. Accordingly, Merritt provided a discharge statement to the lawyer for 157, which showed an amount due of $1,384,692.00 as of November 6, 2008.

15 The agreement of purchase and sale did not close and the Bank's mortgage was not paid out.

After November 6, 2008, 157 remained in possession of the mortgaged property, made the monthly mortgage payments, and continued to receive rents from the tenants on the property.

16 The Bank's mortgage matured on October 1, 2010, but 157 did not pay the balance due. On October 13, 2010, 157 issued the Statement of Claim in this action wherein 157 alleged that the Bank committed certain torts and/or breached its contractual obligation by refusing to postpone the mortgage in favour of the site plan agreement and refusing to consent to the condominium conversion.

17 157 has remained in possession of the mortgaged property to date, and continues to collect the rents from the tenants. The Bank has attempted to attorn the rents, and has provided some evidence that 157 has interfered with its attempts to attorn rents.

THE BANK'S MOTION FOR SUMMARY JUDGMENT ON THE MORTGAGE

18 I am of the view that there is no genuine issue for trial on the Bank's counterclaim, and accordingly the Bank is entitled to summary judgment on the mortgage pursuant to Rule 20.

19 The facts as they relate to the mortgage are not in dispute. There is a written registered mortgage from 157 to the Bank that clearly sets out the terms of the mortgage including the principal amount, the interest, and the due date. The total amount of the mortgage was due in full on October 1, 2010. 157 did not pay the amount due on the mortgage on October 1, 2010, or at any time. 157 remains in possession of the mortgaged property. There is no allegation that the Bank agreed to renew or extend the mortgage.

20 Where a mortgage has come due and the mortgagor has not paid the balance owing and the mortgagee has chosen not to renew the mortgage, the mortgagee has the right to judgment and has the right to possess and/or sell the property to collect the amount owing. There is very little that a mortgagor can do to stop that process.

21 If a mortgagor has a complaint about the Bank's conduct, the mortgagor may make a claim for damages against the Bank, but a claim for damages does not give the mortgagor the right to withhold any monies owed on the mortgage or to possess the mortgaged property.

22 Therefore, in the present case, regardless of 157's allegation of misconduct by the Bank with respect to its refusal to consent to the postponement and condominium conversion, the full balance owing on the mortgage is due. 157 is in default under the mortgage and the Bank is entitled to summary judgment.

23 In anticipation of the court's decision to grant summary judgment on the mortgage, 157 has requested a stay of the enforcement of any judgment on the mortgage pursuant to Rule 20.08 pending the trial of 157's claim against the Bank.

24 In my view, a stay of the enforcement of the judgment on the mortgage is not appropriate in these circumstances. A stay is an equitable remedy that requires the court to weigh and compare the effects on both parties if a stay were granted or dismissed. Most of the factors in this case do not support a stay.

25 The most obvious factor against granting the stay is that there is no real connection between the Bank's counterclaim on the mortgage and 157's claim for damages. A disconnect between the facts that give rise to the defendant's claim and the plaintiff's claim generally results in a refusal of a stay of execution. See *Cuddy Food Products v. Puddy Bros. Ltd.* (2002), 35 C.P.C. (5th) 159.

26 Here, the mortgage is due and the money is owing to the Bank by 157. 157 has no right, and does not claim to have any right, to extend or renew the mortgage. In fact, the conduct that is the subject of 157's complaint is conduct that took place entirely between September and November 2008, two years before the balance of the mortgage came due.

27 Also, 157's claim is for monetary damages, and there can be no doubt that the Bank has sufficient assets to cover any monetary judgment. It is not necessary to deprive the Bank of money to which it is entitled for the purpose of ensuring that 157 will be able to collect any judgment against the Bank.

28 Further, a stay would have the effect of depriving the Bank of possession of the property and the corresponding ability to collect rents. Even if 157 were successful at trial, 157 would have no right to possession of the property.

29 Still further, there is evidence that the condition of the property has been deteriorating while in the possession of 157. Bufalino deposed that the property was not in top condition and he was having financial trouble maintaining the property. This suggests that the Bank should properly take possession of the property so that it may take whatever steps are necessary to preserve the asset that constitutes its security for the money owing on the mortgage.

30 As to the strength of the claims of the parties, I accept that 157's claim against the Bank is a difficult one. Proving lack of honesty or good faith is a difficult task, and the evidence in this case is slim. Moreover, even if 157 were successful at trial, there is a serious question as to the quantum of the monetary damages.

31 For all of these reasons there will not be a stay of the enforcement of the judgment on the mortgage. The Bank's motion for summary judgment on the counterclaim is allowed. The Bank is granted judgment for the full amount due on the mortgage, including the principal, interest and property tax arrears. Further, the Bank is granted possession of the mortgaged property.

157'S MOTION FOR AN INTERLOCUTORY INJUNCTION

32 157's claim for injunctive relief assumed that 157 would remain in possession of the

mortgaged property. Therefore, this motion by 157 is subsumed in the Bank's motion for summary judgment on the counterclaim.

33 Because I have granted the Bank's motion for summary judgment on the counterclaim, 157's request for injunctive relief is moot. Therefore, 157's motion is dismissed.

THE BANK'S MOTION TO DISMISS 157'S CLAIM

34 157 alleges that the Bank's failure to consent to a postponement of the mortgage in favour of a site plan agreement, and its failure to consent to a condominium conversion, give rise to a tort of inducing breach of contract, a tort of interfering with economic relations, and a breach of the contractual obligation to act in good faith.

35 I have some concern as to 157's ability to prove the requisite intention element of the two torts aforementioned, but considering my analysis of 157's allegation of a breach of a contractual obligation to act in good faith, I need not and will not express any opinion on those two torts.

36 The mortgage between 157 and the Bank provides that the Bank "may give or withhold its consent or approval for any reason that it may see fit in its sole and absolute discretion ...". There is no provision in the mortgage that the Bank's consent may not be unreasonably withheld.

37 Despite the obvious literal interpretation of mortgages that contain the above-mentioned wording, the courts have generally found that even in situations in which one party is given the absolute discretion to give or withhold consent, that party must exercise that discretion honestly and in good faith. See the cases of *P. & G. Cleaners Ltd. v. Johnson*, 1995 CarswellMan 187, at paras. 26-27, and *Agribrands Purina Canada Inc. v. Kasamekas*, [2010] O.J. No. 84, at para. 102.

38 In the *Agribrands Purina* case Quigley J. considered the issue of the limitations on a manufacturer that had a contractual right to decide in its sole discretion whether to terminate or renew a dealership agreement. Quigley J. referred to the case of *Gateway Realty Ltd. v. Arton* (1991), 106 N.S.R. (2d) 180, and then wrote at para. 102:

> The insistence at common law on the presence of good faith in discretionary conduct relating to the formation, performance and enforcement of contracts merely fulfills the court's obligation to do justice between contending parties, but *Gateway Realty* also shows that where a party exercises its rights pursuant to a "sole discretion" clause in a contract, it must act honestly and in good faith.

39 In my view this same principle applies to the present case. In a mortgage relationship, the Bank has the right to protect its own interests and to do what it considers best for the Bank. The Bank is not required to do what is best for the mortgagor. However, the Bank cannot act in an arbitrary, capricious, or fraudulent manner. Rather, the Bank must act honestly and in good faith.

40 In the present case there is no allegation that the Bank acted fraudulently. In summary, 157 alleges that the Bank simply was asked to consent and refused to consent without giving the request by 157 any proper consideration. In response, the Bank submits that 157's request was properly considered, and that the risk to the Bank under the mortgage would have changed if the consent had been given. Consequently, the Bank chose in good faith to exercise its right to refuse to consent.

41 On a motion for summary judgment or dismissal both sides are required to set out their best case, and are not permitted to rely on bald allegations. In this case, it is incumbent upon 157 to set out its evidence on the absence of honesty and good faith, and it is also incumbent upon the Bank to set out its case in support of its position that it acted honestly and in good faith.

42 The only purported evidence of the Bank's consideration of 157's request is set out in two affidavits sworn by Merritt, but these two affidavits contain very little solid evidence on that issue. In her first affidavit, sworn on February 1, 2011, Merritt provides no insight as to the Bank's consideration of 157's request. Merritt simply deposes "in accordance with its rights under the mortgage, the Bank determined not to consent to a postponement of the site plan agreement and registration of the condominium."

43 In Merritt's second affidavit, sworn March 11, 2011, she deposes that in her experience she believed that there were certain risks to a mortgagee that could arise from the conversion of a rental property to a condominium, including the "fracturing" of a blanket mortgage on the property into individual mortgages, the subordination of the mortgage to the site plan agreement, and the possibility of cost overruns during the conversion process. However, Merritt did not depose that she, or any Bank employee, considered any of these risks when the Bank decided not to consent in the present case.

44 At paragraphs 16, 17 and 18 of that affidavit Merritt essentially deposed that she discussed the matter with McGrath and they determined that the Bank would not consent "relying on the terms of the mortgage". There is no information as to what Merritt and McGrath discussed.

45 The absence of evidence from the Bank is also clear in the cross-examination of Merritt. During cross-examination Merritt testified that she had never been involved in the conversion of a rental property to a condominium prior to the present transaction, which raises the question of her experience that formed the basis of her second affidavit. She also testified that she had no knowledge of s.14 of the *Condominium Act* (regarding fracturing of a blanket mortgage) until she swore her second affidavit on March 11, 2011, and that she had no knowledge of any cost overruns with respect to this condominium conversion.

46 During cross-examination Merritt confirmed that she did not seek any legal advice before the decision to refuse to consent, although she said she spoke with both McGrath and Bruchkowsky. Again, there is no evidence as to what was discussed in the conversations between Merritt, McGrath, and Bruchkowsky.

47 In contrast to the Bank's evidence on this issue, 157 filed an affidavit from Bufalino who deposed that he met with the Manager of the St. Catharines branch of the Bank, Lucie Catterall ("Catterall"), and he discussed the agreement of purchase and sale with her. Bufalino deposed that he was assured that the Bank would consent to the condominium conversion provided that the appropriate penalty was paid, and that he was given the Bank's assurances of cooperation.

48 Although Bufalino's affidavit also lacks some detail, I note that Bufalino was never cross-examined and his evidence is unchallenged. Further, the Bank did not provide any affidavit evidence from Catterall.

49 Therefore, in considering the Bank's motion for summary dismissal, I find that there is a distinct absence of evidence from the Bank as to the process that was undertaken with respect to the Bank's consideration of 157's request for its consent. Specifically, I do not know what factors, if any, were considered by Merritt; I do not know what was discussed between Merritt, McGrath and Bruchkowsky; and I do not know Catterall's version of the events. I do have a sworn statement from Bufalino that he believed that he had assurances of the Bank's cooperation.

50 In my view there may well have been an honest and good faith consideration of 157's request by the Bank, but there is very little evidence as to what consideration was undertaken before me today.

51 Therefore, even though Rule 20.04(2.1) permits me as a motions judge to weigh the evidence and to draw inferences, on the basis of the evidence before me today I cannot make any finding as to whether the Bank acted honestly and in good faith.

52 For these reasons the Bank's motion for summary dismissal of 157's claim is dismissed. 157's claim will proceed to trial, and the issues will be fully fleshed out by way of *viva voce* evidence at the trial.

CONCLUSION AND SUMMARY

53 In summary, the Bank's motion for summary judgment on the mortgage is allowed. It is ordered and adjudged that the Bank is entitled to full payment of the amounts due under the mortgage including the principal, interest and property tax arrears. Further, it is ordered and adjudged that the Bank is entitled to possession of the mortgaged property.

54 The plaintiff's request for a stay of the enforcement of the summary judgment is dismissed, and the plaintiff's motion for injunctive relief is dismissed.

55 The Bank's motion for summary dismissal of 157's claim is dismissed.

56 Regarding costs, considering the mixed success on this motion and considering the fact that the issue of whether the Bank acted honestly and in good faith will be determined at trial, I order

that the costs of all of these motions are reserved to the trial judge.

J.R. HENDERSON J.

cp/e/qllqs/qlvxw/qlana

Indexed as:

Olympia & York Developments Ltd. (Re)

Re Olympia & York Developments Ltd. and 23 other Companies set out in Schedule "A"

[1993] O.J. No. 545

12 O.R. (3d) 500

17 C.B.R. (3d) 1

38 A.C.W.S. (3d) 1149

Action No. B125/92

Ontario Court (General Division),

R.A. Blair J.

February 5, 1993

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1 **R.A. BLAIR J.** (orally):--On May 14, 1992, Olympia & York Developments Limited and 23 affiliated corporations (the "applicants") sought, and obtained, an order granting them the protection of the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, for a period of time while they attempted to negotiate a plan of arrangement with their creditors and to restructure their corporate affairs. The Olympia & York group of companies constitute one of the largest and most respected commercial real estate empires in the world, with prime holdings in the main commercial centres in Canada, the U.S.A., England and Europe. This empire was built by the Reichmann family of Toronto. Unfortunately, it has fallen on hard times, and, indeed, it seems, it has fallen apart.

2 A Final Plan of compromise or arrangements has now been negotiated and voted on by the numerous classes of creditors. Twenty-seven of the 35 classes have voted in favour of the Final Plan; eight have voted against it. The applicants now bring the Final Plan before the court for sanctioning, pursuant to s. 6 of the Companies' Creditors Arrangement Act.

THE PLAN

3 The Plan is described in the motion materials as "The Revised Plans of Compromise and Arrangement dated December 16, 1992, as further amended to January 25, 1993". I shall refer to it as the "Plan" or the "Final Plan". Its final purpose, as stated in art. 1.2,

> . . . is to effect the reorganization of the businesses and affairs of the Applicants in order to bring stability to the Applicants for a period of not less than five years, in the expectation that all persons with an interest in the Applicants will derive a greater benefit from the continued operation of the businesses and affairs of the Applicants on such a basis than would result from the immediate forced liquidation of the Applicants' assets.

4 The Final Plan envisages the restructuring of certain of the O & Y ownership interests, and a myriad of individual proposals -- with some common themes -- for the treatment of the claims of the various classes of creditors which have been established in the course of the proceedings.

5 The contemplated O & Y restructuring has three principal components, namely:

1. The organization of O & Y Properties, a company to be owned as to 90 per cent by OYDL and as to 10 per cent by the Reichmann family, and which is to become OYDL's Canadian real estate management arm;
2. Subject to certain approvals and conditions, and provided the secured creditors do not exercise their remedies against their security , the transfer by OYDL of its interest in certain Canadian real estate assets to O & Y Properties, in exchange for shares; and,
3. A GW reorganization scheme which will involve the transfer of common shares of GWU holdings to OYDL, the privatization of GW utilities and the amalgamation of GW utilities with OYDL.

6 There are 35 classes of creditors for purposes of voting on the Final Plan and for its implementation. The classes are grouped into four different categories of classes, namely, by claims of project lenders, by claims of joint venture lenders, by claims of joint venture co-participants, and by claims of "other classes".

7 Any attempt by me to summarize, in the confines of reasons such as these, the manner of proposed treatment for these various categories and classes would not do justice to the careful and detailed concept of the Plan. A variety of intricate schemes are put forward, on a class-by-class basis, for dealing with the outstanding debt in question during the five-year Plan period.

8 In general, these schemes call for interest to accrue at the contract or some other negotiated rate, and for interest (and, in some cases, principal) to be paid from time to time during the Plan period if O & Y's cash flow permits. At the same time, O & Y (with, I think, one exception) will

continue to manage the properties that it has been managing to date, and will receive revenue in the form of management fees for performing that service. In many, but not all, of the project lender situations, the Final Plan envisages the transfer of title to the newly formed O & Y Properties. Special arrangements have been negotiated with respect to lenders whose claims are against marketable securities, including the Marketable Securities Lenders, the GW Marketable Security and Other Lenders, the Carena Lenders and the Gulf and Abitibi Lenders.

9 It is an important feature of the Final Plan that secured creditors are ceded the right, if they so choose, to exercise their realization remedies at any time (subject to certain strictures regarding timing and notice). In effect, they can "drop out" of the Plan if they desire.

10 The unsecured creditors, of course, are heirs to what may be left. Interest is to accrue on the unsecured loans at the contract rate during the Plan period. The Final Plan calls for the administrator to calculate, at least annually, an amount that may be paid on the O & Y unsecured indebtedness out of OYDL's cash on hand, and such amount, if indeed such an amount is available, may be paid out on court approval of the payment. The unsecured creditors are entitled to object to the transfer of assets to O & Y Properties if they are not reasonably satisfied that O & Y Properties "will be a viable, self- financing entity". At the end of the Plan period, the members of this class are given the option of converting their remaining debt into stock.

11 The Final Plan contemplates the eventuality that one or more of the secured classes may reject it. Section 6.2 provides:

a) that if the Plan is not approved by the requisite majority of holders of any Class of Secured Claims before January 16, 1993, the stay of proceedings imposed by the initial CCAA order of May 14, 1992, as amended, shall be automatically lifted; and,

b) that in the event that Creditors (other than the unsecured creditors and one Class of Bondholders' Claims) do not agree to the Plan, any such Class shall be deemed not to have agreed to the Plan and to be a Class of Creditors not affected by the Plan, and that the Applicants shall apply to the court for a Sanction Order which sanctions the Plan only insofar as it affects the Classes which have agreed to the Plan .

12 Finally, I note that art. 1.3 of the Final Plan stipulates that the Plan document "constitutes a separate and severable plan of compromise and arrangement with respect to each of the Applicants".

THE PRINCIPLES TO BE APPLIED ON SANCTIONING

13 In Elan Corp. v. Comiskey (1990), 1 O.R. (3d) 289, 1 C.B.R. (3d) 101 sub nom. Nova Metal Products Inc. v. Comiskey (Trustee of) (C.A.), Doherty J.A. concluded his examination of the purpose and scheme of the Companies' Creditors Arrangement Act, with this overview, at pp.

308-09 O.R., pp. 122-23 C.B.R.:

> Viewed in its totality, the Act gives the court control over the initial decision to put the reorganization plan before the creditors, the classification of creditors for the purpose of considering the plan, conduct affecting the debtor company pending consideration of that plan, and the ultimate acceptability of any plan agreed upon by the creditors. The Act envisions that the rights and remedies of individual creditors, the debtor company, and others may be sacrificed, at least temporarily, in an effort to serve the greater good by arriving at some acceptable reorganization which allows the debtor company to continue in operation: Icor Oil & Gas Co. v. Canadian Imperial Bank of Commerce (No. 1) (1989), 102 A.R. 161 (Q.B.), at p. 165.

14 Mr. Justice Doherty's summary, I think, provides a very useful focus for approaching the task of sanctioning a plan.

15 Section 6 of the CCAA reads as follows:

> 6. Where a majority in number representing three-fourths in value of the creditors, or class of creditors, as the case may be, present and voting either in person or by proxy at the meeting or meetings thereof respectively held pursuant to sections 4 and 5, or either of those sections, agree to any compromise or arrangement either as proposed or as altered or modified at the meeting or meetings, the compromise or arrangement may be sanctioned by the court, and if so sanctioned is binding
>
> (a) on all the creditors or the class of creditors, as the case may be, and on any trustee for any such class of creditors, whether secured or unsecured, as the case may be, and on the company; and
> (b) in the case of a company that has made an authorized assignment or against which a receiving order has been made under the Bankruptcy Act or is in the course of being wound up under the Winding-up Act, on the trustee in bankruptcy or liquidator and contributories of the company.

(Emphasis added)

16 Thus, the final step in the CCAA process is court sanctioning of the Plan, after which the Plan becomes binding on the creditors and the company. The exercise of this statutory obligation imposed upon the court is a matter of discretion.

17 The general principles to be applied in the exercise of the court's discretion have been developed in a number of authorities. They were summarized by Mr. Justice Trainor in Re

Northland Properties Ltd. (1988), 73 C.B.R. (N.S.) 175 (B.C.S.C.), and adopted on appeal in that case by McEachern C.J.B.C., who set them out in the following fashion at (1989), 73 C.B.R. (N.S.) 195 (B.C.C.A.), p. 201:

> The authorities do not permit any doubt about the principles to be applied in a case such as this. They are set out over and over again in many decided cases and may be summarized as follows:
>
> (1) There must be strict compliance with all statutory requirements . . .
>
> (2) All materials filed and procedures carried out must be examined to determine if anything has been done [or purported to have been done] which is not authorized by the C.C.A.A.;
>
> (3) The plan must be fair and reasonable.

18 In an earlier Ontario decision, Re Dairy Corp. of Canada, [1934] O.R. 436, [1934] 3 D.L.R. 347 (C.A.), Middleton J.A. applied identical criteria to a situation involving an arrangement under the Ontario Companies Act, R.S.O. 1927, c. 218. The Nova Scotia Court of Appeal recently followed Re Northland Properties Ltd. in Re Keddy Motor Inns Ltd. (1992), 13 C.B.R. (3d) 245, 6 B.L.R. (2d) 116 (N.S.C.A.). Farley J. did as well in Re Campeau (1992), 10 C.B.R. (3d) 104 (Ont. Gen. Div.).

Strict compliance with statutory requirements

19 Both this first criterion, dealing with statutory requirements, and the second criterion, dealing with the absence of any unauthorized conduct, I take to refer to compliance with the various procedural imperatives of the legislation itself, or to compliance with the various orders made by the court during the course of the CCAA process: see Re Campeau.

20 At the outset, on May 14, 1992, I found that the applicants met the criteria for access to the protection of the Act -- they are insolvent; they have outstanding issues of bonds issued in favour of a trustee, and the compromise proposed at that time, and now, includes a compromise of the claims of those creditors whose claims are pursuant to the trust deeds. During the course of the proceedings creditors' committees have been formed to facilitate the negotiation process, and creditors have been divided into classes for the purposes of voting, as envisaged by the Act. Votes of those classes of creditors have been held, as required.

21 With the consent, and at the request of, the applicants and the creditors' committees, the Honourable David H.W. Henry, a former justice of this court, was appointed "claims officer" by

order dated September 11, 1992. His responsibilities in that capacity included, as well as the determination of the value of creditors' claims for voting purposes, the responsibility of presiding over the meetings at which the votes were taken, or of designating someone else to do so. The Honourable Mr. Henry, himself, or the Honourable M. Craig or the Honourable W. Gibson Gray -- both also former justices of this court -- as his designees, presided over the meetings of the classes of creditors, which took place during the period from January 11, 1993 to January 25, 1993. I have his report as to the results of each of the meetings of creditors, and confirming that the meetings were duly convened and held pursuant to the provisions of the court orders pertaining to them and the CCAA.

22 I am quite satisfied that there has been strict compliance with the statutory requirements of the Companies' Creditors Arrangement Act.

Unauthorized conduct

23 I am also satisfied that nothing has been done or purported to have been done which is not authorized by the CCAA.

24 Since May 14, the court has been called upon to make approximately 60 orders of different sorts, in the course of exercising its supervisory function in the proceedings. These orders involved the resolution of various issues between the creditors by the court in its capacity as "referee" of the negotiation process; they involved the approval of the "GAR" orders negotiated between the parties with respect to the funding of O & Y's general and administrative expenses and restructuring costs throughout the "stay" period; they involved the confirmation of the sale of certain of the applicants' assets, both upon the agreement of various creditors and for the purposes of funding the "GAR" requirements; they involved the approval of the structuring of creditors' committees, the classification of creditors for purposes of voting, the creation and defining of the role of "information officer" and, similarly, of the role of "claims officer". They involved the endorsement of the information circular respecting the Final Plan and the mail and notice that was to be given regarding it. The court's orders encompassed, as I say, the general supervision of the negotiation and arrangement period, and the interim sanctioning of procedures implemented and steps taken by the applicants and the creditors along the way.

25 While the court, of course, has not been a participant during the elaborate negotiations and undoubted boardroom brawling which preceded and led up to the Final Plan of compromise, I have, with one exception, been the judge who has made the orders referred to. No one has drawn to my attention any instances of something being done during the proceedings which is not authorized by the CCAA .

26 In these circumstances, I am satisfied that nothing unauthorized under the CCAA has been done during the course of the proceedings.

27 This brings me to the criterion that the Plan must be "fair and reasonable".

Fair and reasonable

28 The Plan must be "fair and reasonable". That the ultimate expression of the court's responsibility in sanctioning a plan should find itself telescoped into those two words is not surprising. "Fairness" and "reasonableness" are, in my opinion, the two keynote concepts underscoring the philosophy and workings of the Companies' Creditors Arrangement Act. "Fairness" is the quintessential expression of the court's equitable jurisdiction -- although the jurisdiction is statutory, the broad discretionary powers given to the judiciary by the legislation make its exercise an exercise in equity -- and "reasonableness" is what lends objectivity to the process.

29 From time to time, in the course of these proceedings, I have borrowed liberally from the comments of Mr. Justice Gibbs, whose decision in Quintette Coal Ltd. v. Nippon Steel Corp. (1990), 2 C.B.R. (3d) 303, 51 B.C.L.R. (2d) 105 (C.A.), contains much helpful guidance in matters of the CCAA. The thought I have borrowed most frequently is his remark, at p. 314 C.B.R., p. 116 B.C.L.R., that the court is "called upon to weigh the equities, or balance the relative degrees of prejudice, which would flow from granting or refusing" the relief sought under the Act. This notion is particularly apt, it seems to me, when consideration is being given to the sanctioning of the Plan.

30 If a debtor company, in financial difficulties, has a reasonable chance of staving off a liquidator by negotiating a compromise arrangement with its creditors, "fairness" to its creditors as a whole, and to its shareholders, prescribes that it should be allowed an opportunity to do so, consistent with not "unfairly" or "unreasonably" depriving secured creditors of their rights under their security. Negotiations should take place in an environment structured and supervised by the court in a "fair" and balanced -- or "reasonable" -- manner. When the negotiations have been completed and a plan of arrangement arrived at, and when the creditors have voted on it -- technical and procedural compliance with the Act aside -- the plan should be sanctioned if it is "fair and reasonable".

31 When a plan is sanctioned it becomes binding upon the debtor company and upon creditors of that company. What is "fair and reasonable", then, must be assessed in the context of the impact of the plan on the creditors and the various classes of creditors, in the context of their response to the plan, and with a view to the purpose of the CCAA.

32 On the appeal in Re Northland Properties Ltd., supra, at p. 201, Chief Justice McEachern made the following comment in this regard:

> . . . there can be no doubt about the purpose of the C.C.A.A. It is to enable compromises to be made for the common benefit of the creditors and of the company, particularly to keep a company in financial difficulties alive and out of the hands of liquidators. To make the Act workable, it is often necessary to permit a requisite majority of each class to bind the minority to the terms of the plan, but the plan must be fair and reasonable.

33 In Re Alabama, New Orleans, Texas & Pacific Junction Railway Co., [1891] 1 Ch. 213 (C.A.), a case involving a scheme and arrangement under the Joint Stock Companies Arrangement Act, 1870 (U.K.), c. 104, Lord Justice Bowen put it this way, at p. 243:

> Now, I have no doubt at all that it would be improper for the Court to allow an arrangement to be forced on any class of creditors, if the arrangement cannot reasonably be supposed by sensible business people to be for the benefit of that class as such, otherwise the sanction of the Court would be a sanction to what would be a scheme of confiscation. The object of this section is not confiscation . . . Its object is to enable compromises to be made which are for the common benefit of the creditors as creditors, or for the common benefit of some class of creditors as such.

Again at p. 245:

> It is in my judgment desirable to call attention to this section, and to the extreme care which ought to be brought to bear upon the holding of meetings under it. It enables a compromise to be forced upon the outside creditors by a majority of the body, or upon a class of the outside creditors by a majority of that class.

34 Is the Final Plan presented here by the O & Y applicants "fair and reasonable"?

35 I have reviewed the Plan, including the provisions relating to each of the classes of creditors. I believe I have an understanding of its nature and purport, of what it is endeavouring to accomplish, and of how it proposes this be done. To describe the Plan as detailed, technical, enormously complex and all-encompassing, would be to understate the proposition. This is, after all, we are told, the largest corporate restructuring in Canadian -- if not worldwide -- corporate history. It would be folly for me to suggest that I comprehend the intricacies of the Plan in all of its minutiae and in all of its business, tax and corporate implications. Fortunately, it is unnecessary for me to have that depth of understanding. I must only be satisfied that the Plan is fair and reasonable in the sense that it is feasible and that it fairly balances the interests of all of the creditors, the company and its shareholders.

36 One important measure of whether a plan is fair and reasonable is the parties' approval of the Plan, and the degree to which approval has been given.

37 As other courts have done, I observe that it is not my function to second guess the business people with respect to the "business" aspects of the Plan, descending into the negotiating arena and substituting my own view of what is a fair and reasonable compromise or arrangement for that of the business judgment of the participants. The parties themselves know best what is in their interests in those areas.

38 This point has been made in numerous authorities, of which I note the following: Re Northland Properties Ltd., supra, at p. 205; Re Langley's Ltd. , [1938] O.R. 123, [1938] 3 D.L.R. 230 (C.A.), at p. 129 O.R., pp. 233-34 D.L.R.; Re Keddy Motor Inns Ltd, supra; École internationale de haute esth etique Edith Serei Inc. (Receiver of) v. Edith Serei internationale (1987) Inc. (1989), 78 C.B.R. (N.S.) 36 (Que. S.C.).

39 In Re Keddy Motor Inns Ltd., the Nova Scotia Court of Appeal spoke of "a very heavy burden" on parties seeking to show that a plan is not fair and reasonable, involving "matters of substance", when the plan has been approved by the requisite majority of creditors: see pp. 257-58 C.B.R., pp. 128-29 B.L.R. Freeman J.A. stated at p. 258 C.B.R., p. 129 B.L.R.:

> The Act clearly contemplates rough-and-tumble negotiations between debtor companies desperately seeking a chance to survive and creditors willing to keep them afloat, but on the best terms they can get. What the creditors and the company must live with is a plan of their own design, not the creation of a court. The court's role is to ensure that creditors who are bound unwillingly under the Act are not made victims of the majority and forced to accept terms that are unconscionable.

40 In Re École internationale, at p. 38, Dugas J. spoke of the need for "serious grounds" to be advanced in order to justify the court in refusing to approve a proposal, where creditors have accepted it, unless the proposal is unethical.

41 In this case, as Mr. Kennedy points out in his affidavit filed in support of the sanction motion, the Final Plan is "the culmination of several months of intense negotiations and discussions between the applicants and their creditors, [reflects] significant input of virtually all of the classes of creditors and [is] the product of wide-ranging consultations, give and take a compromise on the part of the participants in the negotiating and bargaining process". The body of creditors, moreover, Mr. Kennedy notes, "consists almost entirely of sophisticated financial institutions represented by experienced legal counsel" who are, in many cases, "members of creditors' committees constituted pursuant to the amended order of May 14, 1992". Each creditors' committee had the benefit of independent and experienced legal counsel.

42 With the exception of the eight classes of creditors that did not vote to accept the Plan, the Plan met with the overwhelming approval of the secured creditors and the unsecured creditors of the applicants. This level of approval is something the court must acknowledge with some deference.

43 Those secured creditors who have approved the Plan retain their rights to realize upon their security at virtually any time, subject to certain requirements regarding notice. In the meantime, they are to receive interest on their outstanding indebtedness, either at the original contract rate or at some other negotiated rate, and the payment of principal is postponed for a period of five years.

44 The claims of creditors -- in this case, secured creditors -- who did not approve the Plan are

specifically treated under the Plan as "unaffected claims", i.e., claims not compromised or bound by the provisions of the Plan. Section 6.2(c) of the Final Plan states than the applicants may apply to the court for a sanction order which sanctions the Plan only insofar as it affects the classes which have agreed to the Plan.

45 The claims of unsecured creditors under the Plan are postponed for five years, with interest to accrue at the relevant contract rate. There is a provision for the administrator to calculate, at least annually, an amount out of OYDL's cash on hand which may be made available for payment to the unsecured creditors, if such an amount exists, and if the court approves its payment to the unsecured creditors. The unsecured creditors are given some control over the transfer of real estate to O & Y Properties, and, at the end of the Plan period, are given the right, if they wish, to convert their debt to stock.

46 Faced with the prospects of recovering nothing on their claims in the event of a liquidation, against the potential of recovering something if O & Y is able to turn things around, the unsecured creditors at least have the hope of gaining something if the applicants are able to become the "self-sustaining and viable corporation" which Mr. Kennedy predicts they will become "in accordance with the terms of the Plan".

47 Speaking as co-chair of the unsecured creditors' committee at the meeting of that class of creditors, Mr. Ed Lundy made the following remarks:

> Firstly, let us apologize for the lengthy delays in today's proceedings. It was truly felt necessary for the creditors of this Committee to have a full understanding of the changes and implications made because there were a number of changes over this past weekend, plus today, and we wanted to be in a position to give a general overview observation to the Plan.
>
> The Committee has retained accounting and legal professionals in Canada and the United States. The Co-Chairs, as well as institutions serving on the Plan and U.S. Subcommittees with the assistance of the Committee's professionals have worked for the past seven to eight months evaluating the financial, economic and legal issues affecting the Plan for the unsecured creditors.
>
> In addition, the Committee and its Subcommittees have met frequently during the CCAA proceedings to discuss these issues. Unfortunately, the assets of OYDL are such that their ultimate values cannot be predicted in the short term. As a result, the recovery, if any, by the unsecured creditors cannot now be predicted.

> The alternative to approval of the CCAA Plan of arrangement appears to be a bankruptcy. The CCAA Plan of arrangement has certain advantages and disadvantages over bankruptcy. These matters have been carefully considered by the Committee.
>
> After such consideration, the members have indicated their intentions as follows . . .
>
> Twelve members of the Committee have today indicated they will vote in favour of the Plan. No members have indicated they will vote against the Plan. One member declined to indicate to the committee members how they wished to vote today. One member of the Plan was absent. Thank you.

48 After further discussion at the meeting of the unsecured creditors, the vote was taken. The Final Plan was approved by 83 creditors, representing 93.26 per cent of the creditors represented and voting at the meeting and 93.37 per cent in value of the claims represented and voting at the meeting.

49 As for the O & Y applicants, the impact of the Plan is to place OYDL in the position of property manager of the various projects, in effect for the creditors, during the Plan period. OYDL will receive income in the form of management fees for these services, a fact which gives some economic feasibility to the expectation that the company will be able to service its debt under the Plan. Should the economy improve and the creditors not realize upon their security, it may be that at the end of the period there will be some equity in the properties for the newly incorporated O & Y Properties and an opportunity for the shareholders to salvage something from the wrenching disembodiment of their once shining real estate empire.

50 In keeping with an exercise of weighing the equities and balancing the prejudices, another measure of what is "fair and reasonable" is the extent to which the proposed Plan treats creditors equally in their opportunities to recover, consistent with their security rights, and whether it does so in as non- intrusive and as non-prejudicial a manner as possible.

51 I am satisfied that the Final Plan treats creditors evenly and fairly. With the "drop out" clause entitling secured creditors to realize upon their security, should they deem it advisable at any time, all parties seem to be entitled to receive at least what they would receive out of a liquidation, i.e., as much as they would have received had there not been a reorganization: see Re NsC Diesel Power Inc. (1990), 79 C.B.R. (N.S.) 1, 97 N.S.R. (2d) 295 (T.D.). Potentially, they may receive more.

52 The Plan itself envisages other steps and certain additional proceedings that will be taken. Not the least inconsiderable of these, for example, is the proposed GW reorganization and contemplated arrangement under the Business Corporations Act, R.S.O. 1990, c. B.16. These further steps and

proceedings, which lie in the future, may well themselves raise significant issues that have to be resolved between the parties or, failing their ability to resolve them, by the court. I do not see this prospect as something which takes away from the fairness or reasonableness of the Plan but rather as part of grist for the implementation mill.

53 For all of the foregoing reasons, I find the Final Plan put forward to be "fair and reasonable".

54 Before sanction can be given to the Plan, however, there is one more hurdle which must be overcome. It has to do with the legal question of whether there must be unanimity amongst the classes of creditors in approving the Plan before the court is empowered to give its sanction to the Plan.

Lack of unanimity amongst the classes of creditors

55 As indicated at the outset, all of the classes of creditors did not vote in favour of the Final Plan. Of the 35 classes that voted, 27 voted in favour (overwhelmingly, it might be added, both in terms of numbers and percentage of value in each class). In eight of the classes, however, the vote was either against acceptance of the Plan or the Plan did not command sufficient support in terms of numbers of creditors and/or percentage of value of claims to meet the 50/75 per cent test of s. 6.

56 The classes of creditors who voted against acceptance of the Plan are in each case comprised of secured creditors who hold their security against a single project asset or, in the case of the Carena claims, against a single group of shares. Those who voted "no" are the following:

> Class 2 -- First Canadian Place Lenders Class 8 -- Fifth Avenue Place Bondholders Class 10 -- Amoco Centre Lenders Class 13 -- L'Esplanade Laurier Bondholders Class 20 -- Star Top Road Lenders Class 21 -- Yonge-Sheppard Centre Lenders Class 29 -- Carena Lenders
> Class 33a -- Bank of Nova Scotia Other Secured creditors

57 While s. 6 of the CCAA makes the mathematics of the approval process clear -- the Plan must be approved by at least 50 per cent of the creditors of a particular class representing at least 75 per cent of the dollar value of the claims in that class -- it is not entirely clear as to whether the Plan must be approved by every class of creditors before it can be sanctioned by the court. The language of the section, it will be recalled, is as follows:

> 6. Where a majority in number representing three-fourths in value of the creditors, or class of creditors . . . agree to any compromise or arrangement . . . the compromise or arrangement may be sanctioned by the court.

(Emphasis added)

58 What does "a majority . . . of the . . . class of creditors" mean? Presumably it must refer to

more than one group or class of creditors, otherwise there would be no need to differentiate between "creditors" and "class of creditors". But is the majority of the "class of creditors" confined to a majority within an individual class, or does it refer more broadly to a majority within each and every "class", as the sense and purpose of the Act might suggest?

59 This issue of "unanimity" of class approval has caused me some concern, because, of course, the Final Plan before me has not received that sort of blessing. Its sanctioning, however, is being sought by the applicants, is supported by all of the classes of creditors approving, and is not opposed by any of the classes of creditors which did not approve.

60 At least one authority has stated that strict compliance with the provisions of the CCAA respecting the vote is a prerequisite to the court having jurisdiction to sanction a plan: See Re Keddy Motor Inns Ltd., supra. Accepting that such is the case, I must therefore be satisfied that unanimity amongst the classes is not a requirement of the Act before the court's sanction can be given to the Final Plan.

61 In assessing this question, it is helpful to remember, I think, that the CCAA is remedial and that it "must be given a wide and liberal construction so as to enable it to effectively serve this . . . purpose": Elan Corp. v. Comiskey , supra, per Doherty J.A., at p. 307 O.R., p. 120 C.B.R. Speaking for the majority in that case as well, Finlayson J.A. (Krever J.A., concurring) put it this way, at p. 297 O.R., pp. 110-11 C.B.R.:

> It is well established that the CCAA is intended to provide a structured environment for the negotiation of compromises between a debtor company and its creditors for the benefit of both. Such a resolution can have significant benefits for the company, its shareholders and employees. For this reason the debtor companies . . . are entitled to a broad and liberal interpretation of the jurisdiction of the court under the CCAA.

62 Approaching the interpretation of the unclear language of s. 6 of the Act from this perspective, then, one must have regard to the purpose and object of the legislation and to the wording of the section within the rubric of the Act as a whole. Section 6 is not to be construed in isolation.

63 Two earlier provisions of the CCAA set the context in which the creditors' meetings which are the subject of s. 6 occur. Sections 4 and 5 state that where a compromise or an arrangement is proposed between a debtor company and its unsecured creditors (s. 4) or its secured creditors (s. 5), the court may order a meeting of the creditors to be held. The format of each section is the same. I reproduce the pertinent portions of s. 5 here only, for the sake of brevity. It states:

> 5. Where a compromise or an arrangement is proposed between a debtor company and its secured creditors or any class of them, the court may, on the application in a summary way of the company or of any such creditor . . . order a meeting of the creditors or class of creditors.

(Emphasis added)

64 It seems that the compromise or arrangement contemplated is one with the secured creditors (as a whole) or any class -- as opposed to all classes -- of them. A logical extension of this analysis is that, other circumstances being appropriate, the plan which the court is asked to approve may be one involving some, but not all, of the classes of creditors.

65 Surprisingly, there seems to be a paucity of authority on the question of whether a plan must be approved by the requisite majorities in all classes before the court can grant its sanction. Only two cases of which I am aware touch on the issue at all, and neither of these is directly on point.

66 In Re Wellington Building Corp., [1934] O.R. 653 (S.C.), Mr. Justice Kingstone dealt with a situation in which the creditors had been divided, for voting purposes, into secured and unsecured creditors, but there had been no further division amongst the secured creditors who were comprised of first mortgage bondholders, second, third and fourth mortgagees, and lienholders. Kingstone J. refused to sanction the plan because it would have been "unfair" to the bondholders to have done so (p. 661). At p. 660, he stated:

> I think, while one meeting may have been sufficient under the Act for the purpose of having all the classes of secured creditors summoned, it was necessary under the Act that they should vote in classes and that three-fourths of the value of each class should be obtained in support of the scheme before the Court could or should approve of it.

(Emphasis added)

67 This statement suggests that unanimity amongst the classes of creditors in approving the plan is a requirement under the CCAA. Kingstone J. went on to explain his reasons as follows (p. 660):

> Particularly is this the case where the holders of the senior securities' (in this case the bondholders') rights are seriously affected by the proposal, as they are deprived of the arrears of interest on their bonds if the proposal is carried through. It was never the intention under the Act, I am convinced, to deprive creditors in the position of these bondholders of their right to approve as a class by the necessary majority of a scheme propounded by the company; otherwise this would permit the holders of junior securities to put through a scheme inimical to this class and amounting to confiscation of the vested interest of the bondholders.

68 Thus, the plan in Re Wellington Building Corp. went unsanctioned, both because the bondholders had unfairly been deprived of their right to vote on the plan as a class and because they would have been unfairly deprived of their rights by the imposition of what amounted to a confiscation of their vested interests as bondholders.

69 On the other hand, the Quebec Superior Court sanctioned a plan where there was a lack of unanimity in Multidev Immobilia Inc. v. S.A. Just Invest (1988), 70 C.B.R. (N.S.) 91, [1988] R.J.Q. 1928 (S.C.). There, the arrangement had been accepted by all creditors except one secured creditor, S.A. Just Invest. The company presented an amended arrangement which called for payment of the objecting creditor in full. The other creditors were aware that Just Invest was to receive this treatment. Just Invest, nonetheless, continued to object. Thus, three of eight classes of creditors were in favour of the plan; one, Bank of Montreal, was unconcerned because it had struck a separate agreement; and three classes of which Just Invest was a member, opposed.

70 The Quebec Superior Court felt that it would be contrary to the objectives of the CCAA to permit a secured creditor who was to be paid in full to upset an arrangement which had been accepted by other creditors. Parent J. was of the view that the Act would not permit the court to ratify an arrangement which had been refused by a class or classes of creditors (Just Invest), thereby binding the objecting creditor to something that it had not accepted. He concluded, however, that the arrangement could be approved as regards the other creditors who voted in favour of the Plan. The other creditors were cognizant of the arrangement whereby Just Invest was to be fully reimbursed for its claims, as I have indicated, and there was no objection to that amongst the classes that voted in favour of the Plan.

71 While it might be said that Multidev, supra, supports the proposition that a Plan will not be ratified if a class of creditors opposes, the decision is also consistent with the carving out of that portion of the Plan which concerns the objecting creditor and the sanctioning of the balance of the Plan, where there was no prejudice to the objecting creditor in doing so. To my mind, such an approach is analogous to that found in the Final Plan of the O & Y applicants which I am being asked to sanction.

72 I think it relatively clear that a court would not sanction a plan if the effect of doing so were to impose it upon a class, or classes, of creditors who rejected it and to bind them by it. Such a sanction would be tantamount to the kind of unfair confiscation which the authorities unanimously indicate is not the purpose of the legislation. That, however, is not what is proposed here.

73 By the terms of the Final Plan itself, the claims of creditors who reject the Plan are to be treated as "unaffected claims" not bound by its provisions. In addition, secured creditors are entitled to exercise their realization rights either immediately upon the "consummation date" (March 15, 1993) or thereafter, on notice. In short, even if they approve the Plan, secured creditors have the right to drop out at any time. Everyone participating in the negotiation of the Plan and voting on it, knew of this feature. There is little difference, and little different effect on those approving the Plan, it seems to me, if certain of the secured creditors drop out in advance by simply refusing to approve the Plan in the first place. Moreover, there is no prejudice to the eight classes of creditors which have not approved the Plan, because nothing is being imposed upon them which they have not accepted and none of their rights is being "confiscated".

74 From this perspective it could be said that the parties are merely being held to -- or allowed to follow -- their contractual arrangement. There is, indeed, authority to suggest that a plan of compromise or arrangement is simply a contract between the debtor and its creditors, sanctioned by the court, and that the parties should be entitled to put anything into such a plan that could be lawfully incorporated into any contract: see Re Canadian Vinyl Industries Inc. (1978), 29 C.B.R. (N.S.) 12 (Que. S.C.), at p. 18; Houlden & Morawetz, Bankruptcy Law of Canada, vol. 1 (Toronto: Carswell, 1984), pp. E-6 and E-7.

75 In the end, the question of determining whether a plan may be sanctioned when there has not been unanimity of approval amongst the classes of creditors becomes one of asking whether there is any unfairness to the creditors who have not approved it, in doing so. Where, as here, the creditors classes which have not voted to accept the Final Plan will not be bound by the Plan as sanctioned, and are free to exercise their full rights as secured creditors against the security they hold, there is nothing unfair in sanctioning the Final Plan without unanimity, in my view.

76 I am prepared to do so.

77 A draft order, revised as of late this morning, has been presented for approval. It is correct to assume, I have no hesitation in thinking, that each and every paragraph and subparagraph, and each and every word, comma, semicolon, and capital letter has been vigilantly examined by the creditors and a battalion of advisers. I have been told by virtually every counsel who rose to make submissions, that the draft as it exists represents a very "fragile consensus", and I have no doubt that such is the case. Its wording, however, has not received the blessing of three of the classes of project lenders who voted against the Final Plan -- the First Canadian Place, Fifth Avenue Place and L'Esplanade Laurier Bondholders.

78 Their counsel, Mr. Barrack, has put forward their serious concerns in the strong and skilful manner to which we have become accustomed in these proceedings. His submission, put too briefly to give it the justice it deserves, is that the Plan does not and cannot bind those classes of creditors who have voted "no", and that the language of the sanctioning order should state this clearly and in a positive way. Paragraph 9 of his factum states the argument succinctly. It says:

> 9. It is submitted that if the Court chooses to sanction the Plan currently before it, it is incumbent on the Court to make clear in its Order that the Plan and the other provisions of the proposed Sanction Order apply to and are binding upon only the company, its creditors in respect of claims in classes which have approved the Plan, and trustees for such creditors.

79 The basis for the concern of these "no" creditors is set out in the next paragraph of the factum, which states:

> 10. This clarification in the proposed Sanction Order is required not only to ensure that the Order is only binding on the parties to the compromises but also

> to clarify that if a creditor has multiple claims against the company and only some fall within approved classes, then the Sanction Order only affects those claims and is not binding upon and has no effect upon the balance of that creditor's claims or rights.

80 The provision in the proposed draft order which is the most contentious is para. 4 thereof, which states:

> 4. THIS COURT ORDERS that subject to paragraph 5 hereof the Plan be and is hereby sanctioned and approved and will be binding on and will enure to the benefit of the Applicants and the Creditors holding Claims in Classes referred to in paragraph 2 of this Order in their capacities as such Creditors.

81 Mr. Barrack seeks to have a single, but much debated word -- "only" -- inserted in the second line of that paragraph after the word "will", so that it would read "and will only be binding on . . . the Applicants and the Creditors holding Claims in Classes [which have approved the Plan]". On this simple, single word, apparently, the razor-thin nature of the fragile consensus amongst the remaining creditors will shatter.

82 In the alternative, Mr. Barrack asks that para. 4 of the draft be amended and an additional paragraph added as follows:

> 35. It is submitted that to reflect properly the Court's jurisdiction, paragraph 4 of the proposed Sanction Order should be amended to state:
>
> 4. This Court Orders that the Plan be and is hereby sanctioned and approved and is binding only upon the Applicants listed in Schedule A to this Order, creditors in respect of the claims in those classes listed in paragraph 2 hereof, and any trustee for any such class of creditors.
>
> 36. It is also submitted that any additional paragraph should be added if any provisions of the proposed Sanction Order are granted beyond paragraph 4 thereof as follows:
>
> This Court Orders that, except for claims falling within classes listed in paragraph 2 hereof, no claims or rights of any sort of any person shall be adversely affected in any way by the provisions of the Plan, this Order or any other Order previously made in these proceedings.

83 These suggestions are vigorously opposed by the applicants and most of the other creditors.

Acknowledging that the Final Plan does not bind those creditors who did not accept it, they submit that no change in the wording of the proposed order is necessary in order to provide those creditors with the protection to which they say they are entitled. In any event, they argue, such disputes, should they arise, relate to the interpretation of the Plan, not to its sanctioning, and should only be dealt with in the context in which they subsequently arise if arise they do.

84 The difficulty is that there may or may not be a difference between the order "binding" creditors and "affecting" creditors. The Final Plan is one that has specific features for specific classes of creditors, and as well some common or generic features which cut across classes. This is the inevitable result of a Plan which is negotiated in the crucible of such an immense corporate restructuring. It may be, or it may not be, that the objecting project lenders who voted "no" find themselves "affected" or touched in some fashion, at some future time by some aspect of the Plan. With a reorganization and corporate restructuring of this dimension it may simply not be realistic to expect that the world of the secured creditor, which became not-so-perfect with the onslaught of the applicants' financial difficulties, and even less so with the commencement of the CCAA proceedings, will ever be perfect again.

85 I do, however, agree with the thrust of Mr. Barrack's submissions that the sanction order and the Plan can be binding only upon the applicants and the creditors of the applicants in respect of claims in classes which have approved the Plan, and trustees for such creditors. That is, in effect, what the Final Plan itself provides for when, in s. 6.2 (c), it stipulates that, where classes of creditors do not agree to the Plan,

> (i) the applicants shall treat such class of claims to be an unaffected class of claims; and,
> (ii) the applicants shall apply to the court "for a Sanction Order which sanctions the Plan only insofar as it affects the Classes which have agreed to the Plan".

86 The Final Plan before me is therefore sanctioned on that basis. I do not propose to make any additional changes to the draft order as presently presented. In the end, I accept the position, so aptly put by Ms. Caron, that the price of an overabundance of caution in changing the wording may be to destroy the intricate balance amongst the creditors which is presently in place.

87 In terms of the court's jurisdiction, s. 6 directs me to sanction the order, if the circumstances are appropriate, and enacts that, once I have done so, the order "is binding . . . on all the creditors or the class of creditors, as the case may be, and on any trustee for any such class of creditors . . . and on the company". As I see it, that is exactly what the draft order presented to me does.

88 Accordingly, an order will go in terms of the draft order marked "revised Feb. 5, 1993", with the agreed amendments noted thereon, and on which I have placed my fiat.

89 These reasons were delivered orally at the conclusion of the sanctioning hearing which took

place on February 1 and February 5, 1993. They are released in written form today.

Counsel:

COUNSEL FOR SANCTIONING HEARING ORDER SCHEDULE "A"

[para90] David A. Brown, Q.C., Yoine Goldstein, Q.C., Stephen Sharpe and Mark E. Meland, for Olympia & York.

[para91] Ronald N. Robertson, Q.C., for Hong Kong & Shanghai Banking Corp.

[para92] David E. Baird, Q.C., and Patricia Jackson, for Bank of Nova Scotia.

[para93] Michael Barrack and S. Richard Orzy, for First Canadian Place Bondholders, Fifth Avenue Place Bondholders and L'Esplanade Laurier Bondholders.

[para94] William G. Horton, for Royal Bank of Canada.

[para95] Peter Howard and J. Superina, for Citibank Canada.

[para96] Frank J.C. Nebould, Q.C., for Unsecured/Under Secured Creditors Committee.

[para97] John W. Brown, Q.C., and J.J. Lucki, for Canadian Imperial Bank of Commerce.

[para98] Harry Fogul and Harold S. Springer, for The Exchange Tower Bondholders

[para99] Allan Sternberg and Lawrence Geringer, for O & Y Eurocreditco Debenture Holders.

[para100] Arthur O. Jacques and Paul M. Kennedy, for Bank of Nova Scotia, Agent for Scotia Plaza Lenders.

[para101] Lyndon Barnes and J.E. Fordyce, for Crédit Lyonnais, Cr edit Lyonnais Canada.

J. Carfagnini, for National Bank of Canada.

J.L. McDougall, Q.C., for Bank of Montreal.

[para102] Carol V. E. Hitchman, for Bank of Montreal (Phase I First Canadian Place).

[para103] James A. Grout, for Credit Suisse.

[para104] Robert I. Thornton, for I.B.J. Market Security Lenders.

C. Carron, for European Investment Bank.

[para105] W.J. Burden, for some debtholders of O & Y Commercial Paper II Inc.

G.D. Capern, for Robert Campeau.

[para106] Robert S. Harrison and A.T. Little, for Royal Trust Co. as trustee.

Order accordingly.

Case Name:

**IFP Technologies (Canada) Inc. v.
Encana Midstream and Marketing**

**Between
IFP Technologies (Canada) Inc., Plaintiff
(Defendant by Counterclaim), and
Encana Midstream and Marketing, PanCanadian
Resources, Encana Corporation,
Encana Oil & Gas Developments Ltd., Canadian
Forest Oil Ltd. and The Wiser
Oil Company, Defendants (Plaintiffs by Counterclaim)**

[2014] A.J. No. 883

2014 ABQB 470

Docket: 0301 03520

Registry: Calgary

Alberta Court of Queen's Bench

N.C. Wittmann C.J.Q.B.

Heard: January 24, 25, 31, February 1-4,
7-10, 14-18, 22-25, 28, March 1-4,
7-10, 11, 14 and June 29, 30, 2011.
Judgment: July 30, 2014.

(413 paras.)

Natural resources law -- Oil and gas -- Lease or license for production -- Working interest -- Farmout -- Terms and conditions -- Terms -- Contracts -- Breach and default -- Action by IFP seeking damages from PCR for breach of contract dismissed -- PCR provided IFP with interest in enhanced heavy oil production from reservoir in exchange for enhanced recovery technology -- PCR changed its focus to other projects and transferred its interest in reservoir to Wiser, which intended to produce oil using primary wells only -- Transfer triggered IFP's ROFR, but once this

was waived, IFP unreasonably withheld consent to transfer -- Neither PCR nor Wiser bound to use enhanced recovery or to refrain from primary production at reservoir.

Action by IFP seeking damages from PCR for breach of contract. It claimed PCR farmed out its interest in Eyehill Creek reservoir without IFP's consent, thereby making it impossible for IFP to realize on its minority interest. PCR granted IFP a 20 per cent interest in the reservoir for the purpose of developing heavy oil resources located there through the use of enhanced recovery methods developed by IFP. As the years passed and oil prices fell, development of wells on the reservoir became less of a priority for PCR because of better opportunities elsewhere. PCR ultimately disposed of its interest in the reservoir, entering into an agreement with Wiser providing Wiser with the right to earn PCR's working interests in the reservoir in exchange for Wiser assuming PCR's liabilities to deal with the existing wells there. Initially, IFP expressed no concerns with the PCR/Wiser agreement. When Wiser sought from IFP an acknowledgement and agreement regarding its limited interest, IFP waiver its ROFR but refused to consent to the disposition to Wiser on the basis Wiser had no technical capability of intent to pursue thermal or other enhanced recovery methods. Wiser and PCR nonetheless completed their agreement. The present litigation ensued.

HELD: Action dismissed. The Wiser/PCR transaction triggered IFP's ROFR. Once IFP waived its ROFR, its consent was required for the transaction. IFP unreasonably withheld its consent to the transaction on the grounds Wiser did not intend to initiate enhanced oil recovery and refrain from primary production, where PCR had no obligation to conduct itself otherwise. IFP retained its interest in thermal and other enhanced recovery at the reservoir.

Statutes, Regulations and Rules Cited:

Alberta Rules of Court, Rule 13.1

Petroleum and Natural Gas Tenure Regulation, Alta. Reg. 263/97, s. 18(8)

Counsel:

Paul Edwards, Counsel for the Plaintiff/Defendant by Counterclaim.

Rinus de Waal, Co-counsel for the Plaintiff/Defendant by Counterclaim.

Grant N. Stapon, Q.C., Laurie A. Goldbach, Lawrence D. Ator, Counsel for the Defendants/Plaintiffs by Counterclaim.

Table of Contents

I. Introduction 3
II. The Parties 4
III. Witnesses 4
IV. Factual Background and Contractual Relationship Between IFP and PCR 5
A. Factual background 5
B. Key contractual provisions 12
1. Asset Exchange Agreement 12
2. Joint Operating Agreement and Operating Procedure 17
3. Abandonment Reclamation and Option Agreement ("ARO") between PCR and Wiser. 25
V. Position of the Parties 25
VI. Preliminary Issues 26
A. Evidentiary issues 26
1. Exhibits for identification only 26
2. Adverse inference – Severin Saden 27
B. Legal issue 28
1. Did the farmout to Wiser trigger IFP's right of first refusal and the consent requirement? 28
VII. Core Issues 29
A. Did IFP act unreasonably when it withheld its consent to PCR's proposed disposition to Wiser? 29
1. Right of first refusal and consent 29
2. General legal principles 30
3. Argument and Analysis 32
4. What is the relevance of the reasonable expectations of the parties? 37
5. What is the effect of IFP's unreasonable withholding of consent? 40
6. Has the opportunity to pursue a thermal or other enhanced recovery project at Eyehill Creek been destroyed or damaged? 41
VIII. Damages 50
A. General principles for loss of opportunity damages 50
B. Evaluating the Lost Opportunity 51

1. Did IFP have a real, as opposed to fanciful, opportunity to participate in a thermal or other enhanced recovery project at Eyehill Creek? 51
2. What value can be attributed to the loss of opportunity at Eyehill Creek? 52
3. What is the likelihood IFP would have realized on this opportunity? What other risks need to be considered? 65
C. Did IFP fail to mitigate its damages? 69
D. Accounting of profits from Canadian Forest 71
E. Effect of contractual limitation of liability 72
IX. Conclusion 72
X. Counterclaim and Costs 73

Reasons for Judgment

N.C. WITTMANN C.J.Q.B.:--

I. Introduction

1 This is a claim for damages arising out of an alleged breach of contract. The Plaintiff, IFP Technologies (Canada) Inc. ("IFP"), claims the Defendant, PanCanadian Resources, breached its contract with IFP when it farmed out its interest in the Eyehill Creek reservoir without IFP's consent. The Plaintiff submits the natural consequence of this disposition was to make it impossible or impracticable for the Plaintiff to realize upon its minority interest. The Plaintiff seeks damages for this lost opportunity.

2 The Defendants argue there was no breach of contract. They suggest this is a case of a sophisticated business entity inviting the Court to re-write its contract to give it a better deal than the one for which it originally bargained.

3 The Defendants counterclaim for a declaration that the Plaintiff wrongfully withheld its consent to the farmout and for solicitor and own client costs pursuant to the main agreement between the parties.

4 Mr. Justice Ron Stevens heard the trial between January 31 and March 14, 2011 and oral argument on June 29 and 30, 2011. Mr. Justice Stevens passed away on Tuesday, May 13, 2014. Rule 13 .1 of the Alberta Rules of Court provides:

13.1 One judge may act in place of or replace another judge if

(a) that other judge dies,

(b) that other judge ceases to be a judge, or

(c) it is inconvenient, improper, inappropriate or impossible for that other judge to act.

5 Pursuant to Rule 13.1, I took conduct of this matter. I contacted counsel for the parties and they confirmed that this matter could be fairly decided on the record. I agreed to proceed accordingly.

II. The Parties

6 IFP is a body corporate incorporated under the laws of Quebec and extra-provincially registered in Alberta. IFP is wholly owned by IFP Energies Nouvelles, formerly known as l'Institut Français du Pétrole ("IFP France").

7 The Defendant Encana Midstream and Marketing was a partnership registered in and carrying on business in Alberta. At the time the causes of action accrued, the partnership was

known as PanCanadian Resources ("PCR"). In October 2005, PCR was dissolved and its assets and liabilities were assigned to the partners -- Encana Corporation and Encana Heritage Lands. Encana Heritage Lands was dissolved in October 2009 and its assets were wound up into Encana Corporation.

8 The Defendant Encana Corporation is a body corporate incorporated under the laws of Canada; it is the corporate successor to PanCanadian Petroleum Limited. At the time the causes of action accrued, PanCanadian Petroleum Limited was the managing partner of PCR. Nothing turns on the distinctions among these corporate entities, so I will use the abbreviation "PCR" throughout this judgment to refer to one or both entities. Effective November 2009, Encana Corporation was split into two energy companies, Cenovus Energy Inc. and Encana Corporation.

9 The Defendant Encana Oil & Gas Developments Ltd. (formerly known as 592284 Alberta Ltd.) is a body corporate incorporated under the laws of Alberta. At the time the causes of action accrued, it was one of PCR's partners.

10 The Defendant Canadian Forest Oil Ltd. ("Canadian Forest") is a body corporate incorporated under the laws of Alberta; it is a corporate successor to The Wiser Oil Company of Canada. The Defendant The Wiser Oil Company is a body corporate incorporated under the laws of Delaware and extra-provincially registered in Alberta. Throughout these reasons, I will refer to The Wiser Oil

Company of Canada and The Wiser Oil Company as "Wiser".

III. Witnesses

11 The Plaintiff and Defendants called a number of fact and expert witnesses throughout the six-week trial. The Plaintiffs fact witnesses included Eric Delamaide, IFP's general manager in Canada, and Erik Verbraeken, IFP France's legal counsel. Its expert witnesses included Dr. Brad Hayes, David Kisilevsky, Dr. John Carey, Todd White, Richard Baker, Bob Shepherd, Lew Hayes, and Ian Clark. The Plaintiff also read-in the expert evidence of Barry Parker.

12 The Defendants also called a number of fact witnesses, primarily former and current employees of PCR and Encana, including Simon Gittins, senior reservoir and production engineer at PCR, Greg Sinclair, PCR's senior landman, Wayne Sampson, land manager at PCR after its merger with CS Resources Limited, Mark Montemurro, general manager of the heavy oil business unit and later general manager of information services for PCR, and Laureen Little, manager of oil sands development at PCR. The Defendants also presented as witnesses former employees of Canadian Forest and Wiser: Craig Seal, manager of engineering and exploitation at Canadian Forest and Robert Pankiw, project leader for heavy oil and shallow gas at Wiser and later a member of Canadian Forest's heavy oil exploitation and operations team. Brent Grocock was called to give evidence regarding oil field samples he had taken. The Defendants' expert witnesses included Dr. Brant Bennion, James O'Byrne, Michael Uland, and Doug Hollies.

13 I have relied upon the fact witness testimony in setting out the factual background and contractual relationship between IFP and PCR. I will refer to further witness testimony, including expert evidence, in relation to each issue.

IV. Factual Background and Contractual Relationship Between IFP and PCR

A. Factual background

14 At the start of trial, the parties provided a Statement of Agreed Facts along with more than 500 Agreed Exhibits. In their written argument after trial, the parties further coordinated their factual submissions. I provide the following summary of the facts drawing upon these joint resources as well as witness testimony.

15 In the late 1980s and early 1990s, CS Resources Limited ("CS Resources") was a pioneer in the exploitation of heavy oil using horizontal wells. During this time, it had a business relationship with IFP France, which had a wide range of technological expertise relating to petroleum research and development.

16 In February 1988, Société Nationale ELF Aquitaine Production ("SNEAP"), IFP France and CS Resources entered into a Technology Licensing Agreement ("TLA") pursuant to which SNEAP and IFP France granted CS Resources a licence over certain expertise and technical information

relating to the drilling, placement and completion of horizontal wells for the enhanced production of oil and gas (the "Technology") in return for a 3% gross overriding royalty on all lands held or acquired by CS Resources on which the Technology was used. CS Resources could terminate the TLA on 60 days written notice.

17 In April 1990, SNEAP assigned its rights under the TLA to IFP France. In March 1993, IFP France assigned those rights to IFP with CS Resources' consent.

18 At the same time, IFP France and CS Resources entered into a Cooperation Agreement pursuant to which they agreed to extend their collaboration to other technologies that could be linked to the Technology and that could be applied by CS Resources to its field developments. They agreed any production of oil and gas using such other technologies would be subject to the 3% gross overriding royalty payable to IFP under the TLA.

19 By 1997, CS Resources was using the Technology and other technologies to produce oil and gas from certain properties and paid IFP the 3% gross overriding royalty pursuant to the above-described agreements. The IFP royalty on CS Resources' property averaged $3,825/month from January to June 1997.

20 In July 1997, PCR acquired CS Resources. PCR combined the CS Resources properties with its own properties into a single business unit known as the Van Horne business unit. After taking control of CS Resources, PCR expressed its desire to terminate the TLA with IFP and redefine their relationship with the intent to jointly develop and implement new technologies.

21 One of the heavy oil properties of the Van Horne business unit was located in Township 38, Range 1 W4M, Alberta, one township to the west of the border between Alberta and Saskatchewan, south of the City of Lloydminster. PCR first referred to it as the North Bodo property and later as the Eyehill Creek property ("Eyehill Creek"). Prior to 1997, approximately 222 wells had been drilled on the Eyehill Creek lands. By1998, PCR had shut in the still-producing wells.

22 In January 1998, the Van Horne business unit, based on simulations and preliminary economics, identified Eyehill Creek as an attractive potential candidate for development using steam-assisted gravity drainage ("SAGD"). SAGD is a type of enhanced oil recovery ("EOR") process. The general objective of EOR methods is to extract a larger portion of the oil located in a reservoir than is possible through conventional or primary wells, which rely solely on the reservoir's natural energy or drive. SAGD is one of several thermal EOR processes designed for heavy oil reservoirs. In a traditional SAGD project, two horizontal wells are drilled one above the other. Steam is injected into the upper well; the steam renders the oil less viscous and the oil flows down towards the lower, producer well.

23 In April 1998, PCR suggested Eyehill Creek as a property in which IFP might be granted a working interest as part of the consideration for terminating the gross overriding royalty it received under the TLA. Based on the preliminary review of the Eyehill Creek property, PCR's heavy oil

team concluded it was the best thermal project candidate.

24 In August 1998, PCR shared with IFP its preliminary plan for the "Eyehill Creek Thermal Project." The plan was still at an early conceptual phase with many unanswered questions about the project. In this plan, PCR divided the project into two areas: an "undepleted area" it intended to exploit first (south 1/2 of section 16, north 1/2 of section 9 and west 1/2 of section 20) and a "depleted area" to be developed later (north 1/2 of section 16, southwest 1/4 of section 21, southeast 1/4 of section 20 and northeast 1/4 of section 17). Sections 9, 17 and 21 were PCR Fee Land, while sections 16 and 20 were Crown Land.

25 The "depleted" area was so named because the reservoir pressures had been altered due to primary production and PCR expected drilling challenges there arising from low reservoir pressure and potential wormhole development (wormholes are long skinny channels running through the reservoir sand). The preliminary plan focused on the undepleted section 9 and large portions of section 16 as the best suited to SAGD drilling operations; however, the depleted sections were a critical part of the project. Mr. Montemurro explained the economics were very modest on an after-tax basis and the reserves in the undepleted sections were insufficient to justify the capital; to be viable the project also required the depleted pool in spite of the incremental drilling risks. There were an estimated 29 million barrels of original oil in place ("OOIP") in the undepleted area and an estimated 32 million barrels OOIP in the depleted area (of which about 3 million barrels had been produced by primary production).

26 Mr. Gittins explained in testimony that a more detailed technical assessment was needed before bringing any proposals to management. In general, however, PCR believed primary production was finished in the Eyehill Creek area and the field should be considered abandoned if production was limited to primary only.

27 IFP was interested in Eyehill Creek because of its SAGD potential. Erik Verbraeken, IFP France's Legal Counsel, explained the deal with PCR presented an opportunity to become a more active player in Canadian oil fields and to implement IFP's technologies in real field conditions. IFP had expertise in relation to reservoir studies, but PCR had the operational expertise that IFP lacked and from which it wished to benefit. Mr. Montemurro testified that IFP brought technical expertise to meetings between the parties in relation to reservoir engineering, modelling and simulation work, and geophysical techniques. Around this time, Eric Delamaide, formerly a reservoir engineer with IFP France became IFP's General Manager in Canada. His primary task was to promote cooperation between IFP and PCR; he shared space in PCR's Calgary office.

28 In May 1998, at PCR and IFP's request, Dobson Resource Management Ltd. ("Dobson") carried out an independent third party reserve and economic evaluation of Eyehill Creek upon which PCR and IFP could rely in their negotiations. Dobson prepared its evaluation assuming PCR planned to extract the oil from the Eyehill Creek lands with the installation of facilities for a SAGD project. Dobson also prepared an economic evaluation of IFP's existing royalty interest and

estimated its value to be $5.88 million using the June 1997 price forecast and differentials. By May 1998, the price forecast had worsened and the value of the royalty was significantly reduced.

29 In July 1998, PCR and IFP executed a Memorandum of Understanding ("MOU") to redefine their relationship following the termination of the TLA. It stated that it was the mutual intent of IFP and PCR to optimize the development of these lands through the implementation of the technology development program including the application of thermal or other enhanced recovery technologies. The MOU proposed to grant IFP "a 20% working interest in Eyehill Creek, whether such development and production is of a primary, assisted or enhanced nature."

30 On October 26, 1998, PCR and IFP entered into an Asset Exchange Agreement (the "AEA") in which IFP gave up its overriding royalty from the TLA in exchange for working interests in Eyehill Creek and Pelican Lake, and a royalty in one of the formations of Pelican Lake. Appended to and incorporated into the AEA as Schedules were a number of other Agreements including Schedule F Eyehill Creek Joint Operating Agreement ("JOA") and Schedule G Technology Development Agreement ("TDA"). Appended to the JOA as Schedules were Schedule B Operating Procedure (a modified version of the standard operating procedure developed by the Canadian Association of Petroleum Landmen known as the 1990 CAPL Operating Procedure) and Schedule C Assignment Procedure (the 1993 CAPL Assignment Procedure).

31 The AEA was negotiated principally between Mark Montemurro, PCR's general manager of the heavy oil business unit at that time, and Severin Saden, head of IFP France's legal department and president of IFP Canada, with the assistance of Erik Verbraeken, IFP France's in-house legal counsel and with the further assistance of outside counsel familiar with Alberta oil and gas agreements. Wayne Sampson, a PCR land manager, was involved in the JOA negotiations. It too was negotiated with the assistance of legal counsel.

32 For tax purposes it was necessary for the parties to ascribe a value to the assets being exchanged under the AEA. The agreed value was $16 million; IFP internally allocated $14.8 million of this amount to Eyehill Creek.

33 A key issue in this dispute is the nature of IFP's working interest. While the MOU set out the intention that IFP's 20% working interest would relate to all development and production, whether primary, assisted or enhanced, the JOA purports to limit the parties' working interests to thermal and other enhanced recovery. The JOA relieves IFP of any liability for abandonment obligations related to primary operations. The evidence at trial indicated that it was important to IFP to limit its liability in this regard. I will discuss the relevant contractual clauses and my conclusions in more detail below.

34 In November 1998, the price forecast for gas had increased, changing the economics of the proposed project. Mr. Gittins explained the cost of gas required for the project would have been more than half the total operating cost. He testified that as the economics of the project worsened, the amount of effort put into it diminished.

35 On February 10, 1999, Mark Montemurro sent an internal confidential email explaining that low oil prices have created "a serious resource (capital and people) competition" placing heavy oil in direct competition with many of PCR's other opportunities. He explained that senior management's focus would be on the development of Christina Lake rather than other heavy oil channels such as Eyehill Creek. Nonetheless, some development work at Eyehill Creek continued so as to be ready when prices improved. In particular, there was work on regulatory approval, ground water confirmation, royalty negotiation, and discussions with partners, including IFP.

36 By July 1999, PCR had identified three options for Eyehill Creek: 1) build a new grassroots thermal facility at Eyehill Creek after cleaning up dumps, waste pile sites, unused tankage, pads, etc. not required for such a facility; 2) place PCR's Senlac facility at Eyehill Creek after completing the same cleanup described in option 1 and removing all of the main existing facilities; and 3) divest Eyehill Creek immediately along with all liability, cleanup and reclamation obligations or enter into a partnering/joint venture arrangement with a third party to exploit the field. While PCR engaged in this internal priority setting, IFP had little to no involvement Eyehill Creek.

37 In February 2000, the Alberta Energy and Utilities Board (the "AEUB") approved PCR's application for a SAGD operation at Christina Lake, a project with an estimated 3 billion barrels of OOIP. Mr. Gittins testified the approval set the wheels in motion to develop Christina Lake and required immediate testing of various SAGD well designs. PCR's Senlac property, already in existence, became the SAGD testing ground for Christina Lake. By August 2000, PCR decided it was no longer interested in the thermal potential at Eyehill Creek.

38 In April 2000, PCR's lease with respect to petroleum and natural gas rights in the west half of section 20-38-1 W4M (the "West 1/2 of section 20") expired. By letter dated May 25, 2000, Alberta Resource Development notified PCR of the expiry of the lease. The letter advised that the AEUB would be in touch regarding the 29 shut-in wells remaining on the lands.

39 PCR belatedly applied to continue the lease on the West 1/2 of section 20. By letter dated July 11, 2000, the Crown rejected PCR's late application for continuation. In June 2000, the AEUB issued 29 notices to PCR, one for each non-producing well, requiring PCR to prove its right to produce from the wells within 30 days, failing which PCR would have to abandon the wells. PCR did not forward these notices to IFP in spite of IFP's ownership of a working interest in the lands. After the lease expiry and subsequent AEUB notices, Mr. Sinclair, PCR's senior landman, was "given the property full time" and told "to get the ship righted."

40 The West 1/2 of section 20 was offered for tender at a Crown land sale held in November 2000. PCR tried to repurchase the lease but was outbid by Wiser who offered in excess of $1 million; PCR had bid only $1800. Needless to say, the Crown accepted Wiser's bid. The AEUB granted a variety of extensions to the deadline for commencing work on abandonment of the wells on the West 1/2 of section 20 until Wiser had time to abandon some wells and commence production on others.

41 Meanwhile, on August 31, 2000, Alberta Resource Development issued further notices to PCR pursuant to section 18(8) of the *Petroleum and Natural Gas Tenure Regulation*, Alta Reg 263/97 for parts of sections 16, 20, and 28, informing PCR that it had one year from the date of the notices to provide evidence satisfying the Department that the lands in question were capable of producing petroleum or natural gas in paying quantities. Otherwise the rights under the notices would expire and the leases would be amended accordingly. Mr. Sinclair explained the notices required PCR to have one economically producing well per spacing unit within the year.

42 IFP was not given copies of these notices. Mr. Sinclair suggested in his direct testimony that IFP's working interest had not yet been triggered since there was no thermal development, thus IFP had no liability for the costs associated with bringing primary wells onto production to save the leases. In cross-examination, he admitted that everyone recognized IFP had an interest in the property. Nonetheless, he did not keep IFP informed, explaining that he thought it unnecessary given primary production had to be undertaken:

> ...if we didn't get the lands producing, we were going to have to go out there and abandon and when we abandoned all the wells all the leases would have died and the contracts along with them.

He added that if PCR was abandoning some wells it would abandon everything on the Eyehill Creek lands:

> "If we were out there doing that scale of abandonment we would have abandoned the lands on our fee title as well."

43 After receipt of the s 18(8) notices, Mr. Sinclair consulted with the technical team. He learned PCR had been experimenting with about three wells per month in an attempt to produce economically, but couldn't find a way to make it work. Laureen Little testified that one well on section 28 was started in May, but was shut in one month later because the value of the flared gas was exceeding the value of the produced oil. Another well in section 28 and several wells in section 29 were very gassy and fluid levels were unreliable. PCR also produced from seven vertical wells in section 21. These wells were originally drilled pre-1990 and were relatively good wells. Yet, oil prices were about $9/bbl while operating costs were $8/bbl, making primary production a negligibly profitable enterprise.

44 Mr. Sinclair testified that while it is sometimes possible to obtain a lease continuation with little more than a project proposal, PCR was not in a position to present a thermal project to the Crown at that time. He explained:

> In the case of Eyehill Creek we did not have that passive management support at this point to go forward. For several reasons internally they looked at this facility -- this property as 10,000 barrels a day on average and it was just deemed to be too small to compete for the limited technical resources we had in house and the

> limited capital we had in house, so to go to the Crown and cobble together a plan to do thermal there when you believed it wasn't going to happen would be unethical in my opinion.

45 Faced with these abandonment liabilities, leases that were about to expire if production was not planned (including on section 16) and low prices for heavy oil, PCR determined that developing Eyehill Creek no longer fit its business model. Given Wiser's bid for the West 1/2 of section 20, PCR concluded it might be interested in additional lands in the area. PCR and Wiser began negotiating with respect to Wiser's acquisition of PCR's Eyehill Creek assets in exchange for Wiser's assumption of an abandonment liability estimated to be in the range of $10 to $15 million on the existing conventional wells.

46 By early 2001, no EOR operations had been undertaken in the Eyehill Creek area. In February 2001, PCR gave IFP informal notice of the pending agreement with Wiser by giving Mr. Delamaide, IFP's general manager in Canada, a copy of the draft letter agreement which Mr. Delamaide showed to Mr. Saden. IFP did not raise any concerns about the proposed deal or complain that it permitted primary production or new wells; nor did IFP suggest that a counteroffer or complaint should be made on its behalf.

47 In March 2001, PCR and Wiser executed a letter agreement (the "Letter Agreement"), setting out the parties' intentions to give Wiser the right to earn PCR's working interests in Eyehill Creek in exchange for dealing with the 222 pre-existing wells on the lands, by abandoning or reclaiming wells, re-working or placing shut-in wells on production, or converting wells to injector wells. Wiser was also given the opportunity to drill and abandon or produce new wells on the lands. The Letter Agreement stated PCR was acting on behalf of all the working interest owners, including IFP.

48 If Wiser did not complete the program in accordance with the proposed Abandonment, Reclamation and Option Agreement ("ARO"), it would earn no interest whatsoever in the assets. In the interim, it would act as PCR's operator. Ms. Little testified it was an unusual farmout agreement. Normally in a farmout arrangement the other company drills wells to earn land, but in this case the land would be earned through abandoning the wells.

49 On April 19, 2001, pursuant to Clause 2401B of the 1990 CAPL Operating Procedure, PCR sent IFP a Right of First Refusal ("ROFR") Notice. On May 4, 2001, Mr. Sinclair, on behalf of Glenn Booth at Wiser, sent a letter to Mr. Delamaide seeking clarification of IFP's interest. As Mr. Sinclair put it in his testimony: "We wanted to understand that we were on -- singing from the same song sheet as to what their interest was."

50 The letter highlights the parties' uncertainty about the nature of the interest transferred by the AEA and the JOA, even at this early stage:

> ... Due to the inconsistencies between the Asset Exchange Agreement and the

> Joint Operating Agreement as to the nature of the interest acquired by IFP pursuant to such agreements, Wiser hereby seeks confirmation from IFP that its interest in the Thermal Lands is limited to petroleum substances produced by means of thermal or enhanced recovery schemes or mechanisms and operations in relation thereto.

51 Mr. Sinclair, on Wiser's behalf, sought IFP's acknowledgment and agreement regarding its limited interest:

> By executing this letter agreement, IFP acknowledges and agrees that pursuant to the Asset Exchange Agreement and the Joint Operating Agreement it only acquired the right to 20% of PCR's interest in the Lands and operations thereon respecting the exploration of petroleum substances through thermal or enhanced recovery operations or schemes. No thermal or enhanced recovery operations or schemes have been conducted with respect to the Lands from the effective date of the Asset Exchange Agreement and the Joint Operating Agreement to the current date and IFP acknowledges and agrees that the operations to be conducted by Wiser pursuant to the ARO Agreement do not constitute thermal or enhanced recovery operations and IFP has no right to participate in the operations or to receive information or any benefits arising from such operations.
> ...

52 On May 9, 2001, Mr. Verbraeken wrote to PCR waiving IFP's ROFR, but refusing to consent to the disposition to Wiser on the basis Wiser had no technical capability or intent to pursue thermal or other enhanced recovery methods. His letter made no mention of Mr. Sinclair's May 4 letter.

53 On May 18, 2001, in spite of IFP's refusal to consent, PCR and Wiser entered into the formal ARO; PCR notified IFP of the ARO by letter dated July 18, 2001. In the ARO, PCR no longer purported to act on IFP's behalf. In fact, IFP's refusal to consent to the transaction was directly addressed in an indemnity agreement between PCR and Wiser.

54 Wiser immediately commenced its program to abandon, re-enter and place on production, or convert the suspended wells on the Eyehill Creek lands, including sections 9, 16, 17, 19, 20, 21, 28, 29, and 30. Robert Pankiw was responsible for assessing all the wellbores, abandoning those no longer capable of economic production and reactivating those with potential. By April 2002, Wiser had abandoned 72 non-productive suspended wells. It reactivated 42 existing wells resulting in 650 bbl/day of production and drilled 23 new wells (16 horizontal wells and 7 directional wells) adding a total of approximately 500 bbl/day oil production. Wiser was successful in continuing all the leases set for expiry. Mr. Pankiw testified that he was not asked to keep IFP informed of the steps taken in the Eyehill Creek lands.

55 Mr. Delamaide and Mr. Booth met in late June 2001 on a without prejudice basis to discuss IFP's refusal of consent, Wiser's operations, etc. Mr. Booth expressed an interest in PCR's

previously developed plans for thermal production and asked Mr. Delamaide to forward those to him. Mr. Delamaide could not specifically remember if he had done so, but he stated that he "had no reason not to send it."

56 Canadian Forest acquired Wiser's interests in November 2004. It has continued to produce petroleum and natural gas from the Eyehill Creek lands. In carrying out operations, Wiser and Canadian Forest have used the surface facilities that were situated on the lands before the ARO was entered into and that Wiser was deemed to have earned under the ARO. None of Wiser's or Canadian Forest's operations has been in the nature of thermal or other enhanced recovery; both companies have produced oil from the Eyehill Creek reservoir using only primary production methods. Craig Seal confirmed that Canadian Forest, like Wiser, did not keep IFP informed of its operations, pending lease expiries, etc. on the understanding that IFP was not a working interest owner in primary operations. IFP's interests were not taken into consideration in making operational decisions.

57 On June 13, 2002 IFP wrote to PCR seeking to resolve the Eyehill Creek matter. IFP claimed the farmout to Wiser was in breach of contract since IFP had refused consent to the transaction. PCR replied on July 31, 2002 stating it did not see any merit in IFP's claims and took the position IFP had been unreasonable in withholding its consent. In November 2002, IFP and Encana representatives met with little effect. The Statement of Claim was filed on March 4, 2003.

B. Key contractual provisions

58 This case turns on the interpretation of the complex set of agreements between the parties. At the heart of this case is the nature of the working interest granted to IFP, in particular whether it was limited to thermal and other enhanced recovery only. A key liability issue is whether IFP acted reasonably when it refused to consent to the proposed transaction between PCR and Wiser. Not surprisingly, the parties present very different interpretations of the key provisions. Accordingly, I will set out in the sections below the relevant provisions of the agreements and their schedules and address some of the parties' preliminary contractual arguments. All bold emphasis in quotations from the agreements is mine.

1. Asset Exchange Agreement

59 The AEA is dated October 26, 1998 and identifies an Adjustment Date of July 1, 1998. The purpose of the AEA was to redefine the relationship between PCR and IFP away from a royalty regime towards working interest ownership and joint operations. The preamble states in part:

> AND WHEREAS following Closing IFP and PCR **shall each own working interests in and to the PCR Lands**, which shall be operated by PCR for and on behalf of PCR and IFP, **all subject to and in accordance with the terms and conditions of the Joint Operating Agreements** described in section 2.9 hereof.

60 The preamble sets out the parties' intention that PCR would carry out operations for itself and for IFP. It also indicates that the terms and conditions of the JOA inform the understanding and interpretation of the working interests granted in the AEA.

61 The "Definitions" clause identifies the assets being exchanged. The "PCR Assets" include the "PCR Eyehill Creek Assets", which are defined as follows:

> (t) **"PCR Eyehill Creek Assets" means an undivided interest equal to 20% of the working interest of PCR**, as and at the date hereof and as more particularly described in Exhibit 2 of Schedule "B-4" hereof, in and to:
>
> > (i) the **PCR Eyehill Creek Petroleum and Natural Gas Rights**; and
> >
> > (ii) the **PCR Eyehill Creek Miscellaneous Interests**;

62 The PCR Eyehill Creek Petroleum and Natural Gas Rights are set out in the List of Lands in Exhibit 2 of Schedule B-4, while the PCR Eyehill Creek Miscellaneous interests are defined as follows:

> (w) **"PCR Eyehill Creek Miscellaneous Interests"** means, subject to any and all limitations and exclusions provided for in this definition, **all property, assets, interests and rights pertaining to the PCR Eyehill Creek Petroleum and Natural Gas Rights**, but only to the extent that such property, assets, interests and rights pertain to the PCR Eyehill Creek Petroleum and Natural Gas Rights, including without limitation any and all of the following:
>
> > (i) **contracts and agreements** relating to the PCR Eyehill Creek Petroleum and Natural Gas Rights, including without limitation gas purchase contracts, processing agreements, transportation agreements and agreements for the construction, ownership and operation of facilities;
> >
> > (ii) **fee simple rights to, and rights to enter upon, use or occupy, the surface of any lands** which are or may be used to gain access to or otherwise use the PCR Eyehill Creek Petroleum and Natural Gas Rights; and
> >
> > (iii) **all records, books, documents, licences, reports and data** which relate to the PCR Eyehill Creek Petroleum and Natural Gas Rights, including any

of the foregoing that pertain to seismic, geological or geophysical matters;

63 Article 1.5 of the AEA identifies a number of Schedules appended to the AEA, including Schedule B-4 PCR Assets Eyehill Creek Area and Schedule F (JOA). Schedule B-4 includes four exhibits: Exhibit 1 Land Plan, Exhibit 2 List of Lands, Exhibit 3 List of Existing Contracts, and Exhibit 4 Type Log: Base of Mannville Group of Cretaceous Age.

64 The JOA also attaches several schedules and exhibits: Schedules A1 & A2 Lists of Lands, Schedule B Operating Procedure, Schedule C Assignment Procedure, Exhibit B PASC Accounting Procedure and Exhibit C Type Log: Base of Mannville Group of Cretaceous Age. Exhibit 2 to Schedule B-4 "List of Lands" of the AEA contains the same list of lands as Schedules A1 and A2 "List of Lands" in the JOA.

65 Article 1.5 incorporates the various schedules into the AEA, but grants the AEA predominance in the event of a conflict between any terms or conditions:

> Such schedules are **incorporated herein by reference as though contained in the body hereof. Wherever any term or condition of such schedules conflicts** or is at variance with any term or condition in the body of this Agreement, **such term or condition in the body of this Agreement shall prevail.**

66 Thus the JOA, as Schedule F to the AEA, is incorporated by reference and forms part of the AEA.

67 Article 2.1 identifies the nature of the purchase and sale transaction. It states:

> PCR hereby agrees to sell, assign, transfer, convey and set over to IFP, and **IFP hereby agrees to purchase from PCR, all of the right, title, estate and interest of PCR** (whether absolute or contingent, legal or beneficial) **in and to the PCR Assets, ...all subject to and in accordance with the terms of this Agreement.**

68 As will be discussed in more detail below, there is uncertainty whether the "right, title, estate and interest" purchased by IFP from PCR was limited to thermal and other enhanced recovery working interests or whether IFP received something more.

69 Article 2.4 grants IFP a right to obtain title documents from PCR reflecting its interests in the Eyehill Creek Lands:

> **Within a reasonable time following the written request of IFP, PCR shall deliver to IFP copies of the PCR Title Documents** and any other agreements and documents to which the PCR Assets are subject and copies of contracts, agreements, records, books, documents, licences, reports and data comprising

PCR Miscellaneous Interests which are now in the possession of PCR or of which it gains possession prior to Closing.

70 This clause grants IFP the legal right to request title documents from PCR consistent with its ownership position in the Eyehill Creek lands.

71 Article 2.9(a) provides that PCR and IFP at Closing shall execute Joint Operating Agreements as Schedules; as already mentioned, Schedule F contains the JOA for Eyehill Creek.

72 Article 2.9(c) was expressly negotiated between the parties and addresses the possibility that IFP will need to call upon external investors to finance its share of expenses for the development of Eyehill Creek:

> (c) **PCR acknowledges that IFP may have to call upon external investors in an effort to secure the funding necessary to allow IFP to contribute its proportionate share of certain costs and expenses to be incurred for the joint account** pursuant to the terms of the joint operating agreements referred to in subclause 2.9(a) hereof. The parties agree, **should IFP be unable to secure from such external investors all or part of the funding required to contribute IFP's proportionate share of the costs and expenses in respect of a given operation, to negotiate in good faith in an effort to agree on a means by which IFP's failure to secure such funding may be addressed** (which means, for example, may include the carrying by PCR of IFP's proportionate share of such costs and expenses, a proportionate reduction of IFP's working interest in the appropriate portions of the PCR Lands, or the conversion of IFP's working interest in the appropriate portions of the PCR Lands to a net profits interest or some other form of interest).

73 Articles 2.9(d) provides for the removal of 2.9(c) from the AEA upon execution of the JOA:

> (d) **Upon the execution of the joint operating agreements** referred to in subclause 2.9(a) hereof, **subclause 2.9(c) hereof shall be terminated** and shall be of no further force or effect, and **the relationship of the parties with respect to the PCR Lands shall be governed solely by** the terms and provisions of said **joint operating agreements.**

74 The Defendants argue article 2.9(d) means the AEA has no further effect once the JOA is executed. They argue that once conveyance has occurred PCR and IFP agreed to have their entire relationship governed by the JOA.

75 The Plaintiff disputes this characterization. It states article 2.9(c) is a specific provision dealing with the possibility that IFP may have to call upon external investors. The Eyehill Creek JOA includes at Clause 9(c) a provision corresponding to and replacing article 2.9(c) of the AEA. It

is identical to article 2.9(c), aside from some additional information at the end of the clause. It is reproduced below in its entirety for comparative purposes:

> 9(c) **PCR acknowledges that IFP may have to call upon external investors in an effort to secure the funding necessary to allow IFP to contribute its proportionate share of certain costs and expenses to be incurred for the joint account** pursuant to the terms of this Agreement. The parties agree, **should IFP be unable to secure from such external investors all or part of the funding required to contribute IFP's proportionate share of the costs and expenses in respect of a given operation, to negotiate in good faith in an effort to agree on a means by which IFP's failure to secure such funding may be addressed** (which means, for example, may include the carrying by PCR of IFP's proportionate share of such costs and expenses, a proportionate reduction of IFP's working interest in the appropriate portions of the Joint Lands, or the conversion of IFP's working interest in the appropriate portions of the Joint Lands to a net profits interest or some other form of interest); **provided, however, that nothing in this subclause shall obligate PCR to agree to any such means in any particular circumstance, and further provided that should the parties fail to reach such agreement, their relationship shall continue to be governed by clauses (a) and/or (b) as applicable, of this Clause 9.**

76 I do not accept the Defendants' submission that Article 2.9(d) of the AEA results in the termination of the AEA such that the parties' entire relationship is governed solely by the JOA. Article 2.9(b) clearly states that the execution and delivery of the JOA in no way affects any representations, warranties, covenants or indemnities set out in the AEA:

> (b) Except as provided in subclause 2(d), but otherwise notwithstanding anything to the contrary in this Agreement, **the execution and delivery of such joint operating agreements in no way affects any representations, warranties, covenants or indemnities set out in this Agreement.**

77 The AEA contains a variety of representations, warranties, covenants and indemnities that are not contained in the JOA. Furthermore, Article 1.5, referenced above, states the schedules form part of the AEA, not replace it.

78 As the Plaintiff argues, the AEA and JOA were signed contemporaneously; the AEA is not a previous written agreement between the parties to be superseded by the JOA. Also, the AEA contemplates that it will co-exist with the JOA; it expressly provides that its terms shall prevail over any term of the JOA at variance with it. There would have been no need for such a provision if the AEA was being superseded.

79 Furthermore, the AEA contains provisions that undoubtedly continue to apply after execution of the JOA. For example, article 2.10 of the AEA deals with the negotiation of freehold leases at

some future time. I also note the Defendants themselves rely on provisions of the AEA, in spite of arguing it has been replaced by the JOA. In particular, they rely on the limitation of liability in article 7.9 and on article 1.6 providing for solicitor-client costs.

80 I find article 2.9(d) simply provides that upon execution of the JOA the relationship of the parties with respect to financing the development of Eyehill Creek is no longer governed by article 2.9(c) but by the terms of the JOA itself.

81 Article 3 of the AEA sets out representations and warranties. In Articles 3.1 and 3.2, IFP and PCR each acknowledge they are purchasing one another's interests and assets on an "as is, where is" basis, without representation and warranty and without reliance on any information provided to or on behalf of IFP by PCR or vice versa or by any third party. The Defendants note there are no representations or warranties with respect to any promise to commence a thermal project or to refrain from primary production.

82 Articles 4 and 5 relate to Indemnities and Article 6 to Operating Adjustments. Article 7 contains some general provisions, including "Further Assurances" by each party.

83 Article 7.3 contains an entire agreement clause:

> **The provisions contained in any and all documents and agreements collateral hereto shall at all times be read subject to the provisions of this Agreement and, in the event of conflict, the provisions of this Agreement shall prevail.** No amendments shall be made to this Agreement unless in writing, executed by the Parties. **This Agreement supersedes all other agreements, documents, writings, and verbal understandings among the Parties** relating to the subject matter hereof and **expresses the entire agreement of the Parties** with respect to the subject matter hereof.

84 This article makes clear the parties intended to have the AEA and attached schedules govern their relationship, without reference to any prior agreement or verbal understandings. The AEA takes precedence over any collateral agreements in the event of conflict. This includes the MOU signed by the parties prior to the AEA that, as discussed above, contained slightly different language on key terms.

85 Article 7.9 purports to limit liability of either party with respect to claims arising out of or in connection with the AEA to the value of assets set out in Article 2.7, namely $16 million:

> **In no event shall the liability of PCR to IFP in respect of claims of IFP arising out of or in connection with this Agreement exceed, in the aggregate, the value for the PCR Assets as set out in section 2.7**, taking into account any and all increases or decreases to such value that occur by virtue of the terms of this Agreement. In no event shall the liability of IFP to PCR in respect of claims

> of PCR arising out of or in connection with this Agreement exceed, in the aggregate, the value for the IFP Assets as set out in section 2.7, taking into account any and all increases or decreases to such value that occur by virtue of the terms of this Agreement.

86 IFP claims more than $45 million in damages for breach of contract. I must determine whether this clause limits IFP's recovery, if it is successful in its claim. I will discuss this later in these reasons.

2. Joint Operating Agreement and Operating Procedure

87 The JOA was executed on the same date as the AEA, October 26, 1998, and declares the same effective date of July 1, 1998. The Preamble sets out its purpose:

> WHEREAS, through an Asset Exchange Agreement made effective July 1, 1998, IFP acquired an interest in the Joint Lands,
>
> AND WHEREAS **the parties wish to provide for the exploration, operation, maintenance and development of the Joint Lands** and Title Documents as and from the Effective Date hereof;
>
> NOW THEREFORE THIS AGREEMENT WITNESSETH that, in consideration of the premises, of the mutual covenants herein contained and the benefits to be derived herefrom, the parties agree as follows: ...

88 Schedule "B" of the JOA contains the Operating Procedure, defined as "the 1990 CAPL Operating Procedure attached to and forming part of this Agreement as Schedule 'B' and includes the Accounting Procedure attached as Exhibit 'B'."

89 The JOA sets out other relevant definitions. First, it states the definitions contained in Clause 101 of the Operating Procedure apply to the JOA, its recitals and Schedules, unless the context requires otherwise or the term is otherwise defined. The Operating Procedure defines a number of relevant terms at Article 1 Interpretation:

> (d) "Agreement" means the agreement to which this Operating Procedure is attached and made a part [in other words, the JOA]
>
> ...
>
> (o) "for the joint account" means for the benefit, interest, ownership, risk, cost, expense and obligation of the parties in proportion to their respective working interests.

(p) "joint lands" means **those lands and interests therein which have been made subject hereto by the Agreement, or so much thereof which remains subject hereto** and, except where the context otherwise requires, shall include the petroleum substances within, upon or under those lands and interests, insofar as those lands and interests are subject to the title documents.

(q) "joint operation" means an operation conducted hereunder for the joint account.

(r) "Joint-Operator" means **a party having a working interest in the joint lands**, including the Operator if it has a working interest in the joint lands.

...

(u) "Operator" means **the party appointed by the Joint-Operators to conduct operations hereunder for the joint account**, except as provided in Clause 1004.

...

(ee) "title documents" means the documents of title by virtue of which the parties are entitled to drill for, win, take or remove petroleum substances underlying the joint lands, and all renewals, extensions or continuations thereof or further documents of title issued pursuant thereto.

(ff) "working interest" **means the percentage of undivided interest held by a party in a production facility or the joint lands**, or the respective zones, portions, parcels or parts thereof, **which percentage is as provided in the Agreement or is as modified subsequently pursuant to the provisions hereof.**

90 The determination of IFP's working interest is at the heart of this claim.

91 Clauses 4(a) and 4(b) of the JOA set out the structure of the parties' joint operations:

4(a) **All operations** conducted by the parties pursuant to this Agreement shall be **at each party's sole risk and expense** unless the contrary is specifically stated and always **in accordance with Clause 5 hereof.**

(b) All operations conducted by the parties pursuant to this Agreement shall be conducted in a lawful manner and in accordance with good oilfield practice.

92 Clause 4(c) limits the working interests of the parties to thermal or other enhanced recovery schemes and projects:

> 4(c) It is specifically agreed and understood by the parties **that the working interests of the parties as described in Clause 5 of this Agreement relate exclusively to thermal or other enhanced recovery schemes and projects** which may be applicable in respect of the petroleum substances found within or under the Joint Lands and the Title Documents. Unless specifically agreed to in writing, **IFP will have no interest and will bear no cost and will derive no benefit from the recovery of petroleum substances by primary recovery methods from any of the rights otherwise described as part of the Joint Lands or the Title Documents.**

93 The Defendants argue this is a very significant clause. They rely on it to argue that IFP's working interest was reduced from the provisions of the AEA which conveyed a percentage of all of PCR's interest in the Title Documents and the Joint Lands to a working interest relating exclusively to thermal or other enhanced recovery schemes. They submit IFP has no interest in any other production from the lands and the JOA applies only to production from thermal or other enhanced recovery methods.

94 Clause 5, referenced in clause 4(c) above, sets out the parties' "participating interests":

> 5 **Except as otherwise provided in this Agreement**, as and from the Effective Date hereof, the **parties hereto shall bear all royalties, costs, risks and expenses paid or incurred under this Agreement and the Operating Procedure** and shall own the Title Documents, the Joint Lands, the petroleum substances and the operations to be carried out pursuant to this Agreement as follows:
>
> (a) That portion of the Joint Lands described in Schedule "A1":
>
> PCR -- an undivided 80% working interest
>
> **IFP -- an undivided 20% working interest**
>
> (b) That portion of the Joint Lands described in Schedule "A2":
>
> PCR -- as described in Schedule "A2"

IFP -- as described in Schedule "A2"

(i) In any event and at all times, unless otherwise specifically agreed in writing, **the working interests of the parties will be in the proportions PCR 80%, IFP 20%;**

95 Clause 5(c) of the JOA addresses the ownership of existing facilities:

> 5(c) For greater clarity, there exist, in conjunction with the Joint Lands, numerous wells, flowlines, processing facilities and other similar and related surface and underground installations which have been or are being used in the primary production of petroleum substances and which are owned, at least partially, by PCR. The parties do not intend that IFP will, pursuant to this Agreement, acquire any interest in such wells, flowlines, facilities or installations. Unless otherwise specifically agreed in writing, the only circumstance in which IFP will come into possession of a proportionate 20% working interest share in any of the aforementioned wells, flowlines, facilities or installations is in the event such wells, flowlines, facilities, or installations are included within the definition of a thermal or other enhanced recovery project. At such time as the parties agree to the inclusion of any such well, flowline, facility or installation in a thermal or other enhanced recovery scheme or project, IFP will forthwith become the owner of a proportionate 20% working interest in any such well, flowline, facility or installation without further consideration paid by IFP to PCR. In such circumstance, IFP will assume its proportionate share of all future costs, liabilities and benefits derived from or associated with its ownership of such well, flowline, facility or installation. Any interest so acquired will become subject to the Operating Procedure without further action by the parties.

96 The Defendants argue that by virtue of clauses 4 and 5 of the JOA, IFP's working interest (and the only interest for which IFP could direct or control operations pursuant to the Title Documents) was 20% of the right to thermal or other enhanced production from the joint lands. The Defendants submit primary production rights are reserved to PCR and were expressly contemplated to be for PCR's sole benefit. The Defendants argue the combined effect of clauses 4 and 5 is that IFP has no financial or operational rights or responsibilities for either primary operations or abandonment liabilities.

97 I find that IFP's working interest pursuant to these agreements has always been limited to thermal and other enhanced recovery methods. I find the AEA did not grant broad rights that were subsequently reduced or modified by the JOA, as assumed by both the Plaintiff and the Defendants. The AEA does not define the term working interest. The Preamble to the AEA states, however, that

the ownership of working interests is subject to and in accordance with the terms and conditions of the JOA. Furthermore, the JOA is incorporated by reference into the AEA as though it were contained in the body of the AEA. As such, the definition of working interest in the JOA is incorporated by reference into the AEA.

98 Turning to the JOA, it adopts the definition of working interest set out in the Operating Procedure: "... the percentage of undivided interest held by a party in a production facility on the joint lands, ... which percentage is as provided in the Agreement..." The JOA then provides at Clause 4(c) that the parties' 80% and 20% working interests relate to thermal and enhanced recovery operations only.

99 The AEA and JOA are contemporaneous documents. Article 1.5 of the AEA incorporates the Schedules and makes them part of the body of the AEA. This is not a case of inconsistency between the terms and conditions of the AEA and the JOA; rather, the AEA lacks a definition that the JOA and Operating Procedure provide. I conclude IFP's working interests under these Agreements is in respect of thermal and other enhanced recovery operations only.

100 Relying upon these above-described provisions of the JOA, the Defendants further argue that since the ARO with Wiser did not contemplate thermal or other enhanced recovery, neither the ROFR provisions nor the consent requirement was triggered by the ARO. I reject this argument for reasons set forth later in this judgment.

101 Returning to the JOA, clause 6 provides that PCR will hold IFP's interest in trust:

> PCR has agreed **to hold the participating interest stated in Clause 5**, covering the Joint Lands in Schedule "A1" and Schedule "A2", **in trust, for IFP** subject always to the terms and conditions of the Agreement.

102 Clause 7 provides in the event of a conflict between the JOA and the Operating Procedure appended to it, the JOA is to prevail:

> Wherever there is a **conflict between this Agreement and the Operating Procedure, the terms and provisions of this Agreement shall prevail.** ...

103 Clause 107 of the Operating Procedure is similar, granting precedence to the JOA over the Operating Procedure:

> If any provision contained in the Agreement conflicts with a provision herein, **the provision in the Agreement shall prevail**...

104 Clause 8 of the JOA appoints PCR as the initial Operator to conduct operations on the Joint Lands for the parties. The Defendants argue that nothing in the JOA or the Operating Procedure prohibits PCR from engaging a contract operator such as Wiser or from transferring operatorship, so

long as IFP's rights pursuant to the JOA are respected. Likewise, they argue nothing in the JOA prohibits IFP from assuming the operatorship of the Joint Lands by way of independent operations. The Plaintiff agrees PCR is entitled to engage an Operator, but states that such engagement is subject to its own right of first refusal or consent.

105 Clause 9 of the JOA sets out the application of the Operating Procedure. It applies to all operations conducted in respect of the exploration, development and maintenance of the Joint Lands for the production of petroleum substances. Subclauses 9(b) and 9(c) modify Article 10 of the Operating Procedure, which relates to Independent Operations.

106 In the normal course, the Operating Procedure provides at Article 1002 that the parties will consult one another:

> (a) The **parties normally shall consult with respect to decisions to be made for the exploration, development and operation of the joint lands.** Whether or not such consultation has occurred or has been requested, a party may at any time become a proposing party and give to the other parties an operation notice for an operation on or with respect to the joint lands ...

At no time did IFP become a proposing party for thermal or enhanced recovery exploration, development and operation in the joint lands. Subclauses 1002(b) through 1002(e) of the Operating Procedure set out the details of how independent operations are to be conducted, including timelines, penalty clauses, etc.

107 Clause 9(b) of the JOA acknowledges the potential inapplicability of the Independent Operations provision for secondary or thermal projects and suggests the parties will negotiate in good faith to resolve non-participation or suffer a 400% penalty:

> Notwithstanding the provisions of Article X of the Operating Procedure, **the parties acknowledge and agree that the provisions of such Article X may not be appropriate** to apply to a situation where there is a non-participating party **with respect to a secondary or tertiary recovery project on the Joint Lands.** The parties agree that prior to or upon such situation arising, **they will negotiate in good faith in an effort to agree upon an appropriate means of handling such non-participation, and that failing such agreement the non-participating party shall be subjected to a 400% production penalty** (calculated in accordance with clause 1007 of the Operating Procedure) with respect to all production from all Joint Lands which are exploited by or as a result of the applicable independent operation.

108 Clause 9(c) of the JOA, as discussed earlier in these reasons, addresses IFP's potential need to call on outside investment to finance a project. In argument, the Defendants placed great emphasis on this clause and on IFP's contractual right to proceed with independent operations. They

submit IFP had, at all material times, the right to propose independent operations and failing concurrence by the then Operator, to proceed with those proposed operations on its own at a very significant penalty to PCR or its successors. When combined with the right to enter the lands as a joint owner, IFP had all of the rights it needed to advance a thermal project even if PCR or its successors chose not to do so.

109 Clause 10 of the JOA deals with the assignment of interests. Clause 10(b) provides that PCR must inform IFP of any intention to dispose of its interest and must include IFP's interests in any such disposition, if possible:

> 10(b) **In the event PCR proposes to sell, assign or otherwise dispose of any of its interest** of PCR in and to the Joint Lands, **PCR shall inform IFP and, if so requested by IFP, shall use all commercially reasonable best efforts to have IFP's interest in and to the Joint Lands included in any disposition** to such third party; provided, however, that nothing in this clause shall obligate PCR to accept anything other than the best offer (in the sole discretion of PCR) for any interest of PCR in and to the Joint Lands.

110 Article 24 of the Operating Procedure addresses the disposition of interests and grants a right of first refusal prior to a proposed disposition by one party, or alternatively, imposes a consent requirement:

> 2401 RIGHT TO ASSIGN, SELL OR DISPOSE -- Other than as required and allowed one party to another elsewhere in this Operating Procedure and subject to Clause 2402 [not applicable here], **a party shall not dispose of any of its working interest**, whether by assignment, sale, trade, lease, sublease, farmout or otherwise, **without first complying with the provision of ALTERNATE B below...**

111 Alternate B requires the party wishing to make the disposition (the "disposing party") to advise the other party (the "offeree") of its intention. The disposing party must include a description of the working interest to be disposed, the identity of the proposed assignee, the price or other consideration, the proposed effective date, etc. The offeree must respond within a stipulated time period whether it elects to purchase the working interest on the proposed terms. If the working interest is not purchased by the offeree, the disposing party requires the offeree's consent to proceed with the transaction:

> 2401B(e) In the event that the working interest described in the disposition notice is not disposed of to one or more of the offerees pursuant to the preceding Subclause, **the disposition to the proposed assignee shall be subject to the consent of the offerees. Such consent shall not be unreasonably withheld, and it shall be reasonable for an offeree to withhold its consent to the disposition if it reasonably believes that the disposition would be likely to**

> **have a material adverse effect on it, its working interest or operations to be conducted** hereunder, including, without limiting the generality of all or any part of the foregoing, a reasonable belief that the proposed assignee does not have the financial capability to meet prospective obligations arising out of this Operating Procedure. ...

112 Clause 2401B(e) is at the core of this case. The Defendants argue IFP unreasonably withheld its consent to the disposition of PCR's working interest to Wiser. IFP claims its withholding of consent was reasonable. I will address this determinative issue later in these reasons.

113 Clause 13 of the JOA is the termination provision:

> This Agreement shall terminate on that date which is the later of the date **when no portion of the Joint Lands are owned jointly by any of the parties** ...

114 The Operating Procedure contains a comparable provision at Article 29, setting out the Term of the Operating Procedure:

> 2901 TO CONTINUE DURING ANY JOINT OWNERSHIP -- Subject to Clause 1803, **this Operating Procedure shall terminate when no portion of the joint lands and no production facility is owned jointly by two or more parties** ...

115 The Defendants argue the termination provision in the Operating Procedure is different from the termination provision contained in the JOA because it provides for termination when no portion of the Joint Lands and no production facility are owned "**jointly by two or more** parties", whereas the JOA provides for termination when no portion of the Joint Lands "are owned **jointly by any** of the parties." The Defendants submit the JOA continues so long as **any** party holds **any** interest in the Joint Lands. As such, they argue the JOA continues to bind the working interests of the parties (and therefore their successors, including Wiser and Canadian Forest) for so long as IFP continues to hold its interest even in the face of a disposition by PCR.

116 I reject this argument. I understand the JOA to say the same thing as the Operating Procedure; the JOA terminates when "no portion of the Joint Lands are owned **jointly by any** of the parties." The Operating Procedure is more explicit in saying that no portion of the Joint Lands is owned "**jointly by two** or more parties; "two or more" is the very essence of the meaning of the word jointly. The Operating Procedure, like the JOA, terminates when no portion of the joint lands is jointly owned.

117 The JOA defines "party" to mean a person "that is bound by the terms of this Agreement". The question is whether Wiser, now Canadian Forest, is bound by the terms of the JOA. IFP admits that someone who properly became novated into the JOA would become a party to the Agreement, but that Wiser, and later Canadian Forest, was not properly novated. The Plaintiff argues that a

person to whom one of the parties assigned its interests in the absence of consent and in breach of clause 2401B(e) cannot become a party to the JOA. Consequently, the Plaintiff argues that because its consent was never granted, Wiser did not become a party to the JOA and it is terminated.

118 The Plaintiff also relies on the CAPL 1993 Assignment Procedure attached as Schedule C to the JOA. It clearly states an assignment becomes effective against a "Third Party" (in this case, IFP) if "all prohibitions, limitations or conditions (such as ... a requirement for prior consent from Third Party) applying to the Assigned Interest have been complied with and satisfied pursuant to the Agreement, or waived by the Third Party..." Only then does the party acquiring the interest become a party to the JOA and the Operating Procedure.

119 I will address these arguments at the same time I consider whether IFP was reasonable in withholding its consent.

120 Clause 15 of the JOA includes a number of miscellaneous provisions including a "Supersedes" clause:

> (g) This Agreement supersedes all previous Agreements whether oral or written among the parties hereto as it relates to the Title Documents and the Joint Lands.

121 In reliance on this clause, the Defendants again argue the JOA replaces the AEA and governs with respect to the nature of the working interest held by IFP in the Joint Lands. My conclusion is as set forth above. The AEA and the JOA are contemporaneous agreements. Neither supersedes the other; rather, the JOA is incorporated by reference into the body of the AEA. The parties' working interests for the purposes of these agreements are limited to thermal and other enhanced recovery only.

122 Finally, Article 15 of the Operating Procedure describes the legal relationship of the parties as tenants in common:

> 1501 **The rights, duties, obligations and liabilities of the parties hereunder shall be separate and not joint or collective**, nor joint and several, it being the express purpose and intention of the parties that **their interests in the joint lands and in the wells, equipment, production facilities and property thereon held for the joint account shall be held as tenants in common**, subject to the modification of the incidents thereof that are provided in this Operating Procedure. **Nothing contained herein shall be construed as creating a partnership, joint venture or association of any kind or as imposing upon any party, any partnership duty, obligation or liability to any other party.**

123 The Defendants argue this is a very important part of the Agreement in that it demonstrates that IFP and PCR were entitled to look to their own interests even if the pursuit of those interests might result in so-called "harm" to the other. Thus, they argue, PCR could pursue primary

production without regard to "any partnership duty, obligation or liability" to IFP as long as PCR otherwise had the lawful right to engage in the activity. Likewise, PCR was not obligated to pursue a thermal or other enhanced recovery project and if it did so, IFP was not obligated to participate, just as PCR would not be obligated to participate in a project proposed by IFP. PCR submits the only thing the parties were obliged to do was to live by the terms of the AEA and the JOA.

3. Abandonment Reclamation and Option Agreement ("ARO") between PCR and Wiser

124 The ARO between PCR and Wiser is also relevant in that it sets out the rights and interests PCR transferred to Wiser. In a letter from PCR to IFP entitled Right of First Refusal Notice, PCR summarized the rights being transferred as 100% of PCR's working interest:

> PanCanadian hereby gives notice pursuant to Clause 2401B of the 1990 CAPL Operating Procedure attached as Schedule B to the Agreement that it has executed a letter agreement dated March 7, 2001 ("Letter Agreement") with The Wiser Oil Company of Canada ("Farmee"), an Extension and Interim Operation Agreement dated March 31, 2001 with the Farmee ("Extension Agreement") and is in the process of finalizing a formal Abandonment, Reclamantion and Option Agreement with the Farmee ("ARO Agreement") which embodies the terms of the Letter Agreement and the Extension Agreement. **The transaction contemplated by the ARO Agreement is the disposition of 100% of PanCanadian's working interest in the Lands and the tangibles and facilities associated therewith** (collectively, the "Interests").

125 It should be noted PCR sought to protect itself from any legal conclusion that might be drawn from the issuance of this letter:

> This Right of First Refusal Notice **does not constitute any acknowledgment by PanCanadian as to the nature or the applicability of your interest to the transactions** contemplated by the Letter Agreement, the Extension Agreement or ARO agreement.

V. Position of the Parties

126 IFP claims PCR breached the contract between the parties when it farmed out its interest in Eyehill Creek to Wiser without IFP's consent. IFP seeks damages for the loss of opportunity to pursue thermal and other enhanced recovery at Eyehill Creek.

127 The Defendants take the position that IFP acted unreasonably in withholding its consent and that PCR had every right to enter into the transaction with Wiser. In the alternative, the Defendants argue that even if PCR breached its contract with IFP, IFP has suffered no damages. In the further alternative, PCR argues IFP failed to mitigate its damages.

128 IFP advances an alternative claim against Canadian Forest for an accounting of the profits which Canadian Forest has realized from Eyehill Creek, on the basis the beneficial working interests in the property are held by IFP and Canadian Forest as co-tenants and that there is no contractual relationship between IFP and Canadian Forest.

129 The Defendants take the position that Canadian Forest is entitled to the benefit of the JOA, pursuant to which IFP agreed it was not entitled to benefit from primary production at Eyehill Creek.

VI. Preliminary Issues

130 Several issues, both evidentiary and legal, arose in argument after trial. I will address these now because their resolution has an impact on the evidence before the Court and informs the contractual interpretation.

A. Evidentiary issues

1. Exhibits for identification only

131 The Defendants argue that the Plaintiff relies upon certain documents that were not admitted into evidence at trial as full exhibits, but were marked for identification only. The Defendants submit an exhibit marked for identification is not evidence and cannot be relied upon by the trier of fact for the truth of its contents in rendering a decision, unless and until the proposed evidence has been proven and there has been a ruling on its admissibility. The Defendants submit none of the exhibits marked for identification referenced in the Plaintiff's argument were ruled as admissible evidence at trial. As a result, they submit these exhibits for identification do not form part of the trial evidence and have no probative value.

132 The Defendants provide no particular examples of exhibits for identification so relied upon by the Plaintiff. Furthermore, the Defendants concede that an exhibit for identification can be put to a witness in direct or cross-examination in responding to questioning.

133 The Plaintiff submits the Defendants' complaint is without merit. Throughout trial, in having exhibits marked for identification, it was doing no more than acceding to the Defendants' request not to split its case. IFP's experts commented extensively on reports prepared by the Defendants' experts, some of whom the Defendants later elected not to call as witnesses. IFP's experts were also cross-examined with reference to those reports and with reference to other documents prepared by the Defendants' experts. IFP submits it is appropriate for an expert witness to comment on the reports of experts for the opposing party who have not testified. Such evidence is proper and can be considered by the court whether or not the authors of the other reports are called: ***Quantrill v Alcan-Colony Contracting Co Ltd*** (1978), 18 OR (2d) 333 (CA).

134 I agree with the Plaintiff and find the Defendants' complaints on this ground to be without

merit. They did not support their allegations with specific examples, making it very difficult to ascertain the foundation of their complaint. Further, this Court is well aware of the rules of evidence and will rely only upon those documents properly put into evidence at trial.

2. Adverse inference -- Severin Saden

135 The Defendants ask this Court to draw an adverse inference against the Plaintiff for its failure to call as a witness, Severin Saden, head of IFP France's legal department and president of IFP Canada, since he was one of the key negotiators of the agreements at issue in this case. They argue his evidence was important because he likely has material evidence regarding the negotiation of the agreements and IFP's reasonable expectations. The Defendants submit the evidence of other witnesses suggests Mr. Saden saw IFP as more than a technology company and specifically negotiated for rights that would allow IFP to play an operational role in its projects, including Eyehill Creek. The Defendants argue Mr. Saden, as a citizen of France, is non-compellable by Canadian courts, but is within IFP's exclusive control as its former employee.

136 IFP disputes the Defendants' claim that Mr. Saden is within its exclusive control. He is no longer employed by IFP, having retired in 2002. In ***Spartan Developments Ltd v Capital City Savings and Credit Union Limited***, 2004 ABCA 12 at para 9, the Court of Appeal affirmed the trial judge's refusal to draw an adverse inference against the defendant for failing to call two former employees "on the basis that there was no property in a witness and either party could have called the two former employees." Like the former employees in ***Spartan Developments***, Mr. Saden was not "uniquely available" to IFP; IFP did not have "exclusive control", or any control for that matter, over Mr. Saden.

137 Furthermore, IFP has no evidentiary burden in relation to the inference the Defendants seek to draw. There is no evidence for which Mr. Saden's testimony was necessary. In ***Opron Construction Co v Alberta*** (1994), 151 AR 241 at para 768 (QB) Feehan J stated:

> The doctrine of adverse inference is in fact a very narrow one. It arises when someone has an evidentiary burden to establish an issue and does not call evidence in respect of that issue.

138 IFP does not have any evidentiary burden in relation to the issue raised by the Defendants, i.e. whether Mr. Saden saw IFP as more than a technology company. This is not one of the issues in this lawsuit. IFP submits there is no issue on which Mr. Saden was the only or the best witness to testify. The Court has evidence respecting his role and how he saw IFP. Mr. Verbraeken testified that Mr. Saden was interested in getting involved in the oil and gas business in Canada, but not as an operator. It is not apparent why this is controversial.

139 As stated by McIntyre J in ***Chapman Management & Consulting Services Ltd v Kernic Equipment Sales Ltd***, 2004 ABQB 870 at para 179: "[a]dverse inferences from failing to call witnesses are essentially matters of common sense." I agree with IFP that common sense indicates

there was no reason for IFP to call Mr. Saden, nor is there a reason why this Court should draw the adverse inference the Defendants seek.

B. Legal issue

1. Did the farmout to Wiser trigger IFP's right of first refusal and the consent requirement?

140 PCR argued for the first time in its written brief that the farm-out to Wiser did not trigger the "disposition of interests" requirement set out in Article 2401B of the Operating Procedure. The Defendants submit that since IFP's working interest is limited by the JOA to thermal or other enhanced recovery and the ARO with Wiser did not contemplate any thermal or other enhanced recovery operations, it did not trigger IFP's right of first refusal, nor did the transaction require IFP's consent.

141 The Plaintiff rejects the Defendants' interpretation of Article 2401B, arguing it clearly applies to a disposition of working interests by farmout (or otherwise). IFP argues the right of first refusal and consent requirement apply to **any** disposition of **any** working interest, regardless of what the purchaser intends to do with the lands. For clarity, I reproduce the relevant portion of Clause 2401B(e):

> ...**a party** shall not dispose of **any of its working interest**, whether by assignment, sale, trade, lease, sublease, farmout or otherwise, **without first complying** with the provisions of Alternate B below ...

Alternate B then describes the notice procedure and the requirement for consent, which must not be unreasonably withheld.

142 The JOA also contains an assignment clause stating the Assignment Procedure, attached as Schedule C, shall apply with respect to any assignment of an interest. The Assignment Procedure sets out a similar right of first refusal and consent requirement. The combination of these provisions suggests that **any** disposition of **any** of PCR's working interest triggers the assignment clause.

143 The key then is to determine whether PCR's ARO with Wiser was a disposition of any of PCR's working interest in Eyehill Creek. The clause requires an assessment of PCR's working interest; the nature of IFP's working interest is irrelevant.

144 The transaction with Wiser contemplated a disposition of 100% of PCR's working interest in the lands and the tangibles and facilities associated therewith. Clearly, the proposed disposition is a disposition of "any" of PCR's working interest and triggers the right of first refusal and consent requirement.

145 For all of the above reasons, I find the assignment clause was triggered. IFP waived its right

of first refusal. Mr. Delamaide explained IFP had no time in 30 days to find an alternate operations partner or to raise the necessary funds. Furthermore, exercising the right of first refusal would have required IFP to take on the numerous abandonment obligations it had contracted out of at the outset.

146 Upon waiver of the ROFR, IFP's consent was required for the transaction but IFP did not consent. I must determine whether IFP's consent was unreasonably withheld.

VII. Core Issues

A. Did IFP act unreasonably when it withheld its consent to PCR's proposed disposition to Wiser?

1. Right of first refusal and consent

147 PCR sent IFP a ROFR Notice on April 19, 2001, giving notice pursuant to Clause 2401B of the 1990 CAPL Operating Procedure that it had executed a letter agreement dated March 7, 2001 with Wiser as Farmee, and an Extension and Interim Operation Agreement dated March 31, 2001, and that it was in the process of finalizing a formal Abandonment, Reclamation and Option Agreement embodying the terms of the Letter Agreement and the Extension Agreement.

148 The letter summarized the key terms of the agreements. It made clear the transaction contemplated disposition of 100% of PCR's working interest in the lands and associated tangibles and facilities. It required Wiser to deal with all 222 pre-existing wells on the lands by December 31, 2003, by abandoning them, completing them and placing them on production, or converting them to injector wells. In a further letter dated May 4, 2001, Mr. Sinclair clarified that Wiser's operations would be primary in nature.

149 IFP responded by letter dated May 9, 2011 refusing to consent:

> With respect to your request for consent, we refer to the related clauses of Section 2401B paragraph [e] of the CAPL Operating Procedure, according to which it shall be reasonable for IFP to withhold consent to the disposition, **if the latter would be likely to have a material adverse effect on the working interest of IFP or its operations on the Eyehill Creek lands.**
>
> ...
>
> We understand that Wiser, upon the acquisition of the Eyehill Creek Lands, intends to develop such lands through primary methods of production only and not through thermal or enhanced methods. This is contrary to the understandings reached with PanCanadian at the time of the Asset Exchange Agreement. **Primary development of undeveloped portions of the Eyehill Creek Lands will effectively prevent or severely affect future thermal or enhanced**

> **recovery schemes on these lands and will thereby substantially reduce the value of IFP's interest in these lands.**
>
> Therefore, **IFP has determined that the potential sale by PanCanadian to Wiser of the Eyehill Creek Lands will have a material adverse effect on IFP's working interests and operations in such lands,** and is therefore not prepared at this time to consent to the disposal of PanCanadian's interest in Eyehill Creek lands to Wiser. IFP would be prepared to consider giving its consent if satisfactory agreements can be reached to compensate IFP for the subsequent reduced value of its working interests in the Eyehill Creek Lands, either through a purchase agreement of its interests, the granting of a royalty scheme or some other satisfactory arrangement.

150 The letter makes clear IFP's belief that primary development of Eyehill Creek would harm its interest in future thermal or other enhanced recovery operations, thereby having a material adverse effect on its working interest. IFP submits it was reasonable to withhold consent in the circumstances.

2. General legal principles

151 The parties identified no cases considering clause 2401B of the CAPL Operating Procedure, although they presented evidence through their respective land experts, Ian Clark and James O'Byrne, of industry custom and practice in the interpretation of the CAPL Operating Procedure. I have placed limited weight on this evidence; it is the role of the courts, not the role of experts, to interpret the parties' agreements.

152 In general, the parties agreed on the basic legal principles applicable to this issue, relying primarily on case law regarding reasonable withholding of consent in the landlord-tenant context.

153 The burden of proof is on the party asserting consent was unreasonably withheld: ***Sundance Investment Corporation Ltd v Richfield Properties Limited*** (1983), 41 AR 231 at para 23 (CA).

154 The party whose consent is required is entitled to base its decision on its own interests alone: ***Community Drug Marts P & S Inc, Estate of v William Schwartz Construction Co Ltd***, 31 AR 466 at para 41, (QB), aff'd [1981] AJ No 537.

155 Whether a person has acted reasonably in withholding consent depends on all the factual circumstances: ***Exxonmobil Canada Energy v Novagas Canada Ltd***, 2002 ABQB 455 at para 49. The question is not whether a reasonable person might have given consent, but whether a reasonable person could have withheld consent in the circumstances: ***1455202 Ontario Inc v Welbow Holdings Ltd***, [2003] OJ No 1785 at para 9 (ONSC) ("***Welbow***"). In ***Exxonmobil***, Park J reviewed the evidence on an objective basis to determine whether in the circumstances a reasonable

person would have refused to consent to the assignment.

156 A party must not refuse consent where such refusal is calculated to achieve a collateral purpose, or benefit, not contemplated by the original contract: ***Welbow*** at para 9.

157 Proceeding with an assignment in the face of a reasonable refusal to consent is a clear breach of a negative covenant: ***Exxonmobil*** at para 51.

158 The court should not defer to the party withholding consent, but must assess the reasons for withholding consent and consider whether a reasonable person in similar circumstances would have made the same decision. The court should consider the purpose of the consent clause and the meaning and benefit it was intended to confer.

159 Mesbur J explained in ***Zellers Inc v Brad-Jay Investments Ltd***, [2002] OTC 795 at para 26 (Sup Ct):

> In considering whether the landlord's refusal to consent is unreasonable, **the court must first look at the covenant in the context of the lease, and ascertain the purpose of the covenant in that context.** The court should **look at all the circumstances of the case.** No rigid rules govern the types of reasons that the court may take into account when deciding the question of reasonableness. The test must always **have regard to the contractual matrix**, and the test should **encompass consideration of the surrounding circumstances, the commercial realities and the economic impact of the change of use** on the landlord within the context of a "reasonable person" standard. [Emphasis added, footnotes omitted.]

160 In discussing a consent clause in a lease in ***Welbow***, Cullity J stated at para 9:

> ... The question must be considered in the light of the existing provisions of the lease that define and delimit the subject matter of the assignment as well as the right of the Tenant to assign and that of the Landlord to withhold consent. The Landlord is not entitled to require amendments to the terms of the lease that will provide it with more advantageous terms: ... - but, **as a general rule, it may reasonably withhold consent if the assignment will diminish the value of its rights under it, or of its reversion**: ... A refusal will, however, be unreasonable if it was designed to achieve a collateral purpose, or benefit to the Landlord, that was wholly unconnected with the bargain between the Landlord and the Tenant reflected in the terms of the lease: ... [Emphasis added.]

161 Cullity J continued:

> The question of reasonableness is essentially one of fact that must be determined

> on the circumstances of the particular case, including **the commercial realities of the marketplace and the economic impact of an assignment** on the Landlord. Decisions in other cases that consent was reasonably, or unreasonably, withheld are not precedents that will dictate the result in the case before the court: ...[Emphasis added.]

162 Burnyeat J in ***Hayes Forest Services Limited (Re)***, 2009 BCSC 1169 at para 32 identified similar relevant factors:

> ...The determination will be dependent on such factors as the **commercial realities** of the marketplace, **the economic impact** of the assignment, **and the financial position** of the proposed assignee. [Emphasis added.]

163 In the oil and gas context, Park J commented in ***Exxonmobil*** at para 54 on the purpose of a consent requirement:

> ...The reasons for including a consent requirement in the assignment was **to allow each party the opportunity of reasonably assessing any future contractual partners.** If a proposed assignee did not meet the criteria reasonably required by the other party, the assignment should not proceed. [Emphasis added.]

164 In ***Exxonmobil***, the plaintiff owned a 56% interest in a gas plant and had delegated the management, operation and control of its interest to the defendant. Further, it had appointed the defendant as its sole and exclusive agent with respect to its ownership interests. When the defendant sought to sell its entire interest to a third party, the plaintiff refused to consent until it received information regarding the purchaser's financial and operational ability to manage the plant. These facts can be contrasted, however, with the circumstances of IFP and PCR as tenants-in-common of distinct working interests.

165 In ***Kaiser Francis Oil Co of Canada v Bearspaw Petroleum Ltd***, 1999 ABQB 128 Sullivan J also considered the purpose behind consent clauses. The various contracts between the parties stated an assignment of operatorship could take place only upon satisfaction of certain conditions, including "the consent of the other party 'first had and obtained.'" He suggested the purpose of the clause was to avoid unilateral replacement of an operator or partner at para 76:

> As it happened Kaiser did withhold its consent to the transfer of operatorship by using the restriction for the purpose for which it was originally designed. Such **restrictions on transfer are included deliberately as joint owners** recognize that either one of them could, **if an undesirable transfer took place, be unilaterally stuck in a relationship with an unpleasant and difficult partner.** It is included precisely **to prevent a unilateral replacement** of an operator or an operation partner and Kaiser was within its rights to withhold consent until it was

> satisfied that Bearspaw was, or was not as it turned out, an acceptable operator to them. [Emphasis added.]

166 The nature of the exercise before this Court, therefore, involves examining all the circumstances, including the commercial realities of the marketplace, the status quo under the agreements, the economic impact of the assignment and all other relevant factors to determine whether IFP acted reasonably in withholding its consent to the disposition to Wiser.

3. Argument and Analysis

167 IFP alleged in its pleadings it was reasonable to withhold consent to the proposed disposition to Wiser for the following reasons:

> The effect of the proposed disposition would be the loss or depletion of IFP's working interest in the Lands without any corresponding benefit to IFP;
>
> The intentions of Wiser were to develop the Eyehill Creek Reserves through primary methods only;
>
> Wiser did not have the technology, the expertise or the inclination to carry out PCR's Eyehill Creek Thermal Project, or to develop the Eyehill Creek Reserves through enhanced production; and
>
> The disposition would have a material adverse effect on IFP, on its working interests in Eyehill Creek lands and on secondary production.

168 Throughout the trial and in argument, IFP expanded on these points arguing it was "readily apparent" the proposed farmout to Wiser would be harmful to IFP in a number of ways, "all of which were borne out by subsequent events."

169 IFP submits that in considering all the circumstances, this Court should have regard to the commercial context in which the AEA and JOA were negotiated. IFP was interested in Eyehill Creek because of its SAGD potential and PCR's proposed SAGD development plans and entered into the agreements to pursue thermal and other enhanced recovery operations on these lands. By contrast, Wiser intended to conduct primary operations only. Thus, PCR proposed to transfer its interest to a company that, from IFP's perspective, had no experience or interest in thermal operations.

170 IFP argues it was reasonable in withholding consent because on the simplest level, primary exploitation of the reservoir inevitably results in the "undepleted" area becoming depleted. Any oil

produced by Wiser from "SAGD-able" areas would no longer be available to be produced under a SAGD project. I consider this an oversimplification. The evidence makes clear that primary production recovers between 7% - 10% of the OOIP in a reservoir, whereas thermal development achieves 60% or better recovery. The so-called depletion of the oil in the reservoir is a red herring; it is the other related impacts of primary production that cause concern.

171 Aggressive primary production can be particularly damaging to a reservoir. In February 2000, Mr. Gittins noted in an internal PCR memo his concerns related to primary production in the undepleted area for future SAGD production: "...main concern is that we don't drill any sand production wells in the undepleted pay at the south end."

172 In a follow-up email he explained that if sand production was required "it could prevent future SAGD development and we could wind up with a 10,000,000 bbl oil reserve write down in the future for the sake of a few hundred bbd/day of production." He also noted that "IFP also have a 20% WI in this area and my understanding is that they are only interested in thermal development." At trial, Mr. Gittins further explained his reasoning:

> Well, it -- it leads on from the earlier concern, that it would -- if the wells produced sand, it would impact the potential thermal project that we had planned. And -- and IFP had an interest in that thermal project.

173 Prior to the proposed ARO, PCR had provided IFP with information about wormholes and the challenges they presented in drilling horizontal wells. This information was contained in PCR's August 1998 preliminary proposal for Eyehill Creek. In other words, this information was available to IFP at the time it considered PCR's request for consent to the disposition to Wiser.

174 Furthermore, IFP argued the commencement of a primary operation on the whole reservoir would cause severe practical problems for a minority partner with an interest in initiating a thermal operation. It argues it was not feasible for a SAGD operation to be undertaken in the same location, and at the same time, as a separate primary operation.

175 IFP also argues that PCR, contrary to the joint intentions and expectations set out in the JOA, did not include anything in the ARO to protect IFP or to ensure Wiser would not harm a future thermal project. IFP submits neither Wiser nor Canadian Forest has ever paid attention to the impact of their operations on the thermal potential of the reservoir.

176 IFP points to a letter dated May 4, 2001 from Mr. Sinclair sent at the request of Glen Booth, Wiser's Vice President Land, stating Wiser's limited interest in communicating or working with IFP. The letter was in the form of a proposed letter agreement. It asked IFP to agree to a number of things, one of which was that "IFP has no right to receive information or any benefits arising from" the primary operations that Wiser intended to conduct.

177 Mr. Delamaide stated in his testimony:

> ...it's really an ugly letter. In there, there are provisions, that say well, we are not going to give you access to any information. So basically they wanted to do whatever they want in the reservoir and they are not going to tell us what they are doing. It says, well, you don't have any working interest in the lands, how can we accept that?

178 Finally, IFP submits the ARO purported to grant some of IFP's right and interests to Wiser. The initial Letter Agreement purported to be made by PCR on behalf of all working interest owners and entitled Wiser to earn 100% of the interest of all the Owners. IFP argues PCR purported to grant interests which it had previously granted to IFP. The final ARO, however, limited Wiser's interests to those held by PCR, thereby excluding IFP's interests.

179 IFP submits that after Wiser earned PCR's interests pursuant to the ARO, none of the leases PCR transferred to Wiser contained any acknowledgment of, or reference to, IFP's interest -- the very interests PCR had agreed to hold in trust for IFP. IFP argues the land records still do not show IFP's working interest in any of the lands. As such, Wiser and Canadian Forest have considered only their own interests when making decisions regarding surrenders in response to Crown notices. For all of the above reasons, IFP argues it was reasonable in withholding its consent to the ARO with Wiser.

180 In making its argument, IFP submits it may rely on "any reason, if genuine, for refusal, whether or not earlier told" to the other party: ***Coopers & Lybrand Ltd v William Schwartz Construction Ltd***, [1981] AJ No 537 at para 9. It states the evidence of what subsequently transpired, including the impact of Wiser's eventual operations and whether PCR or Wiser gave any thought to the effect those actions might have on IFP's interests, is relevant in retrospect in judging whether or not IFP's concerns at the time were reasonable. IFP argues it may put forward information that was unavailable at the time but which supports its position; to this end, it has presented evidence it could not have known at the time consent was withheld.

181 The Defendants submit that much of IFP's evidence in support of its argument that it was reasonable in withholding consent is inadmissible because it was not known to IFP at the time of the proposed disposition to Wiser. They state IFP cannot rely on information that would not have existed at the time it withheld its consent. They insist the reasonableness of the decision to withhold consent must be based on the facts available to IFP at the time consent was withheld.

182 The Defendants also argue that by the very terms of the Operating Procedure IFP could rely only on information available to it at the time, since Clause 2401B requires consent to be granted or refused in a 30 day time period.

183 PCR goes so far as to argue that a party can rely only on the reasons given at the time consent was withheld and cannot provide additional reasons, citing ***Welbow*** at para 9:

> In determining the reasonableness of a refusal to consent, **it is the information**

> **available to -- and the reasons given by -- the Landlord at the time of the refusal -- and not any additional, or different, facts or reasons provided subsequently** to the court -- that is material. ... [Emphasis added.]

184 I reject this argument, finding the case relied upon in ***Welbow***, namely ***Bromley Park Garden Estates Ltd v Moss***, [1982] 2 All ER 890 (CA) should not be so broadly construed. Slade LJ in ***Bromley Park*** at 902 explained the court is not confined to the reasons expressly put forward at the time of refusal. While the reasons for refusal need not be stated at the time consent is withheld, Slade LJ found those reasons must have influenced the mind at the relevant time -- the time when the other party is informed consent is being withheld.

185 In ***Coopers & Lybrand***, the Court of Appeal held the party withholding consent can rely on any genuine reason, even if not expressed at the time of refusal, thereby suggesting it does not matter if the reason was expressed at the time consent was withheld. On the facts, however, the court found "the evidence shows that the principal reason, the proposed use, was raised from the start." This former statement accords with ***Bromley Park*** in suggesting that while not necessarily expressed, the reasons for refusal must have influenced the mind of the party withholding consent at the relevant time.

186 I find IFP's references to after-acquired evidence have not introduced any new grounds for withholding consent. Rather, the after-acquired evidence and eventual manner in which Wiser produced the lands support IFP's initial rationale for withholding consent. I accept this evidence only where it does no more than support the belief held by IFP at the material time; that is, where it relates to IFP's stated position at the time consent was withheld.

187 At trial, the parties presented expert evidence about wormholes and other potential negative effects of primary production upon future thermal production. I will deal with this expert evidence later in these reasons. IFP could not have known the information provided by these experts at the time it withheld its consent to the disposition to Wiser and I will not consider it for these purposes.

188 The Defendants argue IFP failed to make sufficient inquiries about Wiser and failed to carry out the analysis necessary to support the reasonableness of its decision to refuse consent. They submit the minimal extent of IFP's notes in evidence do not support its claim of having a reasonable belief in the material adverse effects of the disposition. They put forward ***Exxonmobil***, ***Re Hayes*** and ***Hayes Forest Services Ltd v Weyerhauser***, 2007 BCSC 722 as examples where the party withholding consent made detailed inquiries about the proposed transaction and carried out a careful analysis of the proposal to justify their decision.

189 IFP counters this argument relying upon Mr. Delamaide's evidence:

> ...We had signed on with PanCanadian to do a SAGD project at Eyehill Creek and all of a sudden they decided to sell to a company, Wiser, which is going to do a primary project. This primary project is going to on a practical basis, render

> impossible any SAGD project on the lands. So we felt that it was obvious for us that we had to refuse our consent.

In later testimony, he stated: "I didn't need all the details to understand that it was bad for us."

190 The Defendants also argue that IFP's belief it could have benefitted from a SAGD project at the time of its refusal to consent must be realistic from a technological and economic perspective. They submit IFP identified no information, then or now, related to the feasibility of a SAGD project on these lands. In essence, the Defendants submit that IFP's interests could not be materially affected since IFP had no interest in the primary production contemplated by the contract with Wiser. I find this argument denies the acknowledged impact primary operations have on the thermal potential of a reservoir.

191 Most importantly, however, the Defendants submit the proposed disposition to Wiser must be compared to the status quo to assess the reasonableness of IFP's decision to withhold consent. They point to the annotation to ***Sundance*** by Professors M Litman and B Ziff (24 Alta LR (2d) 1 at 2-4):

> ...Our analysis of the cases suggests that a landlord may withhold his consent to prevent a detriment to the interests granted or reserved by him, but not to optimize the profit potential of the premises. ...the law strikes a balance between the landlord's legitimate interest in protecting himself and the tenant's legitimate interest in alienating his estate and extricating himself from an inconvenient, or perhaps intolerable, situation. **The status quo under the original lease serves as a benchmark against which to determine whether the subletting would be prejudicial to the landlord.** [Emphasis added.]

192 The Defendants argue that if a party to an agreement will receive as much under the proposed disposition as it would have had under the original agreement then a refusal to consent must be unreasonable. They submit Wiser was doing no more than what PCR was entitled to do; the status quo was unchanged and IFP's justification for withholding consent was plainly untenable and unreasonable.

193 I find comparison to the status quo to be a very important aspect of the analysis in this case, as is the commercial reality of the marketplace at the time. IFP understood when it entered its agreement with PCR that there were some primary wells drilled on the lands. It knew that these wells eventually would have to go on production or be abandoned. There is no dispute IFP wished to avoid any abandonment liabilities. PCR put some wells back on primary production in the first few years after signing the agreements, without objection from IFP.

194 The agreements between the parties are unusual in that they create competing working interests. While IFP was granted rights and interests related to thermal and other enhanced recovery only, PCR retained the right to pursue primary production. The agreement neither prohibited PCR

from undertaking primary production, nor obliged it to carry out thermal operations.

195 The parties were not joint venture partners; they held their working interests as tenants-in-common. Expert land-man Ian Clark explained that oil and gas interests are bought and sold routinely, development plans change, companies and their staff change. It is clear from the evidence that PCR's focus shifted between the time it contracted with IFP and the time it entered the ARO with Wiser.

196 In February 2000, PCR received approval for its SAGD project at Christina Lake, which became its corporate focus. At Eyehill Creek, PCR faced extensive abandonment liabilities along with Crown Notices to Produce. Furthermore, the economics for a SAGD project were poor at the time. As discussed in the factual background, PCR wished to divest itself of its interests in the Eyehill Creek property for a variety of internal reasons.

197 It is equally clear that IFP was in no position to undertake a SAGD operation on its own. It had neither the operational know-how nor the financial backing to do so. It could not take advantage of the ROFR clause or initiate independent operations.

198 I can appreciate why IFP believed the disposition to Wiser would be likely to have a material adverse effect on its working interest or future operations. The problem is that such belief must be objectively reasonable. IFP had the unilateral expectation that PCR would initiate a SAGD operation and would refrain from primary production, but the agreements provide no basis for this expectation. Furthermore, in the context of an industry mandating development rather than sitting on rights, an agreement in which each party could make decisions based on its own interests, and tenants-in-common ownership, I find it was unreasonable for IFP to object to the disposition to Wiser on the grounds Wiser would undertake something PCR was entitled to do and in fact was doing. It is not objectively reasonable to withhold consent and prohibit the alienation of PCR's interests on that basis.

4. What is the relevance of the reasonable expectations of the parties?

199 IFP advances an alternate claim that PCR's action in entering into the ARO with Wiser constituted a breach of contract because it undermined the reasonable expectations of the parties at the time of contracting. IFP argues that a "contract should be performed in accordance with the reasonable expectations created by it": ***Mesa Operating Ltd Partnership v Amoco Canada Resources Ltd*** (1994), 149 AR 187 at para 19 (CA). IFP submits the reasonable expectations created by the agreements herein were to pursue thermal development at Eyehill Creek; it argues primary operations were not within the contemplation of either party. Mr. Delamaide captured IFP's position with the following comment in cross-examination: "We had been discussing about doing a thermal project together, in good faith. I never thought they would pull the rug from underneath our feet."

200 In ***Mesa***, the dispute related to the interpretation and performance of a contract. The plaintiff

argued that the defendant had to exercise its powers granted under the contract in good faith. Kerans JA declined to adjudicate the matter of good faith, noting at para 16 that a general obligation expressed in terms of good faith is not part of contract law in Canada. Instead, he found at para 19 that the contract created certain expectations between the parties about its meaning and about performance standards. Those expectations needed to be enforced because they were reasonable; they were shared by the parties and consistent with the express terms of the contract. The appellate court concluded a contract should be performed in accordance with the reasonable expectations created by it and the assessment of those expectations should include regard to the commercial context.

201 The principle in ***Mesa*** has been summarized as follows by Nigel Bankes & Alicia Quesnel in "Recent Judicial Developments of Interest to Oil and Gas Lawyers" (2000) 38 Alta L Rev 294, at 357 n 263:

> [A] breach of good faith exists where, without reasonable justification, one party acts in relation to the contract in a manner which substantially nullifies the bargained objective or benefit contracted for, or causes significant harm to the other, contrary to the original purpose and expectation of the parties.

202 Other cases have considered the concept of reasonable expectations in the performance of a contract. In ***Maritime Life Assurance Co v Regional Capital Properties Corp*** (1996), 190 AR 306 (Master), aff'd 200 AR 317 (QB), Master Funduk considered the plaintiff's reasonable expectations argument. The Master concluded *both* parties must hold the reasonable expectation. In support of this contention, he provided the following example at para 50:

> I expect my salary to be increased by 20%, not cut 5%, but it is unlikely to happen. The point is that the expectation of one party cannot create an obligation on another party. This submission is just a roundabout way of saying that A and B can enter into a contract which imposes an obligation on C because B wants it. No case law goes that far.

203 He also relied upon ***Mesa*** for the proposition that a general good faith contractual obligation is not part of Alberta law.

204 In ***National Courier Services Ltd v RHK Hydraulic Cylinder Services Inc***, 2005 ABQB 856, the defendant argued that the plaintiff owed it a contractual duty of good faith. Justice Topolniski found that Alberta law does not recognize a general duty of good faith between contracting parties, although such a duty can arise in contracts where the relationship mandates good faith dealings as in insurance matters and employment dismissals.

205 Topolniski J stated, at para 29, relying upon *Mesa*, that a duty of good faith also arises where there is significant discretion on the part of one party:

> The issue in *Mesa* was whether liability could exist in the absence of bad motives. The Court of Appeal accepted that a **common law duty to perform a discretionary power in good faith is breached when a party acts in bad faith; that is, when a party acts in a manner that substantially nullifies the contractual objectives or causes significant harm to the other, contrary to the original purposes or expectations of the parties.** [Emphasis added.]

206 Similarly, in ***Schluessel v Maier***, 2001 BCSC 60, rev'd in part on other grounds 2003 BCCA 405, Harvey J stated at para 129 that a general duty of good faith does not exist in contract law. At para 130, he built upon the "reasonable expectation" principle discussed in ***Mesa***:

> It is however possible to endorse a related and somewhat narrower proposition -- namely, that **a party to contract may not act in relation to the contract in such a way as to nullify the bargained objective or benefit moving to the other party** under the contract. [Emphasis added.]

207 Harvey J summarized, at para 130, "a party to a contract has a duty not to act in a manner that deprives another party to the contract of the bargained objective or benefit."

208 A reasonable expectation, therefore, is an expectation held by both parties regarding the performance of obligations under the contract. One party's expectation cannot create an obligation on another party if that expectation is not shared. Reasonable expectations are rarely stated within a contract; rather, the reasonable expectations are an underlying principle of contractual performance in which each party performs in a manner consistent with the objectives, benefits and obligations of the contract.

209 IFP argues that the doctrine of reasonable expectations applies here to refute some of PCR's claims regarding what it was entitled to do under the JOA, particularly PCR's entitlement to pursue primary development that could harm IFP's interest.

210 PCR argues it is factually incorrect for IFP to claim it held a reasonable expectation that primary production would not be pursued at Eyehill Creek. PCR's legal counsel expressed PCR's position in a letter to IFP dated July 31, 2002:

> Your letter makes repeated references to the "spirit" of the "1998 Agreements" and the intent or reasonable expectation of the parties to develop the Eyehill Creek Lands using thermal recovery methods. Certainly at the time of entering into the 1998 Agreements, **the parties may have had intended to evaluate the thermal potential of the Eyehill Creek Lands and if they chose to undertake thermal operations**, may have expected to receive a substantial benefit. However, **we fail to see how this perceived intent is to be transformed into a unilateral obligation on the part of PanCanadian to thermally develop the lands regardless of the economics or its analysis of the prospect.** ... [Emphasis

added.]

211 According to ***Mesa***, the alleged reasonable expectations must be consistent with the express terms of the relevant agreements. Thus, assessing whether expectations are reasonable requires an examination of the written agreements. The commercial context can also inform the interpretation of whether expectations are reasonable.

212 I reject IFP's argument that it had a reasonable expectation that PCR would not pursue primary production at Eyehill Creek. There is nothing in the agreements prohibiting primary production, as conceded by several IFP witnesses. If IFP wanted such a prohibition, it ought to have negotiated it as a term of the agreement. IFP has not identified any specific provision of the contract or industry practice that would indicate its expectations were reasonable. In the absence of express terms or shared expectations regarding primary production, IFP's argument on this ground must fail.

5. What is the effect of IFP's unreasonable withholding of consent?

213 Since I have concluded that IFP was unreasonable in withholding its consent to the ARO between PCR and Wiser and IFP's reasonable expectations argument fails, I must now decide what flows from these findings.

214 As discussed above, the majority of the case law related to unreasonable withholding of consent comes from the landlord and tenant context. In those cases, when the court finds a landlord has unreasonably withheld consent to an assignment the effect is to dispense with the consent requirement. In ***Sundance***, Harradence JA stated at para 50 that "[w]here consent is unreasonably withheld the tenant is released from the obligation to obtain it". Although he was writing in dissent, the academic literature supports his approach.

215 Christopher Bentley, John McNair & Mavis Butkus, *Canadian Law of Landlord and Tenant*, loose leaf (consulted on 11 June, 2014), 6th ed, vol 2 (Toronto: Carswell, 2013) at 15-51 states:

> ...**if the lessor does withhold his consent without good reason**, the lessee, who has asked for the consent and has been refused, **is released from the obligations of the covenant and is at liberty to assign without the lessor's consent**; and the court will declare the lessee's right to do so. [Emphasis added.]

216 Applying these principles to the facts of this case, IFP, in unreasonably withholding consent, freed PCR from the consent requirement. In other words, PCR was free to proceed with the ARO with Wiser, as it did, in the absence of IFP's consent since such consent was unreasonably withheld.

217 The next question is whether Wiser was novated into the agreements between PCR and IFP. It is generally not possible for one party to a contract to substitute another person in its place without the consent of the other party to the contract: ***National Trust Co v Mead***, [1990] 2 SCR 410 at 426-427.

218 The Operating Procedure (as varied by the Assignment Procedure) modifies the law relating to novation so as to make it possible for a purchaser or assignee of one of the parties' interests to be novated into the Operating Procedure without the consent of the other. The Assignment Procedure makes it clear, however, that an assignment of an "Assigned Interest" becomes effective against a "Third Party" (in this case IFP) only if "all prohibitions, limitations or conditions (such as ... a requirement for prior consent from Third Party) applying to the Assigned Interest have been complied with and satisfied pursuant to the Agreement, or waived by Third Party..." If a party fails to respond to a request for consent within the stipulated timeframe, for example, that party is deemed to have consented. The Assignment Procedure is very explicit in stating that this contractual modification of the law of novation does not apply to a purported assignment made in breach of a consent provision.

219 I have already found that there was no breach of the consent requirement in this case. PCR sought IFP's consent, but such consent was unreasonably withheld. In the circumstances, PCR was entitled to proceed with its disposition to Wiser. IFP admits in its reply brief that upon a disposition of PCR's interest, as long as the disposition was proper, the purchaser would automatically become novated into the JOA. IFP further admits that someone who properly became novated into the JOA would become a party to it. The JOA would continue to bind IFP as well as the new 80% working interest owner and both parties would remain bound by clause 4(c). Thus, I find that Wiser has been novated into the agreements and the JOA continues to bind Wiser and IFP.

6. Has the opportunity to pursue a thermal or other enhanced recovery project at Eyehill Creek been destroyed or damaged?

220 If I am wrong in my conclusion that there was no breach of the consent requirement, I must consider whether the breach caused the harm alleged. In other words, I must decide whether PCR's farmout to Wiser and Wiser's subsequent primary development of the Eyehill Creek reservoir (and Canadian Forest's ongoing primary operations) destroyed or damaged IFP's working interest in thermal or other enhanced recovery. IFP bears the burden of proving that it has lost the opportunity to pursue any thermal or other enhanced recovery project at Eyehill Creek, not whether it has lost the opportunity to pursue a specific SAGD project.

221 IFP argues that the opportunity to pursue thermal development does not exist while Wiser (now Canadian Forest) is in the field because it is not possible to initiate thermal development of the reservoir while primary operations are underway; the two cannot co-exist. More significantly, IFP argues the impacts of primary production on the reservoir have created operational challenges that are difficult to overcome and make any future thermal or other enhanced recovery project uneconomic. IFP also alleges the effect of primary production of the Eyehill Creek reservoir has created insurmountable drilling, completion and production challenges. Finally, IFP argues Wiser has surrendered some of the lands in which IFP held an interest, in particular, Legal Sub-divisions ("LSDs") 2, 4 and 8 of section 16, thereby eliminating IFP's working interest in those lands. Some of these LSDs were in the previously undepleted part of the reservoir and formed part of the area on

which IFP's experts proposed their development plan and economic assessment. In sum, IFP argues the primary development of the reservoir has destroyed it for development through thermal and other enhanced recovery methods and no opportunity for this type of development remains.

222 IFP relies extensively on the expert evidence of Mr. Richard Baker who described the negative impacts on the reservoir resulting from primary production and stated he would no longer recommend the Eyehill Creek reservoir for thermal recovery.

223 Mr. Baker was qualified as an expert in the following areas:

(1) petroleum reservoir engineering;

(2) the different methods used for the secondary and enhanced recovery of petroleum and the process of screening a reservoir to determine which recovery method or methods would be feasible for that reservoir;

(3) petroleum reservoir simulations, including and in particular SAGD drainage simulations, other thermal simulations and heavy oil primary simulations; and

(4) fluid movement within reservoirs, petroleum reservoir characteristics and the factors which impact reservoir performance.

224 Mr. Baker presented three primary reports: a report on the EOR potential at Eyehill Creek (the "Screening Report"), a report on the impact of primary production on the EOR potential (the "Impact Report"), and a SAGD simulation report (the "Simulation Report").

225 In his Screening Report, Mr. Baker explained the differences between primary, secondary, tertiary and enhanced oil recovery mechanisms. Primary recovery typically refers to the first phase of reservoir recovery and involves only the natural energy of the reservoir to drive recovery. Secondary recovery refers to recovery beyond what is supported from existing reservoir energy only and involves the injection of water or gas to provide pressure support to the reservoir. Tertiary recovery typically refers to the third (and in many cases last) phase of recovery. He stated the terms primary, secondary or tertiary refer to a chronologically-based approach to implementing recovery methods, although a tertiary method might be applied first if primary or secondary methods would not allow oil to flow. For example, EOR methods are sometimes referred to as tertiary recovery, but Mr. Baker explained it is common for a heavy oil pool to be placed on secondary recovery or EOR shortly after the time of discovery. EOR is a separate type of recovery process that involves the injection of special materials or fluids (e.g. steam, solvents, surfactants, etc.) to change the reservoir fluid properties by mechanisms such as dissolving, mixing, or heat transfer.

226 In his Impact Report, Mr. Baker reported that between 2001 and 2009, 1.43 million barrels of oil have been produced from sections 9 and 16 by primary production. Mr. Baker explained that this production has impacted the economics of any EOR project by reducing the recoverable volumes in the reservoir. I reject this concern. The evidence makes clear that primary production recovers between 7% - 10% of the OOIP in a reservoir, whereas thermal development achieves 60% or better recovery. The so-called depletion of the oil in the reservoir is a red herring; it is the other related impacts of primary production that create some potential concern.

227 Mr. Baker opined in his Impact Report that primary production has decreased the reservoir pressure relative to the initial reservoir pressure, thereby damaging the potential for EOR processes relying on pressure gradients such as SAGD, Cyclic Steam Stimulation ("CSS") and steam flooding. He stated that primary production has caused heterogeneity in pressures and saturations that would cause uncertainty and make it more difficult to plan a thermal project.

228 Mr. Baker explained that the pressure depletion in sections 9 and 16 has resulted in water influx from the western edge pool, leading to increased water saturations in the reservoir. Increased water saturation increases the amount of heat needed for SAGD and reduces SAGD efficiency (the water acts as a "heat sink" absorbing the energy from the injected steam). He opined that well pairs could be placed higher in the reservoir to avoid contact with the water. Water production would be reduced and the steam chamber could avoid losing heat to the underlying water, but such well placement would reduce the amount of reserves recoverable.

229 Mr. Baker also noted the appearance of a small primary gas cap in the southern region of section 9. He opined that the reduced reservoir pressures in sections 9 and 16 have led to increased gas saturations and the possible formation of a secondary gas cap in these sections. Higher gas saturation also negatively affects the efficiency of a SAGD project because, like water, a gas cap can act as a thief zone allowing steam to flow into it and lose heat, resulting in wasted steam energy and higher operating costs. Higher gas saturations in the oil can also reduce the efficiency of SAGD and other enhanced recovery processes.

230 Mr. Baker also suggested that sand production throughout the reservoir from primary operations likely has created significant wormholes throughout the reservoir. He stated this was the single most important factor in his entire report. Wormholes can hurt thermal production by creating channels that permit the steam to bypass the pay zone. He opined that sand production will cause the reservoir to fracture more easily or create sand control challenges that could lead to equipment failures and unforeseen downtimes in production. Mr. Baker did not prepare a simulation or model to determine whether a thermal project still could proceed at Eyehill Creek.

231 In sum, Mr. Baker stated at p 38 of his Impact Report that primary production has made the reservoir less predictable:

> Before production begins from a reservoir there is a good degree of predictability in how the reservoir will behave. Heterogeneity will always keep the future

> behaviour of a reservoir from being known with complete certainty, but the fairly evenly distributed pressure and fluid saturations in a reservoir before production occurs give it higher predictability. ...
>
> As production commences, the behaviour of the reservoir becomes less and less predictable. Local changes in fluid saturations and pressure differentials, and an increasingly uneven distribution of these properties, adds a greater amount of uncertainty to the reservoir. The controllability of the reservoir is significantly reduced, making it harder to plan the optimal development strategy.
>
> I would have strongly recommended SAGD in a field like Eyehill Creek had it been undisturbed. SAGD would have been feasible before primary production occurred. However, due to factors such as the lower oil saturations, higher water and gas saturations, and sand production from primary production, I would no longer recommend the Eyehill Creek pool for thermal recovery (after primary production).

232 Mr. Baker dismissed the possibility of non-thermal recovery methods in his Screening Report. Mr. Baker's screening was a first level screening that did not model or simulate any particular process. He considered the reservoir characteristics of Eyehill Creek before intervention by Wiser and concluded that the ideal EOR process would have been SAGD, but that other thermal EOR techniques, such as CSS and steam flood would have been feasible. He stated in his testimony that the main reason for rejecting chemical or polymer flooding at Eyehill Creek was the high oil viscosity.

233 The Defendants refute IFP's arguments on two grounds. First, they submit that the reservoir characteristics described by Mr. Baker existed in the depleted portions of the Eyehill Creek reservoir when IFP first acquired its working interest. PCR's original thermal development proposal was based on the undepleted and depleted sections of the reservoir. At the time, PCR saw depletion as an economic issue. Depletion from primary production would result in drilling challenges that could be overcome with increased expenditure, but would not create any insurmountable obstacles to SAGD production. The Eyehill Creek Thermal Project prepared by the Van Horne unit in August 1998 stated, "The distinction between depleted and undepleted areas is important because, although it has only a minor effect on the SAGD process, it has a significant effect on our ability to drill the wells." The belief in the ability to drill in the depleted area and overcome any drilling challenges formed part of the foundation of the presentation given to IFP prior to IFP entering into the AEA. The Defendants question why it would have been possible for PCR to overcome the negative effects of primary production in 1998 but is not possible for IFP to do so now.

234 The Defendants also point to evidence suggesting other EOR operations might succeed in the

Eyehill Creek reservoir. Mr. Seal, manager of engineering and exploitation at Canadian Forest, explained in his testimony that Canadian Forest considered the feasibility of implementing a chemical flood in Eyehill Creek and hired a consultant, Surtek Inc. ("Surtek"), to assess the potential for chemical flooding of the reservoir. Surtek concluded that Eyehill Creek "is an excellent polymer or Alkaline-Surfactant-Polymer (ASP) flood candidate. Projected economics are excellent."

235 Mr. Seal claimed Canadian Forest stopped investigating this option due to IFP's lawsuit. He stated, however, that Canadian Forest would have recognized IFP's interest had it proceeded with this type of EOR development. I acknowledge that the authors of the Surtek report were not before the Court and were not subject to cross-examination; I do not rely on the report for the truth of its contents. I do note, however, that Canadian Forest thought the potential for chemical flooding to be worthy of study and spent at least $500,000 to investigate the possibility.

236 The Defendants had given notice of their intention to call Dr. Mehran Pooladi-Darvish as an expert in the general areas of hydrocarbon reservoir engineering and modeling. His rebuttal reports to Mr. Baker's three reports were marked as exhibits for identification and were used in cross-examination of Mr. Baker, but Dr. Pooladi-Darvish was not called as a witness at trial and his reports were not tendered into evidence.

237 In discussing Dr. Pooladi-Darvish's rebuttal report, Mr. Baker admitted in examination in chief that some Canadian companies have had initial success with polymer flooding. He noted, however, that the field process was fairly immature, especially for fields with high oil viscosity and that polymer flooding is very difficult in fields with wormholes. He agreed that selection of the appropriate enhanced recovery process requires experimental valuations and simulation, as well as economic analysis and field pilot projects and particular methods cannot be ruled out conclusively on first screening. When pressed in cross-examination, Mr. Baker did not state that Eyehill Creek could not be developed through EOR methods, only that it would be risky.

238 IFP submits I must accept Mr. Baker's evidence because the Defendants have not called an expert witness to respond to Mr. Baker. It argues Mr. Baker's opinions respecting reservoir impacts (the disadvantages caused by the creation of wormholes, pressure changes, changes in fluid saturations, controllability, risk of cap rock fracture, etc.) have not been contradicted.

239 I reject IFP's argument that I must accept Mr. Baker's evidence because he is the only expert on the issue. Mr. Baker was argumentative and evasive in testimony, particularly when addressing inconsistencies in his evidence, and he deflected questions repeatedly with jargon and long, ultimately unhelpful, explanations. There were detailed challenges to his evidence and opinion through which it became evident that Mr. Baker's analysis of the impacts of primary production on the reservoir was more qualitative than quantitative. In relation to one issue, he admitted his answer was "speculation based on my experience." In general throughout his testimony and in his reports, Mr. Baker appeared to rely on his status as an expert, without substantiating his opinion with solid

information or coherent explanation. Coupled with his complete lack of candour with respect to his calculation of oil viscosity at high temperatures, discussed in more detail below, I find I am unable to give Mr. Baker's evidence much weight. His reports and testimony were less than compelling.

240 On the whole, I agree with the Defendants' position that the operational issues identified by Mr. Baker can be overcome. IFP clearly believed this to be the case given its interest in PCR's initial thermal development proposal which included development of the "depleted" areas of the Eyehill Creek reservoir. While these operational issues may create greater challenges for a SAGD development and will affect its cost, I find they have not made a SAGD or EOR project impossible. IFP presented no economic evidence to prove that the increased costs associated with overcoming these operational challenges would render any future thermal or other enhanced recovery project uneconomic and I cannot so find in the absence of such evidence.

241 IFP also relies on the evidence of Mr. Lew Hayes to argue that primary production has made it impossible to drill the horizontal wells needed for a SAGD development. Mr. Hayes was qualified as an expert in "the areas of drilling, completion and production of oil and gas wells, including industry recommended practices and regulatory requirements for those things in reservoirs that have the potential to become part of a thermal recovery scheme and the planning, operations, and management of heavy oil development projects."

242 Mr. Hayes explained that industry practice generally is "to preserve pristine conditions in the reservoir to ensure consistent operational parameters in the SAGD process." He stated that drilling, completion and production all affect the reservoir condition and often "these combine to substantially increase the risk to future activities."

243 Mr. Hayes examined the production impacts and the physical impacts of primary development in sections 9 and 16. Mr. Hayes described the intensive nature of Wiser's and Canadian Forest's primary operations. Since 2001, Wiser and Canadian Forest collectively drilled 28 new wells in sections 9 and 16 and reactivated 15 previously shut-in wells. His maps and charts graphically illustrate the significant volumes of oil, sand, and water produced in sections 9 and 16 since 2000. He stated "[t]hese volumes must be considered substantial and will have changed the reservoir condition."

244 Mr. Hayes identified similar impacts from primary production mentioned by Mr. Baker such as lowered pressures, wormholes, glory holes (large voids around a primary well with either no sand or less sand than the native reservoir), etc. along with physical impacts related to well and casing design.

245 Mr. Hayes explained the new wells produce sand along with oil through progressive cavity screw pumps or an aggressive high volume pumping system. Sand production is a means of enhancing recovery; it increases the permeability near the well bore by creating glory holes around the vertical wells and wormholes throughout the reservoir. It also lowers the overall reservoir pressure, as does water production. Sand production results in "increased permeability with no

control of where the enhancement will occur in the reservoir -- vertically, laterally or a combination of the two."

246 In 1992, Mr. Hayes, as the drilling and completion manager for CS Resources, oversaw the drilling of a horizontal well (4C2H-21) in section 21 of the Eyehill Creek reservoir, an area with significant previous primary production. In drilling the well, his team encountered the most severe lost circulation problems he has ever seen in his career.

247 When drilling a well, the pressures from the drill and drilling fluid typically exceed the reservoir pressures of the formation. Since the pressure from the well is higher, the fluids find a way to flow into the reservoir if it is permeable. Lost circulation occurs when there is uncontrollable flow of drilling fluid out of the well bore and into the reservoir. Reservoir conditions contributing to lost circulation include depletion resulting in low reservoir pressure; sand production creating voids, wormholes, and high permeability networks; and high water saturation, which affects the ability of drilling fluids to prevent the losses.

248 Lost circulation affects drilling in several ways. It may compromise the ability to directionally drill accurately and place the horizontal wells needed for SAGD production. In addition, the materials introduced into the drilling system to correct the lost circulation may have a negative impact on the completion and production processes. Completion involves cementing the vertical portion of the well bore and lining the horizontal well with a slotted liner. Cementing is more difficult in depleted low-pressure reservoirs because, as a heavier substance, the cement used in completing the vertical portion of the well may leak off into the rock the same way as the water or drilling mud.

249 Mr. Hayes described his experience drilling the 4C2H-21 well in which drilling mud came up through the annulus of offsetting vertical producer wells a full pattern away. This occurred several times. It was apparent the lost circulation involved direct hydraulic communication between the horizontal well and the pre-existing vertical wells; there were "very, very unrestricted channels in the rock and the mud actually flowed from the horizontal well a significant distance over to the vertical well." Mr. Hayes concluded section 21was not an intact formation. He stated the 4C2H-21 well was a technical and financial failure; CS Resources abandoned the well due to sand production and poor production results.

250 Mr. Hayes likened sections 9 and 16 to section 21, as having the same, potentially major, lost circulation challenges. It was clear throughout Mr. Hayes' examination in chief and cross-examination that the unprecedented difficulties he encountered in section 21 strongly influenced his conclusions as to the likelihood of problems in a SAGD project in sections 9 and 16.

251 Beyond drilling and lost circulation issues, Mr. Hayes highlighted problems posed by non-thermal cement. The wells drilled by Wiser and Canadian Forest after 2000 used neither thermal cement nor thermal casing. Casing is a piece of pipe put through the zone inside the drilled hole and cemented into place in the well. The purpose of the cement and casing is to create

hydraulic isolation between zones and to provide consistent pressure throughout the well. Non-thermal cement will break down at high temperatures and hydraulic isolation will be lost. He explained that industry recommended practices (IRPs) require the use of thermal cement in any thermally affected areas. Wells with non-thermal casing require abandonment prior to undertaking a thermal project.

252 Mr. Hayes reviewed the 10 wells drilled before 2000 in sections 9 and 16: four were drilled and abandoned and six were cased, all with non-thermal cement. Likewise, after 2000, none of the wells used thermal cement. He explained the consequence of these choices at p 16 of his report:

> The decision not to use thermal cement may compromise the future potential for a thermal operation, which **would not be possible at all as long as the wells which were completed without thermal cement are being used in operations.** ...non thermal cement when subjected to high temperature will break down and lose the ability to maintain hydraulic isolation.
>
> The decision not to use thermal cement would impact any Board approval for a future thermal project. **An abandonment solution required with respect to the actions required to alleviate the thermal zonal isolation issue would be required.** [Emphasis added.]

253 He concluded at p 17:

> **...the decision to drill and complete the wells with non thermal cement will compromise the ability to complete a thermal project in the thermal development area.** Approval for a thermal project will not be possible while wells not completed thermally are in operation. After those wells have ceased to operate, there will be an incremental cost to any thermal development project. [Emphasis added.]

254 In his testimony, Mr. Hayes explained a cemented well is a "pretty permanent thing", limiting the options to make it compatible with a thermal project. To remediate, the non-thermal cement and non-thermal casing must be milled out and replaced with a thermal cement plug, at an estimated cost of $250,000 to $400,000 per well, for a total estimated abandonment liability of $8.75 million to $14 million in sections 9 and 16.

255 Cross-examination did not shake Mr. Hayes' evidence on this point, nor did the defendants' expert, Mr. Hollies, refute it. There is no doubt the presence of non-thermal cement needs to be addressed prior to undertaking a thermal project at Eyehill Creek and there will be, quite obviously, a cost associated with doing so.

256 In oral testimony, Mr. Hayes summarized his overall opinion:

> ...I strongly feel that because of the production, because of the well design that has been completed in the area by the companies, Wiser, Canadian Forest, that this project has been -- **the ability to do a SAGD project is somewhat compromised in this area.** I think that it is very important to avoid, as I have talked about, the depleted areas as much as possible, certainly with the experience on the well that I drilled at 4C2H of 21 and that I wouldn't recommend a SAGD project be undertaken here right now because of those impacts. [Emphasis added.]

257 The Defendants countered with Mr. Doug Hollies, qualified as an expert in "oil and gas well drilling, completion, and production requirements and general practice in these fields, including thermal horizontal oil well drilling."

258 Mr. Hollies did not refute Mr. Hayes' opinion outright. In general, he agreed with Mr. Hayes' assessment of the challenges of SAGD development in low-pressure reservoirs but he found the challenges and risks presented by primary production to be "incremental" over those inherent in any SAGD drilling operation. He explained that all horizontal well developments have challenges with respect to: 1) directional drilling control (staying in the zone of interest and wellbore straightness); 2) formation damage (impairment of the formation's ability to flow oil or gas); and 3) mechanical issues associated with drilling around a 90 degree bend and for hundreds of meters through loose sand.

259 Mr. Hollies acknowledged the removal of sand from the Eyehill Creek reservoir will have somewhat destabilized the oil and water bearing sand beds and the resulting instability likely would create challenges with maintaining drilling fluid circulation. He downplayed the severity of these challenges, however, and suggested modern drilling and completion technologies could overcome them.

260 Mr. Hollies explained how thermally decaying direct emulsion fluids can create an external and internal filter cake in the formation and/or the wellbore to maintain circulation. He also suggested calcium carbonate pills or acid soluble particle injection as a means of mitigating lost circulation. Mr. Hollies highlighted newer drilling technologies, including magnetic ranging systems, to better control drilling direction. Overall, he acknowledged approximately 20% higher drilling costs per well to address the various issues arising from the destabilized sands.

261 He concluded the executive summary at p 1 of his report by acknowledging the increased costs, but supporting the technical viability of the project overall:

> I see no concerns regarding wellbore placement or formation damage that might have long term corporate impact. **There may be some increased costs from dealing with infrequent lost circulation** and some advanced drilling fluid technology, but there **seems to be relatively little risk in drilling the horizontal wells** necessary to make the Eyehill Creek Field a successful Steam Assisted

Gravity Drainage (SAGD) Project. [Emphasis added.]

262 Mr. Hollies also suggested a modified SAGD operation might be appropriate at Eyehill Creek. In traditional SAGD, the horizontal injector well is placed 5m vertically above the producer well. In modified SAGD, the horizontal well pairs are offset laterally with less vertical depth. He indicated the spacing of modified SAGD well pairs greatly diminishes the risks associated with increased permeability from the previously produced formation.

263 Mr. Hayes acknowledged in his surrebuttal report that it would be easier to drill such an arrangement than to drill traditional SAGD well pairs. Nonetheless, Mr. Hayes concluded at p 1 that Mr. Hollies "underestimates the magnitude of the problems which can be created by sand production, commonly defined as wormholes, in an environment which has been subjected to primary heavy oil production." He questions whether Mr. Hollies' proposed strategies would have resolved the circulation issues in well 4C2H-21 and whether they would resolve the issues that might arise in sections 9 and 16, given the extensive wormholes likely now present in the reservoir. Mr. Hayes admitted in cross-examination, however, that it cannot be inferred from the failure of the 4C2H-21 well that a modern day SAGD well pair program would also fail. He also conceded that he might not have had enough calcium carbonate to mitigate the lost circulation events he faced. He acknowledged that drilling technology has advanced greatly since that time, presumably improving the chances of successful drilling operations.

264 I find Mr. Hollies' experience with new technologies is more hands-on and direct than that of Mr. Hayes. I also find Mr. Hayes' experience with the unusually severe lost circulation in well 4C2H-21 has heavily influenced his perspective. I find there is no reason to assume, particularly with the modern technologies now available, that such an unprecedented lost circulation event would recur, in spite of potentially similar reservoir conditions.

265 I accept Mr. Hayes' evidence that there are now greater technical hurdles to developing sections 9 and 16 as a SAGD project than there were before Wiser and Canadian Forest initiated primary production in 2000. However, I accept Mr. Hollies' evidence that modern technologies and adequate planning can overcome these hurdles. I appreciate that doing so will require additional expenditures for materials to prevent lost circulation, advanced drilling technologies, etc. and I accept Mr. Hayes' evidence regarding the need to plug the non-thermal wells with thermal cement, also at additional cost.

266 Both Mr. Hayes and Mr. Hollies proffered their opinions on the overall viability of a SAGD operation at Eyehill Creek, but neither is a SAGD expert. Their expertise lies in identifying the drilling challenges likely present in a depleted field and offering solutions on how to overcome them.

267 After considering Mr. Baker's, Mr. Hayes' and Mr. Hollies' evidence, I am not persuaded that it is no longer possible to pursue thermal or other enhanced recovery operations in the Eyehill Creek reservoir. I find that the improved technologies can overcome the challenges arising from the

depletion of the reservoir caused by Wiser's and Canadian Forest's primary operations, although I accept there will be a higher cost in doing so.

268 IFP has not proven that its working interest has been destroyed by Wiser's and Canadian Forest's primary operations, although I accept that its value may have been reduced. While the benefits of IFP's working interest may be more expensive to realize and there is now less oil in the ground, I was provided with limited evidence as to the increased costs of any future development. There is no way for me to calculate the value of any such potential loss.

269 The value of any future development has been reduced further by the loss of LSDs 2, 4 and 8 of section 16, but I also have no means to calculate the value of any such potential loss. Furthermore, I note the contradictory nature of IFP's claim on this ground: IFP objects to Wiser's surrender of these lands, yet it also objects to Wiser's primary production, the most common method of maintaining leases in good standing.

270 In the event that I am wrong and thermal and other enhanced recovery prospects no longer exist at Eyehill Creek, I will go on to calculate the damages for IFP's loss of opportunity.

VIII. Damages

271 Although I have found PCR is not liable to IFP for breach of contract, I will undertake a provisional assessment of damages given the length of the trial and the volume of expert evidence presented on that subject.

A. General principles for loss of opportunity damages

272 The most basic principle of compensatory damages is that the party complaining should be put in the position it would have been in if the wrong had not been done: ***Ticketnet Corp v Air Canada***, (1997), 154 DLR (4th) 271 at para 97 (CA), leave to appeal to SCC refused 161 DLR (4th) viii. The object is to achieve a broadly equitable result: ***Nathu v Imbrook Properties Ltd***, 125 AR 34 at para 25 (CA).

273 Where a contract is breached so that a party is deprived of an "opportunity" to obtain a benefit that was speculative at the time the contract was entered into, the party has suffered a "loss of chance" or "loss of opportunity." Had the contract been completed, the wronged party may or may not have obtained the benefit sought, but since the party has been deprived of the chance to obtain the benefit, that party may seek damages for the value of the lost opportunity.

274 If the plaintiff is able to prove that the defendant's conduct prevented the enjoyment of an opportunity -- beyond the *de minimus* range -- to gain a benefit or avoid a detriment, the plaintiff may be granted relief, discounted to reflect the likelihood of the opportunity being realized. Harvey McGregor, in his text *McGregor on Damages*, 18th ed (UK: Thompson Reuters (Legal) Limited, 2009), quotes at page 345 from ***Davies v Taylor***, [1974] AC 207 (HL) at 213:

> You can prove that a past event happened, but you cannot prove that a future event will happen and I do not think that the law is so foolish as to suppose that you can. All that you can do is to evaluate the chance. Sometimes it is virtually 100 per cent: sometimes virtually nil. But often it is somewhere in between.

275 While it may be impossible to assess the chance lost with precision, the impossibility of achieving accuracy does not relieve the contract-breaker from paying damages: ***Penvidic Contracting Co v International Nickel Co of Canada***, [1976] 1 SCR 267 at 279-80. In assessing damages, the court must make its best conjecture of what "would have been": ***Argus Machine Co v Stan's Power Tong Service Ltd*** (1988), 93 AR 18 at 21-22 (CA), aff'd 97 AR 314. The amount assessed for the loss of opportunity represents an exercise of judgment based on the particular facts of the case: ***REC Holdings Co v Peat Marwick Thorne***, [1997] BCJ No 1640 at para 121 (SC).

276 The quantum of damages is a question of fact and the rules relating to damages assessments must be liberally construed and not too rigidly applied: ***Sunshine Exploration Ltd v Dolly Varden Mines Ltd (NPL)***, [1970] SCR 2 at 18. Once the court has calculated the value of the opportunity, it must assess the likelihood that the plaintiff would have obtained the benefit. The basic principle is that the greater the number of contingencies faced by the plaintiff in the chance to obtain the benefit, the lesser will be the quantum of damages awarded.

277 Thus, assessing damages for a lost opportunity involves the following steps:

(1) deciding whether the claim for lost opportunity is real, as opposed to fanciful;

(2) assessing the value of the opportunity if it had been realized; and

(3) assessing the likelihood the opportunity would have been realized and discounting the damages to reflect the possibility that the opportunity would not have been realized in any event.

278 IFP bears the burden of establishing, beyond the *de minimus* range, that by entering the ARO with Wiser without IFP's consent, PCR prevented IFP from enjoying the opportunity to benefit from thermal development at Eyehill Creek. IFP must then establish the value of the lost opportunity. Finally, IFP must tender sufficient evidence to prove the likelihood of realizing upon the opportunity. The quantum of damages will be discounted proportionate to the likelihood of realizing upon the opportunity.

279 Despite my findings above, for purposes of this damages analysis, I must assume IFP was reasonable in withholding consent. I must also assume that PCR's pursuit of a contract with Wiser in the absence of IFP's consent and Wiser's subsequent development of the reservoir has damaged Eyehill Creek for any future thermal or EOR development.

B. Evaluating the Lost Opportunity

1. Did IFP have a real, as opposed to fanciful, opportunity to participate in a thermal or other enhanced recovery project at Eyehill Creek?

280 The parties' submissions on this issue focussed primarily on the likelihood of a thermal project proceeding at the time of the farmout to Wiser. PCR argued it had no intention of pursuing thermal development at the time because of poor economics and changing corporate priorities. IFP conceded the economics were unfavourable for thermal development but argued this does not mean a thermal project never would have been undertaken or that the Eyehill Creek reservoir no longer had any value as a thermal or EOR project.

281 These arguments do not speak to the question of whether IFP lost a real versus fanciful opportunity. They relate to the final part of the loss of opportunity damages analysis in which the court must assess the likelihood the opportunity would have been realized and discount the damages to reflect this likelihood.

282 At this stage of the analysis, it is a threshold inquiry: establishing beyond the *de minimus* range that there was a real (tangible) opportunity. Placing a man on the moon may have been a fanciful opportunity in 1945, but it was a real opportunity in 1969. Similarly, the question here is whether IFP's opportunity to benefit from thermal or EOR development at Eyehill Creek in 2001 was real or fanciful, not whether it was likely in the existing economic environment.

283 IFP argues that it is clear the reservoir at Eyehill Creek had significant value as a SAGD project. In the AEA, the parties valued the assets transferred at $16 million and IFP allocated $14.8 million to its 20% working interest in Eyehill Creek. IFP submits that PCR's thermal specialist Mr. Gittins described Eyehill Creek as PCR's best SAGD project (technically and economically), even though heavy oil prices were low at the time. PCR's thermal team never changed its views on Eyehill Creek.

284 At the time of the farmout to Wiser, PCR was carrying Eyehill Creek on its books as a thermal and a primary project. As late as August 2000, PCR recognized, evidenced by Laureen Little's minutes, that "the property appears to have value for thermal operations in section 9" which "needs to be evaluated as a potential thermal project for PCR either now or in the future." The minutes further note that PCR needs "to consider what work (if any) would be required to hold section 9 rights until we are ready to pursue this project." PCR made its decision to farmout to Wiser for strategic reasons having regard to its other projects, its finite human resources and other factors unique to its interests. PCR's decision does not mean thermal development of Eyehill Creek was not a possibility.

285 Given the *de minimus* threshold at this stage of the damages inquiry, I find IFP has established that it had a real opportunity.

2. What value can be attributed to the loss of opportunity at Eyehill Creek?

286 The second stage of the analysis is to determine the value of the lost opportunity. As the basis for its damages assessment, IFP has put forward a conceptual model, constructed by its experts, of a SAGD project that could have been carried out at Eyehill Creek if Wiser's and Canadian Forest's primary production operations had not taken place. The model focusses on the previously undepleted areas in sections 9 and 16. IFP did not base its damages model on PCR's 1998 proposed project for the development of the Eyehill Creek field.

287 The Defendants take issue with IFP's damages model, calling it a fictional development. They argue the quantification of IFP's damages should have been a simple affair: it is the market value of IFP's interest today as compared to what it would have been today if the ARO had not closed. The Defendants suggest that IFP failed to put a valuation report before the Court because the value of the lost opportunity is nil.

288 I reject this characterization of the damages analysis. IFP's provisional damages are for the loss of opportunity to develop Eyehill Creek as a thermal or other enhanced recovery project and to obtain the financial benefit of such a project. The market value of the lands may reflect, to some extent, the potential held within those lands, but it does not equal the potential profits to be drawn from exploiting the mineral resources within those lands.

289 They also dispute the reliance placed by IFP's experts on information post-dating 2001, the time of the alleged breach. According to the Defendants, the Plaintiff's reliance on information available in 2009 and 2010 demonstrates "another layer of the fiction of the IFP damages model."

290 It is clear there are significant flaws in the Plaintiff's damages model resulting from a number of errors introduced by several experts. The Defendants submit the Plaintiff's model must be rejected entirely, not simply discounted. I will address each expert's evidence and the corresponding critical errors in turn.

Overview of IFP's experts

291 IFP retained a team of experts to develop its conceptual model for Eyehill Creek. Dr. Brad Hayes was qualified as an expert in the geological interpretation and mapping of petroleum reservoirs. He prepared a detailed geological interpretation of the southern part of the Eyehill Creek reservoir based on well data (cores and well logs), as well as a review of the regional geology, to assist in determining the value of oil reserves potentially recoverable through a SAGD development at Eyehill Creek. The physical cores taken from several of the wells in the Eyehill Creek area were examined by Dr. Hayes. He explained how the various depositional events could be read from the cores.

292 Dr. Hayes identified two main phases of deposition -- the "Lower McLaren" phase of

high-quality reservoir sandstone and a later "Upper McLaren" phase of non-reservoir quality rock that had sharply incised the Lower McLaren in places. He described the reservoir as "highly mappable" in that it was "highly continuous" within the Lower McLaren interval; he had a high degree of confidence that the reservoir rocks could be mapped from well to well based on core and log data.

293 Dr. Hayes directed Mr. David Kisilevsky, who was qualified as an expert in the area of geological interpretation of petroleum reservoirs including quantitative petrophysical analysis, to undertake a quantitative petrophyiscal analysis of the Eyehill Creek reservoir. He did so relying on data from 72 wells in and around the southern part of the reservoir to calculate the physical reservoir characteristics at specific depths including shale volumes, porosity, and water saturation.

294 Dr. Hayes also directed Dr. John Carey, who was qualified as an expert in the geological interpretation and mapping of petroleum reservoirs including the construction of geocellular models, to create a geocellular model of the southern part of the reservoir based on Dr. Hayes' geological interpretation and Mr. Kisilevsky's petrophysical analysis. Geocellular modelling is a standard industry practice commonly used as the basis for reservoir simulations in which a computer-generated three-dimensional model is built to provide a geological representation of a reservoir in quantitative form.

295 Once the model was built, Dr. Carey chose, in consultation with other members of IFP's expert team, two small rectangular areas of the model (400m X 1000m) for simulation by Mr. Baker, rescaling the grid cells so they would fit Mr. Baker's simulation software.

296 Mr. Baker's simulation was designed to estimate the potential oil recovery if SAGD had been implemented in the field before the intervention of Wiser and Canadian Forest. Mr. Baker developed three simulation cases to bracket the range of outcomes. The "Base Case" represented the most likely range of reservoir properties in the heart of the reservoir. The "Thin Case" estimated the response in thinner parts of the reservoir in which the gross pay was less than in the central area. The "Southwest Case" considered an area where an active aquifer underlies the reservoir and there is slightly poorer reservoir quality.

297 Mr. Bob Shepherd was qualified as an expert in the area of petroleum engineering, including the planning, design and implementation of petroleum development projects and the economic and technical evaluation of such projects using industry-standard methods including discounted cash flow forecasts. Together with IFP's other experts, he worked on the development and valuation of a conceptual project consisting of 29 SAGD well pairs in sections 9 and 16: 7 wells in the Base Case, 14 wells in the Thin Case, and 8 wells in the Southwest Case.

298 He predicted production of 9,000 barrels of oil and 30,000 barrels of steam per day over an 8-10 year project life to produce approximately 29 million barrels of oil. Mr. Shepherd estimated the present day value of the Eyehill Creek project as a whole. He later adjusted his calculations in a surrebuttal report, taking into consideration criticism from some of the Defendants' experts. His

revised figures estimated a present day value of $212.2 to $256.8 million for a project with new facilities and a present day value of $243.2 to $294.3 million for a project using some of the existing facilities at Eyehill Creek. (The ranges come from the difference between calculating present day value using the Consumer Price Index versus the Long Term Bond rate.) IFP's share of these amounts would be proportionate to its working interests.

Geomodel

299 Dr. Carey's geomodel was attacked for its inclusion of data points he added to his model, which he variously referred to as "pseudo wells," "dummy wells," or "fake wells." In his primary report, he described them as "imaginary zero points", added to "define a sharp, geologically-reasonable eastern valley edge". He gave them zero thickness values to prevent the valley from spreading out unrealistically to the east. Their purpose was to ensure the model conformed to the geological interpretation. They were clearly identified as fake wells in the output data provided to the other experts.

300 In his testimony, however, Dr. Carey admitted he had forgotten about three other fake wells he had added to the model elsewhere: one to the southwest of the reservoir (in LSD 7 of section 8), one in the south and one in the northeast of section 16. Dr. Carey agreed in cross-examination the effect of his "fake well 7" (the one in LSD 7 of section 8) was to lift the structure of the reservoir, thereby reducing the effect of bottom water. He also acknowledged he had neglected to use an actual well in the same LSD for which Mr. Kisilevsky had provided petrophysical data and that showed the sand to be entirely below the oil/water contact.

301 Dr. Carey was unable to say what effect his fake well 7 would have on his geomodel. While he thought it probably did not have much effect because it was some distance away from the modelling area, he acknowledged it could have an effect on the well pairs in the southwest area.

302 The Plaintiff concedes that Dr. Carey erred in using data from his fake well 7 rather than data from an actual well analyzed by Mr. Kisilvesky and that the error undoubtedly resulted in the structure of the model in the southwest area being raised higher than it should have been. The Plaintiff argues, however, that there is no evidence to suggest how the placement of fake well 7, or any of the other fake wells, affected the geomodel. It suggests the Court remove some of the southwest well pairs from the damages model.

303 The Defendants argue that simply removing the wells affected by Dr. Carey's fake wells is not appropriate. The Plaintiff did not offer any evidence on the effect of removing the improperly included fake wells from the geomodel or on the effect of a changed geomodel on the reservoir simulation model or the resulting development plan and economic analysis. There is no evidence, for example, that a project with a number of wells removed would have the economies of scale to be viable. The Defendants take issue with the Plaintiff's invitation to the Court to accept counsel's estimate of the appropriate discount rather than attempting to quantify the effects with its experts who were well-qualified to do so.

304 The Defendants rely upon the rebuttal report and testimony of their expert Mr. Michael Uland. Mr. Uland prepared an expert report containing an alternate geomodel, marked as Exhibit "A" for identification during the examination of Dr. Hayes. During their testimony, Dr. Hayes, Mr. Kisilevsky, and Dr. Carey presented rebuttal reports with their comments on Mr. Uland's geomodel and were cross-examined using Mr. Uland's geomodel, yet the Defendants chose not to enter Mr. Uland's geomodel into evidence when he testified. Instead, the Defendants entered only his rebuttal report into evidence.

305 The Defendants sought to have Mr. Uland qualified as an expert in the general areas of geology, petrophysics, integrated reservoir characterization, and geostatistical modeling. There was vigorous debate as to whether this was a proper description of his expertise. Justice Stevens proceeded to receive his evidence on the following terms:

> ...As far as I'm concerned, he's clearly an expert in modelling, and he's a professional engineer, and he works with a team that does stuff that sounds an awful lot like Mr. Baker. And when I look at the IFP team as a whole, maybe it's what iReservoir [Mr. Uland's employer] does, but I don't know. I'm going to have difficulty making a determination as to what's what until I hear what he has to say. ...
>
> ...
>
> Here's the way we're going to proceed. You know, he strikes me as an expert. He's not a geologist, but he's a model simulator and been doing it for a long time, and he sounds an awful lot, as I said, like Mr. Baker to me or some of these others that have been in front of this Court. But I like Mr. de Waal's suggestion, which is let him give his evidence, and Mr. de Waal can take him apart, if he can, on cross, as it relates to his expertise. But until I hear what he has to say and you get the explanation as to why he says it, I don't know whether it's modelling or geology. He's going to be in more trouble if he says it's because of geology because he's not a geologist.
>
> But it's apparent to me that these people that model reservoirs, if they're professional engineers, know something about geology. They know something about drilling. They seem to become quite conversant in other areas of specialty in order to do their job. So let's proceed, but I would recommend, the two of you, that you extract from Mr. Uland the basis upon which he has these opinions so that I can differentiate between engineering and geology or reservoir engineering or modelling or simulation or whatever it is. But I need to know so that I can address the concern that Mr. de Waal has raised.

306 In preparing his rebuttal report, Mr. Uland reviewed the input data assumptions, and

modeling parameters, and modeling workflow choices of IFP's experts. He concluded that most of the geomodel construction decisions were within the acceptable range of industry standards, but several other choices were fatally flawed. Mr. Uland identified four problem areas with IFP's experts' reports. First, he opined that IFP's experts placed a number of SAGD wells in areas where the net oil pay zone was not thick enough to support SAGD. Second, he expressed his opinion that several of the Base Case wells were placed inappropriately in high risk locations, including in marginal muddy sands. Third, he alleged two wells in the Base Case were poorly placed in a carbonate-cemented area of the reservoir that would restrict vertical flow permeability. Finally, he stated there was a "globally serious" issue "that affects the entire IFP model" by including muddy-sand oil volumes in the OOIP estimate for the Base Case.

307 These four issues with the IFP geomodel are in addition to the unquantified effect of the fake wells. Mr. Uland explained in his testimony that Dr. Carey's three fake wells were "controlling the answer" produced by the geomodel. Essentially, in the three affected areas, the geomodel used to develop IFP's damages analysis reflects arbitrary numbers attached to fake wells created by IFP's experts, not the actual geology of Eyehill Creek.

308 In sum, the Defendants submit the effect of Mr. Uland's specific critiques of the IFP geomodel are that 13 of the 29 wells in the model should be removed, and that in addition, 24% of the oil recovery claimed by IFP should be risked.

309 Relying on Mr. Uland's evidence, the Defendants submit the geomodel is plainly unreliable, leaving the Plaintiff without a model upon which to base its reservoir simulation, and in turn, its economic analysis.

310 The Plaintiff rejects Mr. Uland's criticisms. It submits they are based largely on a misunderstanding as to the minimum reservoir thickness required for SAGD. Mr. Uland is not a SAGD expert and misinterpreted information he received from Mr. Gittins regarding minimum reservoir thicknesses. Furthermore, the Plaintiff argues Mr. Uland is not a geologist and was not qualified to express any opinion on the geology of the area in which the well pairs were placed. For example, it submits his opinion that two wells were placed in an area with vertical flow perm-baffles must be rejected. The Plaintiff notes Dr. Hayes was satisfied that the calcites were not laterally continuous over any significant area; therefore, they would not provide significant impediments to fluid flow. Also, Dr. Carey added that the cemented streaks were found at different elevations in the wells, so that there was no reason to expect that they represented laterally continuous beds.

311 Dr. Hayes in a surrebuttal report summarized at p 1 the reasons for the Plaintiff's rejection of Mr. Uland's critique:

> Mr. Uland's "issues" are not faults in the PRCL [Petrel Robertson Consulting Ltd. -- IFP's experts] geocellular model nor in its use by Carey to lay out a pattern of horizontal development wells. In my opinion, the issues arise from Mr.

Uland's misunderstanding of PRCL's geological interpretation, his lack of understanding of McLaren reservoir geology (as discussed by Hayes), and his rigid and simplistic assumptions about reservoir net pay cutoffs.

312 Finally, the Plaintiff submits Mr. Uland's opinion that muddy sands should not have been included in the model is beyond his expertise, as a question of geology. The Plaintiff notes Dr. Hayes and Dr. Carey were satisfied, upon examination of the cores and other well data, that the muddy sand facies are part of the reservoir and should be included in the model, with appropriate adjustments to reflect the fact that muddy sand does not have the same quality as the clean sand. The Plaintiff submits Mr. Uland was not qualified to challenge this and offered no technical analysis to support his statement.

313 I find Mr. Uland's criticisms go beyond his areas of expertise and I do not accept them. Nonetheless, the fake wells erroneously included in Dr. Carey's geomodel have created a faulty foundation for Mr. Baker's simulation and Mr. Shepherd's development plan and economic analysis.

SAGD simulation

314 Once IFP's geomodel was complete, Mr. Baker prepared a simulation using a small portion of it. The Defendants argue Mr. Baker's Simulation Report starts from an unreliable foundation, namely Dr. Carey's geomodel, and then introduces its own critical errors.

315 Mr. Baker imported the geomodel developed by Dr. Hayes and Dr. Carey into CMG STARS -- software designed to simulate reservoir performance. He ran simulations of the three scenarios representing different parts of the SAGD development area and concluded that each scenario showed "robust" performance.

316 Mr. Baker compared the results of his simulation with the reported results of two SAGD projects in the Lloydminster area and with recovery rates quoted in the literature. He found that his simulation results were comparable to actual results experienced in fields with similar reservoir characteristics.

317 Central to Mr. Baker's simulation was his measure of oil viscosity to predict the rate and volume of heavy oil recovery through a hypothetical SAGD process in the Eyehill Creek reservoir. The Defendants countered with Dr. Bennion, who was qualified as a viscosity expert (more specifically, a chemical, petroleum engineer with specific expertise in the field of steady-state and unsteady-state multiphase flow tests and reservoir fluid sensitivity evaluations, fluid behaviour analysis, including behaviour and testing of oil viscosity; and enhanced oil recovery evaluation). Dr. Bennion provided opinion evidence unequivocally discrediting the heavy oil viscosity values used by Mr. Baker in his simulation. The Plaintiff has conceded in argument, quite properly, that Mr. Baker's viscosity calculations grossly underestimated the likely viscosity of the heavy oil.

318 Dr. Bennion stated in his report:

> It is not only my expert opinion, but a matter of simple scientific fact, that these oil viscosity values are gross underestimates of the actual in-situ viscosity of Eyehill Creek heavy oil at these conditions and that the provided extrapolation is incorrect.

319 Dr. Bennion provided a number of reasons supporting his conclusions as to the inaccuracy of Mr. Baker's figures. He noted the data referenced in Mr. Baker's Simulation Report indicated typical heavy oil viscosity of about 5 centipoise at 200 degrees Celsius and of about 2 centipoise at 250 degrees Celsius. He questioned why Mr. Baker accepted a calculated viscosity for Eyehill Creek oil of 0.01 centipoise at 250 degrees Celsius when it was so inconsistent his own typical dataset.

320 Dr. Bennion explained Mr. Baker calculated his figures for the viscosity of heavy oil at high temperatures by extrapolating from a very limited data set at low temperatures using an equation more commonly used to predict the viscosity of conventional oils at low temperatures (the Andrade equation); he stated this equation results in inaccuracies at higher temperatures. He suggested two other equations (the Wolther equation or the Svreck/Mehrota correlation) would have generated more accurate results.

321 Dr. Bennion opined it should have been immediately obvious when the correlation produced a viscosity of 0.01 centipoise or 0.01 mPa.s (the metric equivalent) at 250 degrees Celsius (a viscosity that exists only with liquid hydrogen) that there was a gross problem with the data set. Dr. Bennion discussed the viscosity of various hydrocarbons and explained that even the lightest hydrocarbon, methane, does not have a viscosity as low as Mr. Baker's calculated viscosity for Eyehill Creek heavy oil. In fact, even liquid water and steam have higher viscosities.

322 Dr. Bennion stated in his testimony it was immediately obvious to him that the values of heavy oil viscosity predicted by Mr. Baker's correlation were at least 100 times lower than any physical measurement he had ever seen. He wrote, "...this 0.01 mPa.s viscosity is frankly physically impossible and suggests that the pressure-viscosity-temperature (PVT) dataset was formulated without regard for even the most basic principles of high temperature heavy oil properties." He went on to say in his testimony that "anyone who has any knowledge of fluid mechanics, heavy oil operations or multi-phase flow, would immediately know that that is by far out of range."

323 Dr. Bennion's report referenced the actual viscosity measurements taken by Weatherford Laboratories of the heavy oil at Eyehill Creek. At 200 degrees Celsius it had a value of 4-6 centipoise and at 250 degrees Celsius it had a value of 2-3 centipoise -- exactly in line with expectations and all other measured data and in close alignment with the extrapolated viscosity values calculated using more reliable equations.

324 Dr. Bennion's evidence also addressed a number of explanations Mr. Baker gave in his surrebuttal report to explain his low viscosity figures. Dr. Bennion explained in his testimony that even allowing for all of the factors mentioned by Mr. Baker, his figures were still too low:

> Accounting for experimental error, oxidation, thermal cracking, alterations, et cetera, I believe that if we used, say, 3 centipoise as our baseline, you could conceivably have up to 50 percent variation; so down to 1.5 centipoise, which **would still be 150 times higher than the number that he has used.** [Emphasis added.]

325 Dr. Bennion concluded his report by saying the viscosity error led to overly optimistic recovery rates at p 7:

> This is going to result in grossly optimistic oil recovery rates and recovery factors and significantly inflated net present values for the predicted SAGD operation. Since the oil viscosity is so intrinsically tied to the recovery rates and factors, **my opinion is that all of the simulation results conducted using the EPIC viscosity curve are invalid and should be discarded as extreme over estimations of actual field performance.** [Emphasis added.]

326 In his testimony, he explained:

> ...So given a constant permeability, if we use a viscosity that is 100 times too low, we are obviously going to grossly overestimate the production rate ...

...

> Based on that particular rule of thumb [the drainage rate in SAGD was approximately proportional to the square root of the fluid viscosity], **it would have a ten times or a tenfold increase in the production rate of the simulated project.** [Emphasis added.]

327 In spite of its concession regarding Mr. Baker's viscosity figures, the Plaintiff argues he remains the only simulation expert to give evidence and that his simulation can be accepted and a discount applied to account for the viscosity error. IFP submits Mr. Baker was the only expert qualified to express an opinion regarding the effect of using a viscosity value that was too high or too low on the results of a simulation of a heavy oil SAGD project; Dr. Bennion was not qualified to dispute the evidence of Mr. Baker on SAGD simulations.

328 I reject this contention. While not qualified as a simulation expert, Dr. Bennion is an expert in "fluid behaviour and analysis" and "enhanced oil recovery evaluation," so he is well-qualified to give evidence on the effect a dramatically lower viscosity would have on the oil flow rate. He confirmed the common sense conclusion that the results of a simulation are only as accurate as the inputs used in the first place. He noted in his report that "viscosity of the oil phase is one of the single most important controlling factors in the rate of oil recovery and recovery factor and computation of net present value for any thermal simulation project."

329 This echoes Mr. Baker's own comment in his Simulation Report that inaccurate inputs into a simulation model lead to inaccurate outputs:

> ...no matter how complex a mathematical model may be and how powerful the numerical method used, the results could still be misleading **if the formation description is inadequate or data on fluid properties inaccurate. Remember that garbage in equals garbage out.** [Emphasis added.]

330 It is clear that I cannot accept Mr. Baker's viscosity values and the calculations relying upon them.

Mr. Baker as advocate

331 The Defendants argue the entirety of Mr. Baker's evidence should be given limited, if any, weight in these proceedings not only because of his serious viscosity error but also because he demonstrated bias and lack of independence and advocated for the Plaintiff's position.

332 Courts have recognized that "[a]n expert witness should strive to be impartial and independent, and should not be an advocate for either party." ***Envirodrive Inc v 836442 Alberta Ltd***, 2005 ABQB 446 at para 135.

333 One of the key elements of independence is the disclosure by an expert of the facts or assumptions upon which his opinion is based. An expert must strive to ensure no material facts that weaken his opinion are omitted from consideration. While the expert's report itself may strongly advance the position of the expert's client, an expert cannot mislead, either in the report or in court: ***Jacobsen v Sveen***, 2000 ABQB 215 at para 35. Veit J stated at para 32:

> ...all experts who provide evidence in legal proceedings must comply with the basic requirements of such witnesses, **including an obligation to give an honest opinion**...Expert witnesses in civil cases have several duties and responsibilities when they are in court before a judge, and that includes **the duty to give independent and unbiased evidence. They may be advocates for their side and take an adversarial stance, but they cannot mislead the court by giving a less than honest opinion**, or one that would compromise their independence and undermine the court's reliance upon them. [Emphasis added.]

334 Importantly, "'independence' is not a strict criterion for an expert to be accepted by the court ... [a] lack of independence may influence the weight of the expert opinion": ***Malton v Attia***, 2013 ABQB 642 at para 28. Accordingly, "limitations facing an expert that ... relate (a) to his lack of detachment and (b) lack of independence, must go to the issue of weight assigned to the testimony of that expert": ***1159465 Alberta Ltd v Adwood Manufacturing Ltd***, 2010 ABQB 133 at Schedule 2, para 2.17, aff'd 2011 ABCA 259.

335 The Defendants submit Mr. Baker's evidence was debunked such that he should be regarded as an advocate for IFP rather than an impartial expert. Even if he is not found to be an advocate, they argue his evidence should be regarded as having very limited probative value. They suggest his simulation runs are demonstrably of no use in connection with the development project prepared by Mr. Shepherd. The inputs are clearly wrong and "garbage in equals garbage out," as Mr. Baker stated.

336 The Defendants point to a number of elements of Mr. Baker's evidence demonstrating his alleged bias and advocacy; I will address only one. The Defendants suggest Mr. Baker's unrelenting support for the use of the Andrade viscosity equation in his Simulation Report demonstrates the degree to which he was prepared to bolster and support his opinions and defend IFP's case, in the face of overwhelming scientific and expert evidence to the contrary, much of which was referenced in his own report and contemporaneous work.

337 Furthermore, Mr. Baker continued to defend his low viscosity measurement after he reviewed the Defendants' experts' rebuttal reports. He was provided with two rebuttal reports opining that his viscosity equation produced impossible results with respect to oil viscosity and that his model was flawed as a result. Although one of these reports, Exhibit N for identification, was not entered as a full exhibit, Mr. Baker was examined on portions of it. The examination showed he was familiar with the report, and most significantly, that he had notice of serious problems with his viscosity values before he prepared his surrebuttal report. Yet in his surrebuttal report he stated at p 9:

> I disagree with Fekete's statement that the viscosity at high temperature used in my simulation is too low.

Mr. Baker did not admit any error; instead he took vigorous steps to bolster the initial opinion he had expressed in his Simulation Report.

338 The Plaintiff argues Mr. Baker was not an advocate and highlights the differences between the cases in which an expert was found to be an advocate and the situation herein:

> Expert became closely identified with his client's case, used "pejorative and judgmental language" and wrote a report that was essentially a brief on behalf of the client: ***McNamara Construction Co v Newfoundland Transshipment Ltd***, 2000 CarswellNfld 402 at paras 6-7 (SC(TD)).

> Expert publicized he was the expert for one party and earned a large part of his income from a largely defence-oriented expert witness practice: ***Adwood*** at para 2.16 discussing ***Frazer v Haukioja*** (2008), 58 CCLT (3d) 259 (Ont Sup Ct J)

339 The Plaintiff argues Mr. Baker did no more than defend his opinion against that of a

similarly qualified expert, namely Dr. Pooladi-Darvish. The Plaintiff submits at para 25 in Appendix B to its written argument:

> Dr. Pooladi-Darvish had started the debate about viscosity in his rebuttal report. Witnesses on different sides of a trial often disagree -- there is nothing unusual about that. We respectfully submit that Mr. Baker was entitled to defend his opinion on viscosity against the criticisms of Dr. Pooladi-Darvish. The fact that he was eventually shown to have been incorrect does not mean that he was any less qualified than Dr. Pooladi-Darvish to express his opinion and does not make him an advocate for the position of IFP or affect his independence or credibility as an expert.

The qualifications of Dr. Pooladi-Darvish were of the same nature as those of Mr. Baker.

340 The Plaintiff admits that Mr. Baker, in his surrebuttal report in response to Dr. Pooladi-Darvish's rebuttal report, defended his viscosity inputs on a number of grounds. The Plaintiff argues, however, that defending his opinions, even if some of them were wrong, is completely different from identifying himself with IFP's case or advocating on its behalf. There is no reason for suggesting he intentionally manipulated the viscosity value to improve the simulation results to favour IFP, as the Defendants have suggested. The Plaintiff submits that if this had been the case, Mr. Baker surely would have found less obvious ways of doing so.

341 The Plaintiff concedes Mr. Baker was wrong to use the Andrade equation to extrapolate the viscosity of oil at Eyehill Creek from reservoir temperatures to steam temperatures. He was also mistaken in the explanations he provided in his surrebuttal report as to why his conclusions were reasonable. But the Plaintiff notes that Mr. Baker always made it clear that he did not regard himself as an expert on viscosity. He did not attempt to challenge Dr. Bennion on viscosity.

342 I accept the Defendants' criticisms of Mr. Baker's evidence although I find it unnecessary to go so far as to conclude that he was an advocate or biased. As discussed earlier in these reasons, I found him to be an evasive witness who never directly answered a question. He refused to concede his error, even when it was made readily apparent, and chose to vigorously defend his position instead. I cannot give his evidence any weight.

Economic evaluation

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343 Mr. Shepherd prepared a development plan and economic evaluation of the conceptual Eyehill Creek SAGD project. In his testimony he described the nature of his assignment:

> ...my focus was to determine with the team whether there was a potentially viable project here and to develop a plan for it and develop a valuation for it had it

proceeded.

344 His report set out his assumptions and conclusions regarding the project schedule, water treatment and steam generation systems, water sources, water recycling, cost of each well pair, royalty rates, etc. He created two different capital cost scenarios, one in which everything had to be constructed from the ground up and a second in which the existing facilities at Eyehill Creek were used. Both scenarios delivered a positive return on investment, even when he took a number of possible sensitivities into account.

345 He relied upon the information from IFP's other experts and assumed it was correct, including the selected well locations and the simulated well injection and production forecasts. He explained in his testimony that he "assumed that the technical team have appropriately modelled the geologic environment."

346 The Defendants criticize Mr. Shepherd's model for using actual historical oil prices rather than price forecasts. Mr. Shepherd purported to assess the project from the date of the lost opportunity in 2001, but he used actual oil price history from 2002 to 2010 and forecasted prices for beyond 2010. In this way, the Defendants argue he has removed any price risk from the model.

347 I accept Mr. Shepherd's use of actual prices since they provide the most accurate representation of the lost opportunity. I find the price risk issue relates more to the question of whether and/or when the opportunity would be been realized, not the value of the lost opportunity.

348 The Defendants also submit Mr. Shepherd's model takes the upside of every variable input. For example, he includes the cost of strat wells (to get more core samples and geologic information) and observation wells (to monitor temperature, pressure and other reservoir characteristics) but assumes good results for them and does not adjust for the contingency that the results of these further investigations by geologists could change the placement of the wells or the recommendation to proceed.

349 Ultimately, I need not decide on the impact of these concerns. As will be discussed in the section below, I find that the accumulation of errors by IFP's experts, particularly Mr. Baker's low viscosity figure, is such that I cannot accept Mr. Shepherd's valuation of the Plaintiff's conceptual project.

Effect of errors on IFP's damages model as a whole

350 The Plaintiff concedes that Mr. Shepherd's economic evaluation of IFP's conceptual project has been impaired by two things, the first being Dr. Carey's error in using data from fake well 7 in his geocellular model. IFP argues Dr. Carey believed the error would have only a small effect on IFP's damages model as a whole but he was unable to quantify it. The specific impact on the model is that some of the southwest wells may be less robust in their performance or may not be proper wells at all. There are eight southwest wells, out of a total of 29 project model wells. If half of the

southwest wells could not be drilled, they represent 14% of the total wells modelled.

351 The second problem was Mr. Baker's viscosity error. Mr. Baker testified that his error would not make a significant difference to the predicted well performance and that this conclusion is supported by the favourable comparison between his simulation model and actual well performance results. The Plaintiff submits the error should be viewed as introducing uncertainty rather than as a fatal flaw in the model and argues I must accept Mr. Baker's evidence on this point because the Defendants called no expert to give evidence to the contrary. In recognition of Mr. Baker's and Mr. Carey's errors, the Plaintiff suggests a reduction of "as much as 25%" for the uncertainty caused by the inclusion of Dr. Carey's fake well in the geomodel and Mr. Baker's "excessively low viscosity input." In sum, the Plaintiff submits the appropriate way to approach damages is to base them on Mr. Shepherd's model, using his revised and updated figures and then discounting this figure by 25%. The proposal to reduce the totals by 25% was never put to Mr. Shepherd.

352 By contrast, the Defendants argue I cannot accept Mr. Shepherd's economic evidence at all since it is premised on the flawed geomodel and flawed simulation model. They take issue at para 306 of their written argument with the Plaintiff's suggestion that a discount factor can be applied:

> ...The suggestion that Mr. Shepherd's project can start with the quantum of damages sought and discount for flawed geological and engineering inputs reveals the Plaintiff's results-driven approach to its damages model. Starting with the end result is not modeling, it is not good science and, it is submitted, it is not a valid foundation upon which to base a damages assessment.

353 In cross-examination, Mr. Shepherd conceded that errors in the geologic model would impact his economics:

> Q ...if there are problems with the geological model or if there are problems in connection with the modelling process itself, the foundation of your economic runs disappears?
>
> A If you don't believe your models are credible, then your economics aren't.
>
> Q And to get right to the point, the models drive the economics, don't they?

A Yes.

354 As previously mentioned, Mr. Shepherd assumed the technical team appropriately modeled the geological environment. He also acknowledged in cross-examination that viscosity is an important variable and that it can have a significant impact on the final oil recovery rate and steam injection rate. He did not make any changes to his economic analysis to account for Mr. Baker's

viscosity error.

355 I cannot accept the Plaintiff's suggestion that I simply apply a discount factor to Mr. Shepherd's final numbers to take into account the various errors. I find the propagation and accumulation of the errors described above make the damages model entirely unreliable.

356 The burden rests on the plaintiff to prove its case. Even if the plaintiff's damages claim is difficult to prove, the plaintiff must discharge its evidentiary burden by establishing sufficient facts to enable the trial judge to determine its loss with reasonable certainty. As stated by Osborne ACJO in ***Robert McAlpine Ltd v Woodbine Place Inc*** (2001), 141 OAC 167 at para 66 (ONCA):

> There must be evidence, accepted by the Trial Judge, from which, ... the Trial Judge can come to an intelligent conclusion on the quantum of damages. ...a **defendant should not have to pay damages based on unproven, speculative assumptions.** [Emphasis added.]

357 The Plaintiff admits it would have been preferable if the Court had the benefit of a simulation without errors. It submits, however, that mathematical exactness is not required and that courts are often required to make rough estimates or even to "guess" damages: ***Penvidic*** at 279-80.

358 The Plaintiff argues that even where the court rejects in its entirety the expert evidence on the question of damages, this does not relieve the wrongdoer of having to pay substantial damages. It argues the court must do the best it can nonetheless.

359 IFP suggests there is ample evidence from which the Court can estimate the value of the lost opportunity. For example, IFP suggests I rely upon an expert report and economic valuation prepared by Dr. Pooladi-Darvish and Mr. Dale Struksnes of Fekete Associates. Although the Defendants used these reports in their cross-examination of Mr. Shepherd, they were never formally entered into evidence and I cannot rely on their contents.

360 Mr. Shepherd prepared a surrebuttal report in response to these reports that is in evidence and IFP encourages the Court to rely on it. The Plaintiff also points to other evidence of value to be found in the SAGD simulations and economic evaluation done by PCR in 1998 or in the Dobson report commissioned by PCR and IFP. Alternatively, IFP submits the development at PCR's Senlac property also provides useful evidence of value. At the time it was evaluating a SAGD project at Eyehill Creek, PCR frequently compared the Eyehill Creek reservoir to Senlac. The Senlac project ultimately generated substantial net profits and was sold for $110 million in 2009.

361 It is true that when faced with conflicting expert opinions, the trial judge should endeavor to assess value and fix damages even if the resulting calculation is imprecise. The trial judge is not obliged, however, to assess value and fix damages where the resulting figure would be not more than a guess, unsupported by method, principle or evidence: ***Prothroe v Adams*** (1997), 203 AR 321 at para 358 (QB).

362 I find that I am faced with this second situation. Given the difficulties with IFP's damages model, discussed in detail above, any figure I select for damages would be a guess, unsupported by method, principle or evidence.

363 Furthermore, I am unable to accept the Plaintiff's invitation to look elsewhere in the evidence for value. The purpose of the Dobson report, for example, was to prepare an independent third party appraisal of certain oil interests to be used to establish value. It was preliminary nature and the proposed project it considered required further evaluation prior to proceeding.

364 It is not the court's obligation to calculate potential damages from a random array of evidence when the Plaintiff has otherwise failed to prove its claim. Based on the evidence before me, I am unable to assign a value to the lost opportunity.

3. What is the likelihood IFP would have realized on this opportunity? What other risks need to be considered?

365 The third part of the analysis for loss of opportunity damages requires the court to consider the likelihood or probability the opportunity would have been realized and apply an appropriate discount reflecting this factor. In ***Argus Machine Co***, Kerans JA explained it as a discount for the likelihood of non-occurrence at 22:

> The task of a court in awarding damages for a risk of future loss is to award the **present value of the apprehended loss in proportion to the risk of occurrence.** Many judges by habit do it the other way around, as did the trial judge here: **they *discount* the present value in proportion to the chance of *nonoccurrence.* It amounts to the same thing in the end. The real issue is to assess fairly the risk of occurrence.** ... [Bold emphasis added; italics in original.]

366 Satanove J in ***REC Holdings*** characterized it as an exercise in applying negative contingencies at para 121:

> How then does the court assess damages for lost opportunity? Lysyk, J. in *Cuttell v. Bentz*, (1986), 70 B.C.L.R. 85 (B.C.S.C.) said that "the amount to be assessed for the loss of opportunity represents an exercise of judgment based on the particular facts of the case". **Basically, it is an exercise in applying negative contingencies. The court tries to determine what most likely would have happened and then discounts for what possibly**, but not fancifully, **could have happened to prevent the opportunity from reaching fruition.** [Emphasis added.]

367 Such hypothetical events "need not be proven on a balance of probabilities. Instead, they are simply given weight according to their relative likelihood": ***Athey v Leonati***, [1996] 3 S.C.R. 458 at

para 27. The fact that such calculations are, to some degree, an exercise in conjecture "has not resulted in the courts declining the task": ***Nathu*** at para 15.

368 The Plaintiff suggests in its argument that the risks associated with the likelihood of realizing upon the opportunity to thermally develop Eyehill Creek may be divided into two categories: (1) the risk or uncertainty related to whether a project would have proceeded and (2) the risk or uncertainty associated with the success of any such project.

369 IFP argues the risks and uncertainties relevant to whether a SAGD project would have proceeded relate to economics, IFP's minority interest, IFP's need for financing, and the pending lease expiries. The fact that heavy oil and natural gas prices were unfavourable at the time PCR made its decision to farmout to Wiser raises questions about whether the project would have proceeded at all. Given PCR's apparent lack of interest in the project, IFP as 20% working interest holder, would have had to find a majority partner willing to operate a SAGD project. Furthermore, IFP did not have enough cash on hand to finance its share of the capital expenditures associated with a SAGD project, so it would have had to seek funding from its parent company in France or other sources.

370 The Defendants argue that a SAGD project would not have proceeded at the time. They submit that PCR had clearly decided it was not going to pursue a thermal development at Eyehill Creek. Faced with PCR's decision and Crown leases set to expire by August 31, 2001, unless production was planned or initiated, IFP would have had to spearhead a thermal development of the lands to maintain its opportunity to benefit from its working interest. The Defendants argue it is clear from the evidence that IFP was in no position to initiate a project on its own. Even absent the lease expiry issue, Mr. Delamaide and Mr. Verbraeken testified that IFP was not prepared, and never had been prepared, to become an operator with the result that it would have had to prepare its own thermal development plan for the purposes of seeking an operating partner or marketing its right of independent operations.

371 The Defendant points to IFP's conduct, or lack thereof, in late 2000 when it first learned PCR would be putting the Eyehill Creek lands up for sale. IFP did not complain to PCR. It did not try to stop or delay the sale. It did not propose a plan to PCR. It did not undertake any internal processes to try and determine next steps, nor did it even inquire of PCR to determine its intentions with respect to the lands. Likewise, in February 2001, before PCR approved the ARO with Wiser, IFP took no action after being given an outline of the proposed agreement. Nor did IFP turn to its French parent for funding or look for a partner in response to the ROFR.

372 When IFP met with Wiser's Glenn Booth in June 2001 to review its proposed future operations, including its plans for new primary wells on section 9, IFP did not suggest any steps to best protect its working interest (i.e. selection of drilling locations, use of thermal cement). Nor did it seek to enforce its operational rights under the JOA or propose or commence thermal development while Wiser was earning its interest and PCR was still the registered operator.

373 Furthermore, the Defendants submit that when Canadian Forest took over Wiser's operations, IFP had another opportunity to propose a thermal or other enhanced recovery operation, given Canadian Forest's significant engineering resources, but it still took no action.

374 The Defendants suggest that the evidence shows that in the face of PCR's decision not to pursue a thermal project IFP would never have taken action. IFP made it clear it had limited tolerance for risk. The evidence establishes that a thermal project is capital intensive for a long duration and requires a substantial up front gamble. IFP did not have the management team in place to advance or manage such a process, and it called no evidence to suggest there were potential partners who were prepared to advance IFP's plans. IFP did not even look for such a partner, although it argues there was not enough time to do so.

375 IFP refutes the Defendants' arguments saying the fact that it did no work on a SAGD project has no relevance since after Wiser was in possession there was no project to pursue. I find IFP's inaction is relevant to establish that it was unlikely to have proceeded without PCR.

376 IFP argues that other operators might have been interested in thermal development of these lands, even if PCR was not. It submits the low price environment in 2001 did not condemn this or other projects as having no value; it is conceivable the planning stages could have been undertaken then so as to go forward with the project when the economic environment was more favorable. The Plaintiff states in its brief at para 211: "...it is not appropriate to look at the price environment in 2001 in isolation, as if no project would have been undertaken unless one was started without delay at the very time PanCanadian breached its contract with IFP."

377 IFP disputes the Defendants' characterization of a limited time frame in which to start a SAGD project and states that a project could have been initiated on the PCR fee lands at any time, without time pressures related to the pending Crown lease expiries. PCR owned fee title to the petroleum in section 9, as well as other odd-numbered sections. The Plaintiff contends a more flexible time frame would have made finding a partner more probable. The evidence suggests, however, that there were very few SAGD projects at the time and PCR was one of the industry leaders, casting doubt on IFP's ability to find a partner. In fact, IFP admits it would have been difficult to find a partner ready to commit full project funds in 2001. Prices increased in 2002, however, and stayed solid thereafter, possibly improving IFP's prospects for finding a partner.

378 I find the Plaintiff's submissions do not reflect the reality of the oil and gas industry or the Crown's focus on development. Public policy favours development of oil resources, not sitting on those rights. The numerous section 18(8) notices are a testament to this reality. I find it unrealistic to suggest that PCR and IFP could simply sit on their rights and wait for the right price environment.

379 With respect to funding its share of the project, IFP suggests it is entirely likely its parent company, IFP France, would have stepped in to preserve its interest in Eyehill Creek. Also, IFP notes that while the capital necessary to construct a SAGD project is significant, the amount required before project sanction is modest. IFP argues there is no basis for finding that a lack of

funding for IFP's share would have been an impediment to a SAGD project at Eyehill Creek.

380 IFP acknowledges that the Crown's deadline for a lease extension was August 31, 2001 and that without production numerous portions of section 16 would have been lost to the Crown and posted for sale. IFP's land expert, Mr. Clark, explained the options available to a producer upon receipt of a s 18(8) notice: bring one or more wells on production, apply for continuation based on a technical presentation of a proposed development, or apply for a temporary continuation after drilling at least one well. IFP suggests that it is impossible to know what it would have done in response to the s 18(8) notices because PCR did not comply with its contractual duties or with industry practice in passing them on. IFP submits it may have made a lease extension application or proposed a thermal project at Eyehill Creek to save the Crown leases. I find this is pure speculation. There is nothing in the evidence to suggest that IFP was in a position to take such action. Although PCR did not keep IFP informed as it ought to have done, IFP did not seek out the information. Furthermore, Mr. Clark testified it would have been difficult to get a lease extension from the Crown based on an uneconomic project and without a plan for development.

381 I also find that PCR would not have proceeded with a thermal development at Eyehill Creek. In the absence of the farmout to Wiser, I find PCR would have undertaken primary operations to preserve its leases. This option was presented to PCR management as the least costly alternative to the Wiser deal. Alternatively, PCR may have let go of the lands entirely. I find IFP was never in a position to realize upon its minority working interest without a committed operator. I conclude that there is no chance a thermal development would have proceeded at Eyehill Creek within a reasonable time of the alleged breach of contract.

382 The Defendants argue in favour of a discount well in excess of 50% and as high as 100%. They submit the 100% discount would reflect the continued existence of a viable thermal project at Eyehill Creek. I find this is the wrong place for this argument. Loss of opportunity damages are predicated on there being a lost opportunity. In calculating such damages, one cannot suggest that the opportunity hasn't been lost; the loss of opportunity must be presumed. Any discount to damages reflects the "chance of non-occurrence" of the opportunity.

383 I find, however, that the likelihood of occurrence of a SAGD operation initiated by PCR in the absence of the farmout to Wiser to be zero. As discussed above, PCR would have taken an alternate course of action. I also find that IFP would not have initiated such a development on its own. IFP made no move to take advantage of the purported SAGD opportunity when PCR was still a working interest owner and its approach did not change once Wiser, and later Canadian Forest, were in possession. Even if I had been prepared to award damages for the alleged loss of opportunity, I would have discounted them by 100% to reflect the "chance of non-occurrence". IFP has not established that the purported opportunity would have been realized.

384 The parties also made submissions related to the likelihood of success of the project including its geological risks, engineering risks, drilling and completion risks, and operational risks.

In general, IFP submits there is no evidentiary basis for suggesting that there was a risk of failure of a SAGD project at Eyehill Creek in the undepleted area before Wiser's arrival that was more significant than the risk of failure of any other SAGD project. On the contrary, they argue this part of the Eyehill Creek reservoir was uniquely positive. Good well control lent a high degree of confidence as to the reservoir qualities and, prior to Wiser's and Canadian Forest's primary production, the modelled part of the reservoir had not been compromised. IFP submits that the risks of the project succeeding have been taken into consideration in the damages model and do not need to be discounted further.

385 I find it unnecessary to consider the risks associated with development given my conclusion that the opportunity itself would never have been realized.

C. Did IFP fail to mitigate its damages?

386 Although I have not awarded damages, I will address the parties' mitigation arguments. The principal meaning of mitigation in the law of damages refers to actions the plaintiff might have taken to diminish its losses. A plaintiff must take all reasonable steps to mitigate the loss consequent on the breach and cannot claim any part of the damage due to its own neglect in taking such steps: ***British Westinghouse Electric and Manufacturing Company v Underground Electric Railways Company of London***, [1912] AC 673 (HL) at 689. A plaintiff has an obligation to mitigate even if it is doubtful of the defendant's liability: ***Biranda v Anderson*** (1978), 16 AR 330 at para 14 (Dist Ct). The defendant bears the burden of proving the plaintiff's alleged failure to mitigate.

387 In ***Costello v Calgary (City)*** (1997), 209 AR 1 at para 42, leave to appeal to SCC refused, [1998] 1 SCR vii, the Alberta Court of Appeal set out the principles governing the duty to mitigate:

> 1. A decision as to whether or not the plaintiff satisfied the duty to mitigate constitutes a legal conclusion. However, the question as to whether or not she acted reasonably in the circumstances is one of fact, not law...
>
> 2. The onus of proof lies on the defendant to establish on a balance of probabilities that the plaintiff failed to take reasonable steps to avoid losses ... However, the courts will not allow the defendant, in discharge of that onus, to be overly critical of the plaintiff. Having committed a wrong, the defendant should not quickly be heard to point out his victim's shortcomings in avoiding resulting losses ... The benefit of doubt, therefore, generally will be given to the plaintiff.
>
> 3. The duty to mitigate does not invariably require action to be taken immediately upon breach. As the plaintiff need merely act reasonably in the circumstances, considerable delay may be permitted in some cases...

4. The plaintiff need not incur great expense or inconvenience in an attempt to stem the flow of losses resulting from the defendant's breach...

5. Nor need the plaintiff incur an unreasonable risk, or embark upon a speculative venture, in an attempt to mitigate her losses...

388 The Defendants submit IFP had a duty to take steps to mitigate its losses as soon it became clear PCR was proceeding with the ARO with Wiser without IFP's consent. PCR identifies a number of factors as indicative of IFP's failure to mitigate.

389 PCR repeats its argument that IFP did nothing when it learned in late 2000 of the pending farmout of Eyehill Creek. When presented with the proposed ARO with Wiser in February 2001, IFP did not ask PCR to prevent damages to IFP's own interests nor did it advance its own thermal project. When faced with the ROFR in April 2001, IFP took no action beyond requesting compensation. It did not exercise the ROFR or try to sell its rights. It did not seek funding from its parent or look for a partner to initiate a thermal operation. It also took no action during Wiser's earning period to enforce its operational rights under the JOA. Later, it did not seek an investor or joint venture partner. Upon meeting with Wiser's Glenn Booth in June 2001, IFP did not suggest steps that would preserve its assets.

390 The Defendants argue IFP could have and should have served an independent operations notice under Article 10 of the Operating Procedure for a SAGD operation. The Plaintiff disputes such an independent operations notice was possible, given its position that Wiser never became party to the JOA or the Operating Procedure. It also argues the practical realities IFP faced in May 2001 after PCR and Wiser entered into the ARO made this idea completely impractical. These practical realities included Wiser's immediate occupation of the field; the absence of information from Wiser and Canadian Forest about their operations, including details about future wells; and, the challenge of finding a majority partner willing to initiate a SAGD project on a field in which a third party was conducting primary operations. IFP argues that it takes time to bring a SAGD project to fruition. Meanwhile, Wiser's and later Canadian Forest's operations were having an ongoing negative physical impact on the reservoir, complicating the process of studying and planning a SAGD operation. Since primary and thermal projects cannot co-exist, Wiser would have had to stop is operations before any SAGD project could be started.

391 IFP submits, given the practical realities of the situation, it is not tenable to suggest that IFP failed to mitigate its damages by failing to initiate a SAGD project post-ARO.

392 The Defendants also argue that IFP should have tried to stop Wiser by obtaining an injunction, with limited evidence or argument in support. IFP rightly points out that the court might have concluded that damages would be an adequate remedy.

393 In February 2014, Justice Stevens invited further submissions from the parties (limited to two pages) in response to a letter from the Defendants about the Supreme Court of Canada's decision in ***Southcott Estates Inc v Toronto Catholic District School Board***, 2012 SCC 51. The main issue in ***Southcott*** was whether the plaintiff, a single-purpose corporation, was excused from mitigating its losses when the Defendant vendor breached the agreement of purchase and sale, particularly when it had promptly brought an action for specific performance. The Defendants suggest IFP, like the Plaintiff in ***Southcott***, elected only to pursue litigation without any regard to mitigation. I have reviewed the ***Southcott*** decision and the parties' submissions and I find it is not relevant to the disposition of the mitigation issue in this case.

394 The onus is on the Defendants to prove that IFP failed to take reasonable steps to mitigate its losses. Mitigation requires only that a plaintiff take reasonable steps to avoid loss. I accept IFP's argument that it would have been unreasonable to seek an operating partner and expend the money necessary to initiate a thermal development at Eyehill Creek while Wiser, and later Canadian Forest, were actively developing the field. I reject the Defendants' claim that IFP failed to mitigate its damages.

D. Accounting of profits from Canadian Forest

395 In the alternative, IFP claims an accounting of profits from Wiser and Canadian Forest. As explained earlier in these reasons, IFP takes the position that the AEA granted IFP an undivided interest equal to 20% of PCR's working interest in Eyehill Creek and that it is only the JOA that limits this working interest to thermal and other enhanced recovery. IFP argues the breach of contract terminated the JOA and Wiser is not and never was a party to it. Consequently, IFP submits it now holds a 20% working interest in the lands without limitation on the type of recovery.

396 IFP submits that the relationship between two or more holders of working interests in oil or gas is that of "tenants in common of the leases": ***Midcon Oil & Gas Limited v New British Dominion Oil Company***, [1958] SCR 314 at 322, Locke J. They argue that the *Administration of Justice Act*, 1705 (UK), 4 Anne c 16, s 27 (known as the *Statute of Anne*) requires one tenant in common to account to the other tenants in common for their just share of revenues received from the jointly-owned property and that this principle has been applied to persons holding mining interests in joint ownership with others.

397 IFP relies upon American case law to suggest that the production of petroleum rights by one co-tenant without the consent of the other does not constitute waste; rather, the active co-tenant must account to the non-consenting co-tenant for his proportionate share of the proceeds of production.

398 IFP presented the evidence of Barry Parker, a production accountant and joint venture auditor retained by IFP. He prepared a report relying upon Wiser's and Canadian Forest's accounting records. His review showed that the primary development of Eyehill Creek reached payout in the latter part of 2004 and that since that time the project has generated total net revenues

of $27,823,852. IFP calculates its working interest share as $5,408,911.

399 The Defendants submit there is no basis for IFP's claim for an accounting from Wiser and Canadian Forest. First, IFP has not lost its interest in Eyehill Creek. A potential thermal or other enhanced recovery project still exists and IFP will receive its 20% interest if and when it proceeds. Second, the Defendants submit Wiser, and subsequently Canadian Forest, have always recognized IFP's rights and have acknowledged that they will abide by the terms of the JOA.

400 PCR emphasizes the inappropriateness of IFP's claim based on double recovery: on the one hand IFP claims damages based on its alleged lost opportunity to benefit from thermal or other enhanced recovery operations on the Eyehill Creek lands, while on the other hand it claims a 20% interest in all production, including from primary operations.

401 The Defendants reject IFP's suggestion that it should have an election as to remedy, stating it is an example of IFP trying to take all the benefits without giving up anything. The Defendants submit that if IFP obtains an accounting it should be coupled with a declaration that any interest it had or claim in thermal or other enhanced recovery at Eyehill Creek is at an end.

402 As discussed above in Parts VII.A.3. and VII.A.5., I have concluded that IFP was unreasonable in withholding consent and that Wiser was novated into the JOA. I have found that IFP has not lost its interest in Eyehill Creek; IFP will receive the benefit of its 20% working interest in Eyehill Creek if and when a thermal or other enhanced recovery project proceeds.

403 Furthermore, as I concluded in Part IV.B.2., IFP's working interest is limited to thermal and other enhanced recovery. IFP has no contractual entitlement to a share of the proceeds of primary production.

E. Effect of contractual limitation of liability

404 The Defendants submit that even if the Court wholly accepted the Plaintiff's claim, IFP is contractually limited to recover a maximum aggregate amount of $16 million pursuant to Article 7.9 of the AEA:

> In no event shall the liability of PCR to IFP in respect of claims of IFP arising out of or in connection with this Agreement exceed, in the aggregate, the value for the PCR Assets as set out in section 2.7 [$16 million], taking into account any and all increases or decreases to such value that occur by virtue of the terms of this Agreement. ...

The Plaintiff made no submissions on this issue.

405 On its face, a limitation of damages clause is legitimate and enforceable. IFP and PCR are sophisticated business entities who negotiated the AEA with the assistance of legal counsel. There

is no indication of unconscionability or oppression at the time the contract was negotiated. There are also no public policy reasons to ignore the limitation clause.

406 I find that any damages, had they been awarded, would have been limited to a maximum of $16 million. Given the language of the contract, IFP's claim for $45 million in damages was untenable.

IX. Conclusion

407 The contractual matrix entered into is at odds with the unilateral expectations of IFP. Were it to be granted the remedy asked for, the Court would, of necessity, acknowledge a better set of contracts conferring rights on IFP that IFP did not negotiate in the first instance. IFP cannot attain a remedy which it could not have obtained from PCR. IFP did not bargain for a joint venture, notwithstanding its unilateral expectations in this regard. It provided technology in exchange for a working interest. IFP's working interest was restricted to EOR. It had no interest in primary production. Yet, primary production was contemplated in the contractual matrix.

408 In conclusion, I find IFP was unreasonable in withholding its consent to the ARO between PCR and Wiser. Wiser was novated into the JOA and IFP retains its 20% working interest in thermal and other enhanced recovery at Eyehill Creek.

409 If I am wrong in this conclusion and there was a breach, I find that the opportunity to pursue thermal or other enhanced recovery has not been destroyed; there has been no loss of opportunity.

410 If I am wrong in this conclusion and IFP did lose an opportunity, I find that IFP has failed to prove the value of its lost opportunity and this Court cannot therefore make a damages award.

X. Counterclaim and Costs

411 PCR seeks a declaration that IFP wrongfully withheld consent to the ARO between PCR and Wiser. It also seeks solicitor-client costs pursuant to Article 1.6 of the AEA:

> All losses, costs, claims, damages, expenses and liabilities in respect of which a Party has a claim pursuant to this Agreement include without limitation reasonable legal fees and disbursements on a solicitor and client basis.

412 My conclusions, as set out above, make it clear that IFP was unreasonable in withholding its consent. There is no need for the Defendants to seek a declaration separately by way of counterclaim.

413 The parties may make further submissions as to costs, if necessary.

Heard on January 24, 25, 31, February 1, 2, 3, 4, 7, 8, 9, 10, 14, 15, 16, 17, 18, 22, 23, 24, 25, 28, March 1, 2, 3, 4, 7, 8, 9, 10, 11, 14, and June 29 & 30, 2011 before the Honourable Mr. Justice R.G.

Stevens

Dated at the City of Calgary, Alberta this 30th day of July, 2014.

N.C. WITTMANN C.J.Q.B.

* * * * *

Corrected judgment: A corrigendum was issued on August 11, 2014; the corrections have been made to the text and the corrigendum is appended to this judgment.

Corrigendum of the Reasons for Judgment

of

The Honourable Chief Justice Neil Wittman

Appearances: Added names of co-counsel Laurie A. Goldbach and Lawrence D. Ator for Defendants/Plaintiffs by Counterclaim.

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 SINO-FOREST CORPORATION

Commercial Court File No.: CV-12-9667-00CL

The Trustees of the Labourer's Pension Fund of Central and Eastern Canada, et al.	and	Sino-Forest Corporation, et al.
Plaintiffs		Defendants

Superior Court File No: CV-10-414302

ONTARIO
SUPERIOR COURT OF JUSTICE
Commercial List

Proceeding under the *Class Proceedings Act, 1992*
Proceeding commenced at Toronto

BOOK OF AUTHORITIES OF THE PLAINTIFFS DEALERS SETTLEMENT APPROVAL (Returnable May 11, 2015) VOLUME I OF II

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Court File No. CV-12-9667-00-CL

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 AND ARRANGEMENT OF SINO-FOREST CORPORATION

Court File No.: CV-11-431153-00CP

ONTARIO
SUPERIOR COURT OF JUSTICE

B E T W E E N :

THE TRUSTEES OF THE LABOURERS' PENSION FUND OF CENTRAL AND EASTERN CANADA, THE TRUSTEES OF THE INTERNATIONAL UNION OF OPERATING ENGINEERS LOCAL 793 PENSION PLAN FOR OPERATING ENGINEERS IN ONTARIO, SJUNDE AP-FONDEN, DAVID GRANT and ROBERT WONG

Plaintiffs

- and -

SINO-FOREST CORPORATION, ERNST & YOUNG LLP, BDO LIMITED (formerly known as BDO MCCABE LO LIMITED), ALLEN T.Y. CHAN, W. JUDSON MARTIN, KAI KIT POON, DAVID J. HORSLEY, WILLIAM E. ARDELL, JAMES P. BOWLAND, JAMES M.E. HYDE, EDMUND MAK, SIMON MURRAY, PETER WANG, GARRY J. WEST, CREDIT SUISSE SECURITIES (CANADA), INC., TD SECURITIES INC., DUNDEE SECURITIES CORPORATION, RBC DOMINION SECURITIES INC., SCOTIA CAPITAL INC., CIBC WORLD MARKETS INC., MERRILL LYNCH CANADA INC., CANACCORD FINANCIAL LTD., MAISON PLACEMENTS CANADA INC., CREDIT SUISSE SECURITIES (USA) LLC and MERRILL LYNCH, PIERCE, FENNER & SMITH INCORPORATED (successor by merger to Banc of America Securities LLC)

Defendants

Proceeding under the *Class Proceedings Act, 1992*

BOOK OF AUTHORITIES OF THE PLAINTIFFS
DEALER SETTLEMENT APPROVAL
(Returnable May 11, 2015)

VOLUME II OF II

April 24, 2015

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TO : THE ATTACHED SERVICE LIST

Court File No. CV-12-9667-00-CL

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 OF SINO-FOREST CORPORATION

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TABLE OF CONTENTS

1. *Labourers' Pension Fund of Central and Eastern Canada v. Sino-Forest Corp.*, 2013 ONSC 1078

2. *Dabbs v. Sun Life Assurance Co. of Canada*, [1998] O.J. No. 1598 (Gen. Div.)

3. *Nunes v. Air Transat AT Inc.,* [2005] O.J. No. 2527 (S.C.J.)

4. *Osmun v. Cadbury Adams Canada Inc.*, [2010] O.J. No. 1877 (S.C.J)

5. *Parsons v. Canadian Red Cross Society*, [1999] O.J. No. 3572 (S.C.J)

6. *Robertson v. ProQuest Information and Learning Company*, 2011 ONSC 1647

7. *Marcantonio v. TVI Pacific Inc.*,[2009] O.J. No. 3409 (S.C.J.)

8. *Metzler Investment GmbH v Gildan Activewear Inc.*, 2011 ONSC 1146

9. *Robinson v Rochester Financial Ltd.*, 2012 ONSC 911

10. *Semple v Canada (Attorney General)*, 2006 MBQB 285 (Man. Q.B.)

11. *ATB Financial v Metcalfe & Mansfield Alternative Investments II Corp,* 2008 ONCA 587

12. *Healy v. Gregory*, [2009] O.J. No. 2562 (S.C.J.)

13. *Canadian Red Cross Society (Re)*, [1998] O.J. No. 3306 (Gen. Div.)

14. *Century Services Inc. v. Canada (Attorney General)*, [2010] S.C.J. No. 60 (S.C.J.)

15. *Playdium Entertainment Corp. (Re)*, [2001] O.J. No. 4252 (S.C.J.)

16. *Hayes Forest Services Ltd. (Re)*, [2009] B.C.J. No. 1725 (S.C.)

17. *Ontario v. Canadian Airlines Corp.*, [2001] A.J. No. 1457 (Alta. Q.B.)

18. *Canadian Red Cross Society (Re)*, [2002] O.J. No. 2567 (S.C.J.)

19. *Bhasin v. Hrynew*, 2014 SCC 71

20. *1578838 Ontario Inc. v. Bank of Nova Scotia*, 2011 ONSC 3482

21. *Olympia & York Developments Ltd. (Re),* [1993] O.J. No. 545 (Gen. Div.)

22. *IFP Technologies (Canada) Inc. v. Encanada Midstream and Marketing*, [2014] A.J. No. 883 (Alta. Q.B.)

VOLUME II

23. *Sun Indalex Finance, LLC v. United Steelworkers*, [2013] 1 S.C.R. 271 (S.C.C.)

24. *In re IMAX Sec. Litig.*, 283 F.R.D. 178 (S.D.N.Y. 2012)

25. *Federal Housing Fin. Agency v. Nomura Holding Amer. Inc.*, F. Supp. 3d, 2014 WL 7232443

26. *Feyko v. Yuhe Intern., Inc.*, No. CV 11–05511, 2013 WL 816409 (C.D. Cal. Mar. 5, 2013)

27. *Ontario New Home Warranty Program v Chevron Chemical Co.*, [1999] O.J. No. 2245 (S.C.J.)

28. *Eidoo v Infineon Technologies AG,* 2012 ONSC 3801

29. *Sino-Forest Corporation (Re),* 2012 ONSC 7050

30. *Zaniewicz v. Zungui Haixi Corp.*, 2013 ONSC 5490

31. *In re WorldCom, Inc. Sec. Litig.*, 388 F. Supp. 2d 319 (S.D.N.Y. 2005)

32. *Gould v BMO Nesbitt Burns Inc.*, [2007] O.J. No. 1095 (S.C.J.)

33. *Cosimo Borrelli in his capacity as trustee of the SFC Litigation Trust v. David J. Horsley et al.*, Notice of Acton issued May 31, 2013

34. Sino-Forest Litigation Trust Agreement, Art. 1.5(a)-(b)

35. International Accounting Standard 2 — Inventories, IFRS

36. *Dobbie v. Arctic Glacier*, Order dated December 4, 2012 (File No. 08-59725)

37. *McKenna v Gammon Gold*, Order dated December 4, 2012 (File No. 08-36143600CP)

38. *Zaniewicz v. Zungui Haixi Corp.*, Order dated August 26, 2013 (File 36143600CP)

39. *Metzler Investment GmbH v. Gildan Activewear Inc.,* Order dated February 18, 2011 (File No. 58574CP)

40. *Labourers' Pension Fund of Central and Eastern Canada v. Sino-Forest Corp.*, Order dated December 27, 2013 (File 12-9667-00CL/11-431153-00CP)

Indexed as:

Sun Indalex Finance, LLC v. United Steelworkers

Sun Indalex Finance, LLC, Appellant;
v.
United Steelworkers, Keith Carruthers, Leon Kozierok, Richard Benson, John Faveri, Ken Waldron, John (Jack) W. Rooney, Bertram McBride, Max Degen, Eugene D'Iorio, Neil Fraser, Richard Smith, Robert Leckie and Fred Granville, Respondents.
And
George L. Miller, the Chapter 7 Trustee of the Bankruptcy Estates of the U.S. Indalex Debtors, Appellant;
v.
United Steelworkers, Keith Carruthers, Leon Kozierok, Richard Benson, John Faveri, Ken Waldron, John (Jack) W. Rooney, Bertram McBride, Max Degen, Eugene D'Iorio, Neil Fraser, Richard Smith, Robert Leckie and Fred Granville, Respondents.
And
FTI Consulting Canada ULC, in its capacity as court-appointed monitor of Indalex Limited, on behalf of Indalex Limited, Appellant;
v.
United Steelworkers, Keith Carruthers, Leon Kozierok, Richard Benson, John Faveri, Ken Waldron, John (Jack) W. Rooney, Bertram McBride, Max Degen, Eugene D'Iorio, Neil Fraser, Richard Smith, Robert Leckie and Fred Granville, Respondents.
And
United Steelworkers, Appellant;
[page272]
v.
Morneau Shepell Ltd. (formerly known as Morneau Sobeco Limited Partnership) and Superintendent of Financial Services, Respondents, and
Superintendent of Financial Services, Insolvency Institute of Canada, Canadian Labour Congress, Canadian Federation of Pensioners, Canadian Association of Insolvency and Restructuring Professionals and Canadian Bankers Association, Interveners.

[2013] 1 S.C.R. 271

[2013] 1 R.C.S. 271

[2013] S.C.J. No. 6

[2013] A.C.S. no 6

2013 SCC 6

File No.: 34308.

Supreme Court of Canada

Heard: June 5, 2012;
Judgment: February 1, 2013.

Present: McLachlin C.J. and LeBel, Deschamps, Abella, Rothstein, Cromwell and Moldaver JJ.

(280 paras.)

Appeal From:

ON APPEAL FROM THE COURT OF APPEAL FOR ONTARIO

Catchwords:

Pensions -- Bankruptcy and Insolvency -- Priorities -- Company who was both employer and administrator of pension plans seeking protection from creditors under Companies' Creditors Arrangement Act ("CCAA") -- Pension funds not having sufficient assets to fulfill pension promises made to plan members -- Company entering into debtor in possession ("DIP") financing allowing it to continue to operate -- CCAA court granting priority to DIP lenders -- Proceeds of sale of business insufficient to pay back DIP lenders -- Whether pension wind-up deficiencies subject to deemed trust -- If so, whether deemed trust superseded by CCAA priority by virtue of doctrine of federal paramountcy -- Pension Benefits Act, R.S.O. 1990, c. P.8, ss. 57(3), (4), 75(1)(a), (b) -- Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36.

[page273]

Pensions -- Trusts -- Company who was both employer and administrator of pension plans seeking protection from creditors under CCAA -- Pension funds not having sufficient assets to fulfill pension promises made to plan members -- Whether pension wind-up deficiencies subject to deemed trust -- Whether company as plan administrator breached fiduciary duties -- Whether pension plan members are entitled to constructive trust.

Civil Procedure -- Costs -- Appeals -- Standard of review -- Whether Court of Appeal erred in costs endorsement concerning one party.

Summary:

Indalex Limited ("Indalex"), the sponsor and administrator of two employee pension plans, one for salaried employees and the other for executive employees, became insolvent. Indalex sought protection from its creditors under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*"). The salaried plan was being wound up when the *CCAA* proceedings began. The executive plan had been closed but not wound up. Both plans had wind-up deficiencies.

In a series of court-sanctioned steps, the company was authorized to enter into debtor in possession ("DIP") financing in order to allow it to continue to operate. The *CCAA* court granted the DIP lenders, a syndicate of pre-filing senior secured creditors, priority over the claims of all other creditors. Repayment of these amounts was guaranteed by Indalex U.S.

Ultimately, with the approval of the *CCAA* court, Indalex sold its business but the purchaser did not assume pension liabilities. The proceeds of the sale were not sufficient to pay back the DIP lenders and so Indalex U.S., as guarantor, paid the shortfall and stepped into the shoes of the DIP lenders in terms of priority. The *CCAA* court authorized a payment in accordance with the priority but ordered an amount be held in reserve, leaving the plan members' arguments on their rights to the proceeds of the sale open for determination later.

The plan members challenged the priority granted in the *CCAA* proceedings. They claimed that they had priority in the amount of the wind-up deficiency by virtue of a statutory deemed trust under s. 57(4) of the *Pension Benefits Act*, R.S.O. 1990, c. P.8 ("*PBA*"), and a constructive trust arising from Indalex's alleged breaches [page274] of fiduciary duty as administrator of the pension funds. The judge at first instance dismissed the plan members' motions concluding that the deemed trust did not apply to wind up deficiencies. He held that, with respect to the wind-up deficiency, the plan members were unsecured creditors. The Court of Appeal reversed this ruling and held that the pension plan wind-up deficiencies were subject to deemed and constructive trusts which had priority over the DIP financing priority and over other secured creditors. In addition, the Court of Appeal rejected a claim brought by the United Steelworkers, which represented some members of the salaried plan, seeking payment of its costs from the latter's pension fund.

Held (LeBel and Abella JJ. dissenting): The Sun Indalex Finance, George L. Miller and FTI

Consulting appeals should be allowed.

Held: The United Steelworkers appeal should be dismissed.

(1) Statutory Deemed Trust

Per Deschamps and Moldaver JJ.: It is common ground that the contributions provided for in s. 75(1)(a) of the *PBA* are covered by the deemed trust contemplated by s. 57(4) of the *PBA*. The only question is whether this statutory deemed trust also applies to the wind-up deficiency payments required by s. 75(1)(b). The response to this question as it relates to the salaried employees is affirmative in view of the provision's wording, context and purpose. The situation is different with respect to the executive plan as s. 57(4) provides that the wind-up deemed trust comes into existence only when the plan is wound up.

The wind-up deemed trust provision (s. 57(4) *PBA*) does not place an express limit on the "employer contributions accrued to the date of the wind up but not yet due". Section 75(1)(a) explicitly refers to "an amount equal to the total of all payments" that have *accrued*, even those that were not yet due as of the date of the wind up, whereas s. 75(1)(b) contemplates an "amount" that is calculated on the basis of the value of assets and of liabilities that have *accrued* when the plan is wound up. Since both the amount with respect to payments (s. 75(1)(a)) and the one ascertained by subtracting the assets from the liabilities accrued as of the date of the wind up (s. 75(1)(b)) are to be paid upon wind up as employer contributions, they are both included in the ordinary meaning of the words of [page275] s. 57(4) of the *PBA*: "amount of money equal to employer contributions accrued to the date of the wind up but not yet due under the plan or regulations".

The time when the calculation is actually made is not relevant as long as the liabilities are assessed as of the date of the wind up. The fact that the precise amount of the contribution is not determined as of the time of the wind up does not make it a contingent contribution that cannot have accrued for accounting purposes. As a result, the words "contributions accrued" can encompass the contributions mandated by s. 75(1)(b) of the *PBA*.

It can be seen from the legislative history that the protection has expanded from (1) only the service contributions that were due, to (2) amounts payable calculated as if the plan had been wound up, to (3) amounts that were due and had accrued upon wind up but excluding the wind-up deficiency payments, to (4) all amounts due and accrued upon wind up. Therefore, the legislative history leads to the conclusion that adopting a narrow interpretation that would dissociate the employer's payment provided for in s. 75(1)(b) of the *PBA* from the one provided for in s. 75(1)(a) would be contrary to the Ontario legislature's trend toward broadening the protection.

The deemed trust provision is a remedial one. Its purpose is to protect the interests of plan members. The remedial purpose favours an approach that includes all wind-up payments in the value of the deemed trust. In this case, the Court of Appeal correctly held with respect to the salaried plan, that Indalex was deemed to hold in trust the amount necessary to satisfy the wind-up deficiency.

Per LeBel and Abella JJ.: There is agreement with the reasons of Deschamps J. on the statutory deemed trust issue.

Per McLachlin C.J. and Rothstein and Cromwell JJ.: Given that there can be no deemed trust for the executive plan because that plan had not been wound up at the relevant date, the main issue in connection with the salaried plan boils down to the narrow statutory interpretative question of whether the wind-up deficiency provided for in s. 75(1)(b) is "accrued to the date of the wind up" as required by s. 57(4) of the *PBA*.

When the term "accrued" is used in relation to a sum of money, it will generally refer to an amount that is at the present time either quantified or exactly quantifiable [page276] but which may or may not be due. In the present case, s. 57(4) uses the word "accrued" in contrast to the word "due". Given the ordinary meaning of the word "accrued", the wind-up deficiency cannot be said to have "accrued" to the date of wind up. The extent of the wind-up deficiency depends on employee rights that arise only upon wind up and with respect to which employees make elections only after wind up. The wind-up deficiency therefore is neither ascertained nor ascertainable on the date fixed for wind up.

The broader statutory context reinforces the view according to which the most plausible grammatical and ordinary sense of the words "accrued to the date of wind up" is that the amounts referred to are precisely ascertained immediately before the effective date of the plan's wind up. Moreover, the legislative evolution and history of the provisions at issue show that the legislature never intended to include the wind-up deficiency in a statutory deemed trust. Rather, they reinforce the legislative intent to *exclude* from the deemed trust liabilities that arise only *on* the date of wind up.

The legislation differentiates between two types of employer liability relevant to this case. The first is the contributions required to cover current service costs and any other payments that are either due or have accrued on a daily basis up to the relevant time. These are the payments referred to in the current s. 75(1)(a), that is, payments due or accrued but not paid. The second relates to additional contributions required when a plan is wound up which I have referred to as the wind-up deficiency. These payments are addressed in s. 75(1)(b). The legislative history and evolution show that the deemed trusts under s. 57(3) and (4) were intended to apply only to the former amounts and that it was never the intention that there should be a deemed trust or a lien with respect to an employer's potential future liabilities that arise once the plan is wound up.

In this case, the s. 57(4) deemed trust does not apply to the wind-up deficiency. This conclusion to exclude the wind-up deficiency from the deemed trust is consistent with the broader purposes of the legislation. The legislature has created trusts over contributions that were due or accrued to the date of the wind up in order to protect, to some degree, the rights of pension plan beneficiaries and employees from the claims of the employer's other creditors. However, there is also good reason to think that the legislature had in mind other competing objectives in not extending the deemed

[page277] trust to the wind-up deficiency. While the protection of pension plans is an important objective, it is not for this Court to decide the extent to which that objective will be pursued and at what cost to other interests. The decision as to the level of protection that should be provided to pension beneficiaries under the *PBA* is one to be left to the Ontario legislature.

(2) *Priority Ranking*

Per Deschamps and Moldaver JJ.: A statutory deemed trust under provincial legislation such as the *PBA* continues to apply in federally-regulated *CCAA* proceedings, subject to the doctrine of federal paramountcy. In this case, granting priority to the DIP lenders subordinates the claims of other stakeholders, including the plan members. This court-ordered priority based on the *CCAA* has the same effect as a statutory priority. The federal and provincial laws are inconsistent, as they give rise to different, and conflicting, orders of priority. As a result of the application of the doctrine of federal paramountcy, the DIP charge supersedes the deemed trust.

Per McLachlin C.J. and Rothstein and Cromwell JJ.: Although there is disagreement with Deschamps J. in connection with the scope of the s. 57(4) deemed trust, it is agreed that if there was a deemed trust in this case, it would be superseded by the DIP loan because of the operation of the doctrine of federal paramountcy.

Per LeBel and Abella JJ.: There is agreement with the reasons of Deschamps J. on the priority ranking issue as determined by operation of the doctrine of federal paramountcy.

(3) *Constructive Trust as a Remedy for Breach ofFiduciary Duties*

Per McLachlin C.J. and Rothstein and Cromwell JJ.: It cannot be the case that a conflict of interests arises simply because an employer, exercising its management powers in the best interests of the corporation, does something that has the potential to affect the beneficiaries of the corporation's pension plan. This conclusion flows inevitably from the statutory context. The existence of apparent conflicts that are inherent in the two roles of employer and pension plan administrator being performed by the same party cannot be a breach of fiduciary duty because those conflicts are specifically authorized by the statute which permits one party to play both roles. Rather, a situation of conflict of interest occurs [page278] when there is a substantial risk that the employer-administrator's representation of the plan beneficiaries would be materially and adversely affected by the employer-administrator's duties to the corporation.

Seeking an initial order protecting the corporation from actions by its creditors did not, on its own, give rise to any conflict of interest or duty on the part of Indalex. Likewise, failure to give notice of the initial *CCAA* proceedings was not a breach of fiduciary duty to avoid conflicts of interest in this case. Indalex's decision to act as an employer-administrator cannot give the plan members any greater benefit than they would have if their plan was managed by a third party administrator.

It was at the point of seeking and obtaining the DIP orders without notice to the plan beneficiaries

and seeking and obtaining the sale approval order that Indalex's interests as a corporation came into conflict with its duties as a pension plan administrator. However, the difficulty that arose here was not the existence of the conflict itself, but Indalex's failure to take steps so that the plans' beneficiaries would have the opportunity to have their interests protected in the *CCAA* proceedings as if the plans were administered by an independent administrator. In short, the difficulty was not the existence of the conflict, but the failure to address it.

An employer-administrator who finds itself in a conflict must bring the conflict to the attention of the *CCAA* judge. It is not enough to include the beneficiaries in the list of creditors; the judge must be made aware that the debtor, as an administrator of the plan is, or may be, in a conflict of interest. Accordingly, Indalex breached its fiduciary duty by failing to take steps to ensure that the pension plans had the opportunity to be as fully represented in those proceedings as if there had been an independent plan administrator, particularly when it sought the DIP financing approval, the sale approval and a motion to voluntarily enter into bankruptcy.

Regardless of this breach, a remedial constructive trust is only appropriate if the wrongdoer's acts give rise to an identifiable asset which it would be unjust for the wrongdoer (or sometimes a third party) to retain. There is no evidence to support the contention that Indalex's failure to meaningfully address conflicts of interest that arose during the *CCAA* proceedings resulted in any such asset. Furthermore, to impose a constructive trust in [page279] response to a breach of fiduciary duty to ensure for the pension plans some procedural protections that they in fact took advantage of in any case is an unjust response in all of the circumstances.

Per Deschamps and Moldaver JJ.: A corporate employer that chooses to act as plan administrator accepts the fiduciary obligations attached to that function. Since the directors of a corporation also have a fiduciary duty to the corporation, the corporate employer must be prepared to resolve conflicts where they arise. An employer acting as a plan administrator is not permitted to disregard its fiduciary obligations to plan members and favour the competing interests of the corporation on the basis that it is wearing a "corporate hat". What is important is to consider the consequences of the decision, not its nature.

In the instant case, Indalex's fiduciary obligations as plan administrator did in fact conflict with management decisions that needed to be taken in the best interests of the corporation. Specifically, in seeking to have a court approve a form of financing by which one creditor was granted priority over all other creditors, Indalex was asking the *CCAA* court to override the plan members' priority. The corporation's interest was to seek the best possible avenue to survive in an insolvency context. The pursuit of this interest was not compatible with the plan administrator's duty to the plan members to ensure that all contributions were paid into the funds. In the context of this case, the plan administrator's duty to the plan members meant, in particular, that it should at least have given them the opportunity to present their arguments. This duty meant, at the very least, that they were entitled to reasonable notice of the DIP financing motion. The terms of that motion, presented without appropriate notice, conflicted with the interests of the plan members.

As for the constructive trust remedy, it is settled law that proprietary remedies are generally awarded only with respect to property that is directly related to a wrong or that can be traced to such property. There is agreement with Cromwell J. that this condition was not met in the case at bar and his reasoning on this issue is adopted. Moreover, it was unreasonable for the Court of Appeal to reorder the priorities in this case.

[page280]

Per LeBel and Abella JJ. (dissenting): A fiduciary relationship is a relationship, grounded in fact and law, between a vulnerable beneficiary and a fiduciary who holds and may exercise power over the beneficiary in situations recognized by law. It follows that before entering into an analysis of the fiduciary duties of an employer as administrator of a pension plan under the *PBA*, it is necessary to consider the position and characteristics of the pension beneficiaries. In the present case, the beneficiaries were in a very vulnerable position relative to Indalex.

Nothing in the *PBA* allows that the employer *qua* administrator will be held to a lower standard or will be subject to duties and obligations that are less stringent than those of an independent administrator. The employer is under no obligation to assume the burdens of administering the pension plans that it has agreed to set up or that are the legacy of previous decisions. However, if it decides to do so, a fiduciary relationship is created with the expectation that the employer will be able to avoid or resolve the conflicts of interest that might arise.

Indalex was in a conflict of interest from the moment it started to contemplate putting itself under the protection of the *CCAA* and proposing an arrangement to its creditors. From the corporate perspective, one could hardly find fault with such a decision. It was a business decision. But the trouble is that at the same time, Indalex was a fiduciary in relation to the members and retirees of its pension plans. The solution was not to place its function as administrator and its associated fiduciary duties in abeyance. Rather, it had to abandon this role and diligently transfer its function as manager to an independent administrator.

In the present case, the employer not only neglected its obligations towards the beneficiaries, but actually took a course of action that was actively inimical to their interests. The seriousness of these breaches amply justified the decision of the Court of Appeal to impose a constructive trust.

(4) *Costs in United Steelworkers Appeal*

Per McLachlin C.J. and Rothstein and Cromwell JJ.: There is no basis to interfere with the Court of Appeal's costs endorsement as it relates to United Steelworkers in this case. The litigation undertaken here raised novel points of law with all of the uncertainty and risk inherent in such an undertaking. The Court of Appeal in essence decided that the United Steelworkers, representing only 7 of 169 members of the salaried plan, should not without consultation be [page281] able to in effect impose the risks of that litigation on all of the plan members, the vast majority of whom were

not union members. There is no error in principle in the Court of Appeal's refusal to order the United Steelworkers costs to be paid out of the pension fund, particularly in light of the disposition of the appeal to this Court.

Per Deschamps and Moldaver JJ.: There is agreement with the reasons of Cromwell J. on the issue of costs in the United Steelworkers appeal.

Per LeBel and Abella JJ.: There is agreement with the reasons of Cromwell J. on the issue of costs in the United Steelworkers appeal.

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By Deschamps J.

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By Cromwell J.

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(1999), 6 C.B.R. (4) 314; *Donkin v. Bugoy*, [1985] 2 S.C.R. 85; *Soulos v. Korkontzilas*, [1997] 2 S.C.R. 217; *Peter v. Beblow*, [1993] 1 S.C.R. 980; *Nolan v. Kerry (Canada) Inc.*, 2009 SCC 39, [2009] 2 S.C.R. 678; *Hamilton v. Open Window Bakery Ltd.*, 2004 SCC 9, [2004] 1 S.C.R. 303.

By LeBel J. (dissenting)

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[page283]

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APPEALS from a judgment of the Ontario Court of Appeal (MacPherson, Gillese and Juriansz JJ.A.), 2011 ONCA 265, 104 O.R. (3d) 641, 276 O.A.C. 347, 331 D.L.R. (4) 352, 75 C.B.R. (5) 19, 89 C.C.P.B. 39, 17 P.P.S.A.C. (3d) 194, [2011] O.J. No. 1621 (QL), 2011 CarswellOnt 2458, setting aside a decision of Campbell J., 2010 ONSC 1114, 79 C.C.P.B. 301, [2010] O.J. No. 974 (QL), 2010 CarswellOnt 893. Appeals allowed, LeBel and Abella JJ. dissenting.

History and Disposition:

APPEAL from a judgment of the Ontario Court of Appeal (MacPherson, Gillese and Juriansz JJ.A.), 2011 ONCA 578, 81 C.B.R. (5) 165, 92 C.C.P.B. 277, [2011] O.J. No. 3959 (QL), 2011 CarswellOnt 9077. Appeal dismissed.

Counsel:

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Harvey G. Chaiton and *George Benchetrit*, for the appellant George L. Miller, the Chapter 7 Trustee of the Bankruptcy Estates of the U.S. Indalex Debtors.

David R. Byers, *Ashley John Taylor* and *Nicholas Peter McHaffie*, for the appellant FTI Consulting Canada ULC, in its capacity as court-appointed monitor of Indalex Limited, on behalf of Indalex Limited.

Darrell L. Brown, for the appellant/respondent the United Steelworkers.

Andrew J. Hatnay and *Demetrios Yiokaris*, for the respondents Keith Carruthers, et al.

[page285]

Hugh O'Reilly and *Amanda Darrach*, for the respondent Morneau Shepell Ltd. (formerly known as Morneau Sobeco Limited Partnership).

Mark Bailey, *Leonard Marsello* and *William MacLarkey*, for the respondent/intervener the Superintendent of Financial Services.

Robert I. Thornton and *D. J. Miller*, for the intervener the Insolvency Institute of Canada.

Steven Barrett and *Ethan Poskanzer*, for the intervener the Canadian Labour Congress.

Kenneth T. Rosenberg, *Andrew K. Lokan* and *Massimo Starnino*, for the intervener the Canadian Federation of Pensioners.

Éric Vallières, *Alexandre Forest* and *Yoine Goldstein,* for the intervener the Canadian Association of Insolvency and Restructuring Professionals.

Mahmud Jamal, *Jeremy Dacks* and *Tony Devir,* for the intervener the Canadian Bankers Association.

The judgment of Deschamps and Moldaver JJ. was delivered by

1 DESCHAMPS J.:-- Insolvency can trigger catastrophic consequences. Often, large claims of ordinary creditors are left unpaid. In insolvency situations, the promise of defined benefits made to employees during their employment is put at risk. These appeals illustrate the materialization of such a risk. Although the employer in this case breached a fiduciary duty, the harm suffered by the pension plans' beneficiaries results not from that breach, but from the employer's insolvency. For the following reasons, I would allow the appeals of the appellants Sun Indalex Finance, LLC; George L. Miller, Indalex U.S.'s trustee in bankruptcy; and FTI Consulting Canada ULC.

[page286]

2 To improve the prospect of pensioners receiving their full benefits after a pension plan is wound up, the Ontario legislature has protected contributions to the pension fund that have accrued but are not yet due at the time of the wind up by providing for a deemed trust that supersedes all other provincial priorities over certain assets of the plan sponsor (s. 57(4) of the *Pension Benefits Act*, R.S.O. 1990, c. P.8 ("*PBA*"), and s. 30(7) of the *Personal Property Security Act*, R.S.O. 1990, c. P.10 ("*PPSA*")). The parties disagree on the scope of the deemed trust. In my view, the relevant provisions and the context lead to the conclusion that it extends to contributions the employer must make to ensure that the pension fund is sufficient to cover liabilities upon wind up. In the instant case, however, the deemed trust is superseded by the security granted to the creditor that loaned money to the employer, Indalex Limited ("Indalex"), during the insolvency proceedings. In

addition, although the employer, as plan administrator, may have put itself in a position of conflict of interest by failing to give the plan's members proper notice of a motion requesting financing of its operations during a restructuring process, there was no realistic possibility that, had the members received notice and had the *CCAA* court found that they were secured creditors, it would have ordered the priorities differently. Consequently, it would not be appropriate to order an equitable remedy such as the constructive trust ordered by the Court of Appeal.

I. Facts

3 Indalex is a wholly owned Canadian subsidiary of a U.S. company, Indalex Holding Corp. ("Indalex U.S."). Indalex and its related companies formed a corporate group (the "Indalex Group") that manufactured aluminum extrusions. The U.S. and Canadian operations were closely linked.

[page287]

4 In 2009, a combination of high commodity prices and the economic recession's impact on the end-user market for aluminum extrusions plunged the Indalex Group into insolvency. On March 20, 2009, Indalex U.S. filed for Chapter 11 bankruptcy protection in Delaware. On April 3, 2009, Indalex applied for a stay under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*"), and Morawetz J. granted the stay in an initial order. He also appointed FTI Consulting Canada ULC (the "Monitor") to act as monitor.

5 At that time, Indalex was the administrator of two registered pension plans. One was for its salaried employees (the "Salaried Plan"), the other for its executives (the "Executive Plan"). Members of the Salaried Plan included seven employees for whom the United Steelworkers ("USW") acted as bargaining agent. The Salaried Plan was in the process of being wound up when the *CCAA* proceedings began. The effective date of the wind up was December 31, 2006. The Executive Plan had been closed but not wound up. Overall, the deficiencies of the pension plans' funds concern 49 persons (members of the Salaried Plan and the Executive Plan are referred to collectively as the "Plan Members").

6 Pursuant to the initial order made by Morawetz J. on April 3, 2009, Indalex obtained protection under the *CCAA*. Both plans faced funding deficiencies when Indalex filed for the *CCAA* stay. The wind-up deficiency of the Salaried Plan was estimated at $1.8 million as of December 31, 2008. The funding deficiency of the Executive Plan was estimated at $3.0 million on a wind-up basis as of January 1, 2008.

7 From the beginning of the insolvency proceedings, the Indalex Group's reorganization strategy was to sell both Indalex and Indalex U.S. as a going concern while they were under *CCAA* and Chapter 11 protection. To this end, Indalex and Indalex U.S. sought to enter into a common agreement for debtor-in-possession ("DIP") financing under which the two companies [page288]

could draw from joint credit facilities and would guarantee each other's liabilities.

8 Indalex's financial distress threatened the interests of all the Plan Members. If the reorganization failed and Indalex were liquidated under the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("*BIA*"), they would not have recovered any of their claims against Indalex for the underfunded pension liabilities, because the priority created by the provincial statute would not be recognized under the federal legislation: *Husky Oil Operations Ltd. v. Minister of National Revenue*, [1995] 3 S.C.R. 453. Although the priority was not rendered ineffective by the *CCAA*, the Plan Members' position was uncertain.

9 The Indalex Group solicited terms from a variety of possible DIP lenders. In the end, it negotiated an agreement with a syndicate consisting of the pre-filing senior secured creditors. On April 8, 2009, the *CCAA* court issued an Amended and Restated Initial Order ("Amended Initial Order") authorizing Indalex to borrow US$24.4 million from the DIP lenders and grant them priority over all other creditors ("DIP charge") in that amount. In his endorsement of the order, Morawetz J. made a finding that Indalex would be unable to achieve a going-concern solution without DIP financing. Such financing was necessary to support Indalex's business until the sale could be completed.

10 The Plan Members did not participate in the initial proceedings. The initial stay had been granted *ex parte*. The *CCAA* judge ordered Indalex to serve a copy of the stay order on every creditor owed $5,000 or more within 10 days of the initial order of April 3. As of April 8, when the motion to amend the initial order was heard, none of the Executive Plan's members had been served with that order; nor did any of them receive notice of the motion to amend it. The USW did receive short notice, but chose not to attend. Morawetz J. authorized Indalex to proceed on the basis of an abridged time for [page289] service. The Plan Members were given notice of all subsequent proceedings. None of the Plan Members appealed the Amended Initial Order to contest the DIP charge.

11 On June 12, 2009, Indalex applied for authorization to increase the DIP loan amount to US$29.5 million. At the hearing, the Executive Plan's members initially opposed the motion, seeking to reserve their rights. After it was confirmed that the motion was merely to increase the amount of the DIP charge (without changing the terms of the loan), they withdrew their opposition and the court granted the motion.

12 On April 22, 2009, the court extended the stay of proceedings and approved a marketing process for the sale of Indalex's assets. The Plan Members did not oppose the application to approve the marketing process. Under the approved bidding procedure, the Indalex Group solicited a wide variety of potential buyers.

13 Indalex received a bid from SAPA Holding AB ("SAPA"). It was for approximately US$30 million, and SAPA did not assume responsibility for the pension plans' wind-up deficiencies. According to the Monitor's estimate, the liquidation value of Indalex's assets was US$44.7 million.

Indalex brought an application for an order approving a bidding procedure for a competitive auction and deeming SAPA's bid to be a qualifying bid. The Executive Plan's members opposed the application, expressing concern that the pension liabilities would not be assumed. Morawetz J. nevertheless issued the order on July 2, 2009; in it, he approved the bidding procedure for sale, noting that the Executive Plan's members could raise their objections at the time of approval of the final bid.

[page290]

14 The bidding procedure did not trigger any competing bids. On July 20, 2009, Indalex and Indalex U.S. brought motions before their respective courts to approve the sale of substantially all their assets under the terms of SAPA's bid. Indalex also moved for approval of an interim distribution of the sale proceeds to the DIP lenders. The Plan Members opposed Indalex's motion. First, they argued that it was estimated that a forced liquidation would produce greater proceeds than SAPA's bid. Second, they contended that their claims had priority over that of the DIP lenders because the unfunded pension liabilities were subject to a statutory deemed trust under the *PBA*. They also contended that Indalex had breached its fiduciary obligations by failing to meet its obligations as a plan administrator throughout the insolvency proceedings.

15 The court dismissed the Plan Members' first objection, holding that there was no evidence supporting the argument that a forced liquidation would be more beneficial to suppliers, customers and the 950 employees. It approved the sale on July 20, 2009. The order in which it did so directed the Monitor to make a distribution to the DIP lenders. With respect to the second objection, however, Campbell J. ordered the Monitor to hold a reserve in an amount to be determined by the Monitor, leaving the Plan Members' arguments based on their right to the proceeds of the sale open for determination at a later date.

16 The sale to SAPA closed on July 31, 2009. The Monitor collected $30.9 million in proceeds. It distributed US$17 million to the DIP lenders, paid certain fees, withheld a portion to cover various costs and retained $6.75 million in reserve pending determination of the Plan Members' rights. At the closing, Indalex owed US$27 million to the DIP lenders. The payment of US$17 million left a US$10 million shortfall in the amount owed to these lenders. The DIP lenders called on Indalex U.S. to cover this shortfall under the guarantee [page291] contained in the DIP lending agreement. Indalex U.S. paid the amount of the shortfall. Since Indalex U.S. was, as a term of the guarantee, subrogated to the DIP lenders' priority, it became the highest ranking creditor of Indalex, with a claim for US$10 million.

17 Following the sale of Indalex's assets, its directors resigned. Indalex U.S., a part of Indalex Group, took over the management of Indalex, whose assets were limited to the sale proceeds held by the Monitor. A Unanimous Shareholder Declaration was executed on August 12, 2009; in it, Mr.

Keith Cooper was appointed to manage Indalex's affairs. Mr. Cooper was an employee of FTI Consulting Inc.

18 In accordance with the right reserved by the court on July 20, 2009, the Plan Members brought motions on August 28, 2009 for a declaration that a deemed trust equal in amount to the unfunded pension liability was enforceable against the proceeds of the sale. They contended that they had priority over the secured creditors pursuant to s. 57(4) of the *PBA* and s. 30(7) of the *PPSA*. Indalex, in turn, brought a motion for an assignment in bankruptcy to secure the priority regime it argued for in opposing the Plan Members' motions.

19 On October 14, 2009, while judgment was pending, Indalex U.S. converted the Chapter 11 restructuring proceeding in the U.S. into a Chapter 7 liquidation proceeding. On November 5, 2009, the Superintendent of Financial Services ("Superintendent") appointed the actuarial firm of Morneau Sobeco Limited Partnership ("Morneau") to replace Indalex as administrator of the plans.

20 On February 18, 2010, Campbell J. dismissed the Plan Members' motions, concluding that the deemed trust did not apply to the wind-up deficiencies, because the associated payments were not "due" or "accruing due" as of the date of the wind up. He found that the Executive Plan did [page292] not have a wind-up deficiency, since it had not yet been wound up. He thus found it unnecessary to rule on Indalex's motion for an assignment in bankruptcy (2010 ONSC 1114, 79 C.C.P.B. 301). The Plan Members appealed the dismissal of their motions.

21 The Ontario Court of Appeal allowed the Plan Members' appeals. It found that the deemed trust created by s. 57(4) of the *PBA* applies to all amounts due with respect to plan wind-up deficiencies. Although the court noted that it was likely that no deemed trust existed for the Executive Plan on the plain meaning of the provision, it declined to address this question, because it found that the Executive Plan's members had a claim arising from Indalex's breach of its fiduciary obligations in failing to adequately protect the Plan Members' interests (2011 ONCA 265, 104 O.R. (3d) 641).

22 The Court of Appeal concluded that a constructive trust was an appropriate remedy for Indalex's breach of its fiduciary obligations. The court was of the view that this remedy did not harm the DIP lenders, but affected only Indalex U.S. It imposed a constructive trust over the reserved fund in favour of the Plan Members. Turning to the question of distribution, it also found that the deemed trust had priority over the DIP charge because the issue of federal paramountcy had not been raised when the Amended Initial Order was issued, and that Indalex had stated that it intended to comply with any deemed trust requirements. The Court of Appeal found that there was nothing in the record to suggest that not applying the paramountcy doctrine would frustrate Indalex's ability to restructure.

23 The Court of Appeal ordered the Monitor to make a distribution from the reserve fund in order to pay the amount of each plan's deficiency. It also issued a costs endorsement that approved payment of the costs of the Executive Plan's members from that plan's fund, but declined to order

the payment of costs to the USW from the fund of the Salaried Plan (2011 ONCA 578, 81 C.B.R. (5th) 165).

[page293]

24 The Monitor, together with Sun Indalex, a secured creditor of Indalex U.S., and George L. Miller, Indalex U.S.'s trustee in bankruptcy, appeals the Court of Appeal's order. Both the Superintendent and Morneau support the Plan Members' position as respondents. A number of stakeholders are also participating in the appeals to this Court. In addition, USW appeals the costs endorsement. As I agree with my colleague Cromwell J. on the appeal from the costs endorsement, I will not deal with it in these reasons.

II. Issues

25 The appeals raise four issues:

1. Does the deemed trust provided for in s. 57(4) of the *PBA* apply to wind-up deficiencies?
2. If so, does the deemed trust supersede the DIP charge?
3. Did Indalex have any fiduciary obligations to the Plan Members when making decisions in the context of the insolvency proceedings?
4. Did the Court of Appeal properly exercise its discretion in imposing a constructive trust to remedy the breaches of fiduciary duties?

III. Analysis

A. *Does the Deemed Trust Provided for in Section 57(4) of the PBA Apply to Wind-up Deficiencies?*

26 The first issue is whether the statutory deemed trust provided for in s. 57(4) of the *PBA* extends to wind-up deficiencies. This question is one of statutory interpretation, which requires examination of both the wording and context of the relevant provisions of the *PBA*. Section 57(4) of the *PBA* affords protection to members of a pension plan with respect to their employer's contributions upon wind up of the plan. The provision reads:

[page294]

57... .

> (4) Where a pension plan is wound up in whole or in part, an employer who is required to pay contributions to the pension fund shall be deemed to hold in trust for the beneficiaries of the pension plan an amount of money equal to employer contributions accrued to the date of the wind up but not yet due under the plan or regulations.

27 The most obvious interpretation is that where a plan is wound up, this provision protects all contributions that have accrued but are not yet due. The words used appear to include the contribution the employer is to make where a plan being wound up is in a deficit position. This quite straightforward interpretation, which is consistent with both the historical broadening of the protection and the remedial purpose of the provision, is being challenged on the basis of a narrow definition of the word "accrued". I do not find that this argument justifies limiting the protection afforded to plan members by the Ontario legislature.

28 The *PBA* sets out the rules for the operation of funded contributory defined benefit pension plans in Ontario. In an ongoing plan, an employer must pay into a fund all contributions it withholds from its employees' salaries. In addition, while the plan is ongoing, the employer must make two kinds of payments. One relates to current service contributions - the employer's own regular contributions to the pension fund as required by the plan. The other ensures that the fund is sufficient to meet the plan's liabilities. The employees' interest in having the contributions made while the plan is ongoing is protected by a deemed trust provided for in s. 57(3) of the *PBA*.

29 The *PBA* also establishes a comprehensive scheme for winding up a pension plan. Section 75(1)(a) imposes on the employer the obligation to "pay" an amount equal to the total of all "payments" that are due or that have accrued and have not been paid into the fund. In addition, s. 75(1)(b) sets out a formula for calculating the amount that must be [page295] paid to ensure that the fund is sufficient to cover all liabilities upon wind up. Within six months after the effective date of the wind up, the plan administrator must file a wind-up report that lists the plan's assets and liabilities as of the date of the wind up. If the wind-up report shows an actuarial deficit, the employer must make wind-up deficiency payments. Consequently, s. 75(1)(a) and (b) jointly determine the amount of the contributions owed when a plan is wound up.

30 It is common ground that the contributions provided for in s. 75(1)(a) are covered by the wind-up deemed trust. The only question is whether it also applies to the deficiency payments required by s. 75(1)(b). I would answer this question in the affirmative in view of the provision's wording, context and purpose.

31 It is readily apparent that the wind-up deemed trust provision (s. 57(4) *PBA*) does not place an express limit on the "employer contributions accrued to the date of the wind up but not yet due", and I find no reason to exclude contributions paid under s. 75(1)(b). Section 75(1)(a) explicitly refers to "an amount equal to the total of all payments" that have *accrued*, even those that were not

yet due as of the date of the wind up, whereas s. 75(1)(b) contemplates an "amount" that is calculated on the basis of the value of assets and of liabilities that have *accrued* when the plan is wound up. Section 75(1) reads as follows:

> **75.** (1) Where a pension plan is wound up, the employer shall pay into the pension fund,
>
> (a) an amount equal to the total of all payments that, under this Act, the regulations and the pension plan, are due or that have accrued and that have not been paid into the pension fund; and
> (b) an amount equal to the amount by which,
>
> (i) the value of the pension benefits under the pension plan that would be guaranteed by the Guarantee Fund under this Act and the regulations if the Superintendent declares [page296] that the Guarantee Fund applies to the pension plan,
> (ii) the value of the pension benefits accrued with respect to employment in Ontario vested under the pension plan, and
> (iii) the value of benefits accrued with respect to employment in Ontario resulting from the application of subsection 39 (3) (50 per cent rule) and section 74,
>
> exceed the value of the assets of the pension fund allocated as prescribed for payment of pension benefits accrued with respect to employment in Ontario.

32 Since both the amount with respect to payments (s. 75(1)(a)) and the one ascertained by subtracting the assets from the liabilities accrued as of the date of the wind up (s. 75(1)(b)) are to be paid upon wind up as employer contributions, they are both included in the ordinary meaning of the words of s. 57(4) of the *PBA*: "... amount of money equal to employer contributions accrued to the date of the wind up but not yet due under the plan or regulations". As I mentioned above, this reasoning is challenged in respect of s. 75(1)(b), not of s. 75(1)(a).

33 The appellant Sun Indalex argues that since the deficiency is not finally quantified until well after the effective date of the wind up, the liability of the employer cannot be said to have accrued. The Monitor adds that the payments the employer must make to satisfy its wind-up obligations may change over the five-year period within which s. 31 of the *PBA* Regulations, R.R.O. 1990, Reg. 909, requires that they be made. These parties illustrate their argument by referring to what occurred to the Salaried Plan's fund in the case at bar. In 2007-8, Indalex paid down the vast majority of the $1.6 million wind-up deficiency associated with the Salaried Plan as estimated in 2006. By the end

of 2008, however, this deficiency had risen back up to $1.8 million as a result of a decline in the fund's asset value. According to this argument, the amount could not have accrued as of the date of the wind up, because it could not be calculated with certainty.

[page297]

34 Unlike my colleague Cromwell J., I find this argument unconvincing. I instead agree with the Court of Appeal on this point. The wind-up deemed trust concerns "employer contributions accrued to the date of the wind up but not yet due under the plan or regulations". Since the employees cease to accumulate entitlements when the plan is wound up, the entitlements that are used to calculate the contributions have all been accumulated before the wind-up date. Thus the liabilities of the employer are complete - have accrued - before the wind up. The distinction between my approach and the one Cromwell J. takes is that he requires that it be possible to perform the calculation before the date of the wind up, whereas I am of the view that the time when the calculation is actually made is not relevant as long as the liabilities are assessed as of the date of the wind up. The date at which the liabilities are *reported* or the employer's *option* to spread its contributions as allowed by the regulations does not change the legal nature of the contributions.

35 In *Hydro-Electric Power Commission of Ontario v. Albright* (1922), 64 S.C.R. 306, Duff J. considered the meaning of the word "accrued" in interpreting the scope of a covenant. He found that

> the word "accrued" according to well recognized usage has, as applied to rights or liabilities the meaning simply of completely constituted - and it may have this meaning although it appears from the context that the right completely constituted or the liability completely constituted is one which is only exercisable or enforceable *in futuro* - a debt for example which is *debitum in praesenti solvendum in futuro*. [Emphasis added; pp. 312-13.]

36 Thus, a contribution has "accrued" when the liabilities are completely constituted, even if the payment itself will not fall due until a later date. If this principle is applied to the facts of this case, the liabilities related to contributions to the fund allocated for payment of the pension benefits contemplated in s. 75(1)(b) are completely [page298] constituted at the time of the wind up, because no pension entitlements arise after that date. In other words, no new liabilities accrue at the time of or after the wind up. Even the portion of the contributions that is related to the elections plan members may make upon wind up has "accrued to the date of the wind up", because it is based on rights employees earned before the wind-up date.

37 The fact that the precise amount of the contribution is not determined as of the time of the wind up does not make it a contingent contribution that cannot have accrued for accounting purposes (*Canadian Pacific Ltd. v. M.N.R.* (1998), 41 O.R. (3d) 606 (C.A.), at p. 621). The use of the word "accrued" does not limit liabilities to amounts that can be determined with precision. As a

result, the words "contributions accrued" can encompass the contributions mandated by s. 75(1)(b) of the *PBA*.

38 The legislative history supports my conclusion that wind-up deficiency contributions are protected by the deemed trust provision. The Ontario legislature has consistently expanded the protection afforded in respect of pension plan contributions. I cannot therefore accept an interpretation that would represent a drawback from the protection extended to employees. I will not reproduce the relevant provisions, since my colleague Cromwell J. quotes them.

39 The original statute provided solely for the employer's obligation to pay all amounts required to be paid to meet the test for solvency (*The Pension Benefits Act, 1965*, S.O. 1965, c. 96, s. 22(2)), but the legislature subsequently afforded employees the protection of a deemed trust on the employer's assets in an amount equal to the sums withheld from employees as contributions and sums due from the employer as service contributions (s. 23*a*, added by *The Pension Benefits Amendment Act, 1973*, S.O. 1973, c. 113, s. 6). In a later version, it protected not only contributions that were due, but also those that had accrued, with the amounts being calculated as if the plan had been wound up (*The Pension Benefits Amendment Act, 1980*, S.O. 1980, c. 80).

[page299]

40 Whereas *all* employer contributions were originally covered by a single provision, the legislature crafted a separate provision in 1980 that specifically imposed on the employer the obligation to fund the wind-up deficiency. At the time, it was clear from the words used in the provision that the amount related to the wind-up deficiency was excluded from the deemed trust protection (*The Pension Benefits Amendment Act, 1980*). In 1983, the legislature made a distinction between the deemed trust for ongoing employer contributions and the one for certain payments to be made upon wind up (ss. 23(4)(a) and 23(4)(b), added by *Pension Benefits Amendment Act, 1983*, S.O. 1983, c. 2, s. 3). In that version, the wind-up deficiency payments were still excluded from the deemed trust. However, the legislature once again made changes to the protection in 1987. The 1987 version is, in substance, the one that applies in the case at bar. In the *Pension Benefits Act, 1987*, S.O. 1987, c. 35, a specific wind-up deemed trust was maintained, but the wind-up deficiency payments were no longer excluded from it, because the limitation that had been imposed until then with respect to payments that were due or had accrued while the plan was ongoing had been eliminated. My comments to the effect that the previous versions excluded the wind-up deficiency payments do not therefore apply to the 1987 statute, since it was materially different.

41 Whereas it is clear from the 1983 amendments that the deemed trust provided for in s. 23(4)(b) was intended to include only current service costs and special payments, this is less clear from the subsequent versions of the *PBA*. To give meaning to the 1987 amendment, I have to conclude that the words refer to a deemed trust in respect of *all* "employer contributions accrued to

the date of the wind up but not yet due under the plan or regulations".

42 The employer's liability upon wind up is now set out in a single section which elegantly parallels the wind-up deemed trust provision. It can be seen from the legislative history that the protection has expanded from (1) only the service contributions [page300] that were due, to (2) amounts payable calculated as if the plan had been wound up, to (3) amounts that were due and had accrued upon wind up but excluding the wind-up deficiency payments, to (4) all amounts due and accrued upon wind up.

43 Therefore, in my view, the legislative history leads to the conclusion that adopting a narrow interpretation that would dissociate the employer's payment provided for in s. 75(1)(b) of the *PBA* from the one provided for in s. 75(1)(a) would be contrary to the Ontario legislature's trend toward broadening the protection. Since the provision respecting wind-up payments sets out the amounts that are owed upon wind up, I see no historical, legal or logical reason to conclude that the wind-up deemed trust provision does not encompass all of them.

44 Thus, I am of the view that the words and context of s. 57(4) lend themselves easily to an interpretation that includes the wind-up deficiency payments, and I find additional support for this in the purpose of the provision. The deemed trust provision is a remedial one. Its purpose is to protect the interests of plan members. This purpose militates against adopting the limited scope proposed by Indalex and some of the interveners. In the case of competing priorities between creditors, the remedial purpose favours an approach that includes all wind-up payments in the value of the deemed trust in order to achieve a broad protection.

45 In sum, the relevant provisions, the legislative history and the purpose are all consistent with inclusion of the wind-up deficiency in the protection afforded to members with respect to employer contributions upon the wind up of their pension plan. I therefore find that the Court of Appeal correctly held with respect to the Salaried Plan, which had been wound up as of December 31, 2006, that Indalex was deemed to hold in trust the amount necessary to satisfy the wind-up deficiency.

46 The situation is different with respect to the Executive Plan. Unlike s. 57(3), which provides that [page301] the deemed trust protecting employer contributions exists while a plan is ongoing, s. 57(4) provides that the wind-up deemed trust comes into existence only when the plan is wound up. This is a choice made by the Ontario legislature. I would not interfere with it. Thus, the deemed trust entitlement arises only once the condition precedent of the plan being wound up has been fulfilled. This is true even if it is certain that the plan will be wound up in the future. At the time of the sale, the Executive Plan was in the process of being, but had not yet been, wound up. Consequently, the deemed trust provision does not apply to the employer's wind-up deficiency payments in respect of that plan.

47 The Court of Appeal declined to decide whether a deemed trust arose in relation to the Executive Plan, stating that it was unnecessary to decide this issue. However, the court expressed

concern that a reasoning that deprived the Executive Plan's members of the benefit of a deemed trust would mean that a company under *CCAA* protection could avoid the priority of the *PBA* deemed trust simply by not winding up an underfunded pension plan. The fear was that Indalex could have relied on its own inaction to avoid the consequences that flow from a wind up. I am not convinced that the Court of Appeal's concern has any impact on the question whether a deemed trust exists, and I doubt that an employer could avoid the consequences of such a security interest simply by refusing to wind up a pension plan. The Superintendent may take a number of steps, including ordering the wind up of a pension plan under s. 69(1) of the *PBA* in a variety of circumstances (see s. 69(1)(d) *PBA*). The Superintendent did not choose to order that the plan be wound up in this case.

B. *Does the Deemed Trust Supersede the DIP Charge?*

48 The finding that the interests of the Salaried Plan's members in all the employer's wind-up contributions to the Salaried Plan are protected by a [page302] deemed trust does not mean that part of the money reserved by the Monitor from the sale proceeds must be remitted to the Salaried Plan's fund. This will be the case only if the provincial priorities provided for in s. 30(7) of the *PPSA* ensure that the claim of the Salaried Plan's members has priority over the DIP charge. Section 30(7) reads as follows:

> **30. ...**
>
> (7) A security interest in an account or inventory and its proceeds is subordinate to the interest of a person who is the beneficiary of a deemed trust arising under the *Employment Standards Act* or under the *Pension Benefits Act*.

The effect of s. 30(7) is to enable the Salaried Plan's members to recover from the reserve fund, insofar as it relates to an account or inventory and its proceeds in Ontario, ahead of all other secured creditors.

49 The Appellants argue that any provincial deemed trust is subordinate to the DIP charge authorized by the *CCAA* order. They put forward two central arguments to support their contention. First, they submit that the *PBA* deemed trust does not apply in *CCAA* proceedings because the relevant priorities are those of the federal insolvency scheme, which do not include provincial deemed trusts. Second, they argue that by virtue of the doctrine of federal paramountcy the DIP charge supersedes the *PBA* deemed trust.

50 The Appellants' first argument would expand the holding of *Century Services Inc. v. Canada (Attorney General)*, 2010 SCC 60, [2010] 3 S.C.R. 379, so as to apply federal bankruptcy priorities to *CCAA* proceedings, with the effect that claims would be treated similarly under the *CCAA* and the *BIA*. In *Century Services*, the Court noted that there are points at which the two schemes converge:

[page303]

> Another point of convergence of the *CCAA* and the *BIA* relates to priorities. Because the *CCAA* is silent about what happens if reorganization fails, the *BIA* scheme of liquidation and distribution necessarily supplies the backdrop for what will happen if a *CCAA* reorganization is ultimately unsuccessful. [para. 23]

51 In order to avoid a race to liquidation under the *BIA*, courts will favour an interpretation of the *CCAA* that affords creditors analogous entitlements. Yet this does not mean that courts may read bankruptcy priorities into the *CCAA* at will. Provincial legislation defines the priorities to which creditors are entitled until that legislation is ousted by Parliament. Parliament did not expressly apply all bankruptcy priorities either to *CCAA* proceedings or to proposals under the *BIA*. Although the creditors of a corporation that is attempting to reorganize may bargain in the shadow of their bankruptcy entitlements, those entitlements remain only shadows until bankruptcy occurs. At the outset of the insolvency proceedings, Indalex opted for a process governed by the *CCAA*, leaving no doubt that although it wanted to protect its employees' jobs, it would not survive as their employer. This was not a case in which a failed arrangement forced a company into liquidation under the *BIA*. Indalex achieved the goal it was pursuing. It chose to sell its assets under the *CCAA*, not the *BIA*.

52 The provincial deemed trust under the *PBA* continues to apply in *CCAA* proceedings, subject to the doctrine of federal paramountcy (*Crystalline Investments Ltd. v. Domgroup Ltd.*, 2004 SCC 3, [2004] 1 S.C.R. 60, at para. 43). The Court of Appeal therefore did not err in finding that at the end of a *CCAA* liquidation proceeding, priorities may be determined by the *PPSA*'s scheme rather than the federal scheme set out in the *BIA*.

[page304]

53 The Appellants' second argument is that an order granting priority to the plan's members on the basis of the deemed trust provided for by the Ontario legislature would be unconstitutional in that it would conflict with the order granting priority to the DIP lenders that was made under the *CCAA*. They argue that the doctrine of paramountcy resolves this conflict, as it would render the provincial law inoperative to the extent that it is incompatible with the federal law.

54 There is a preliminary question that must be addressed before determining whether the doctrine of paramountcy applies in this context. This question arises because the Court of Appeal found that although the *CCAA* court had the power to authorize a DIP charge that would supersede the deemed trust, the order in this case did not have such an effect because paramountcy had not

been invoked. As a result, the priority of the deemed trust over secured creditors by virtue of s. 30(7) of the *PPSA* remained in effect, and the Plan Members' claim ranked in priority to the claim of the DIP lenders established in the *CCAA* order.

55 With respect, I cannot accept this approach to the doctrine of federal paramountcy. This doctrine resolves conflicts in the application of overlapping valid provincial and federal legislation (*Canadian Western Bank v. Alberta*, 2007 SCC 22, [2007] 2 S.C.R. 3, at paras. 32 and 69). Paramountcy is a question of law. As a result, subject to the application of the rules on the admissibility of new evidence, it can be raised even if it was not invoked in an initial proceeding.

56 A party relying on paramountcy must "demonstrate that the federal and provincial laws are in fact incompatible by establishing either that it is impossible to comply with both laws or that to apply the provincial law would frustrate the purpose of the federal law" (*Canadian Western Bank*, at para. 75). This Court has in fact applied the doctrine of paramountcy in the area of bankruptcy and insolvency to come to the conclusion that a [page305] provincial legislature cannot, through measures such as a deemed trust, affect priorities granted under federal legislation (*Husky Oil*).

57 None of the parties question the validity of either the federal provision that enables a *CCAA* court to make an order authorizing a DIP charge or the provincial provision that establishes the priority of the deemed trust. However, in considering whether the *CCAA* court has, in exercising its discretion to assess a claim, validly affected a provincial priority, the reviewing court should remind itself of the rule of interpretation stated in *Attorney General of Canada v. Law Society of British Columbia*, [1982] 2 S.C.R. 307 (at p. 356), and reproduced in *Canadian Western Bank* (at para. 75):

> When a federal statute can be properly interpreted so as not to interfere with a provincial statute, such an interpretation is to be applied in preference to another applicable construction which would bring about a conflict between the two statutes.

58 In the instant case, the *CCAA* judge, in authorizing the DIP charge, did not consider the fact that the Salaried Plan's members had a claim that was protected by a deemed trust, nor did he explicitly note that ordinary creditors, such as the Executive Plan's members, had not received notice of the DIP loan motion. However, he did consider factors that were relevant to the remedial objective of the *CCAA* and found that Indalex had in fact demonstrated that the *CCAA*'s purpose would be frustrated without the DIP charge. It will be helpful to quote the reasons he gave on April 17, 2009 in authorizing the DIP charge ((2009), 52 C.B.R. (5th) 61):

> (a) the Applicants are in need of the additional financing in order to support operations during the period of a going concern restructuring;

[page306]

(b) there is a benefit to the breathing space that would be afforded by the DIP Financing that will permit the Applicants to identify a going concern solution;
(c) there is no other alternative available to the Applicants for a going concern solution;
(d) a stand-alone solution is impractical given the integrated nature of the business of Indalex Canada and Indalex U.S.;
(e) given the collateral base of Indalex U.S., the Monitor is satisfied that it is unlikely that the Post-Filing Guarantee with respect to the U.S. Additional Advances will ever be called and the Monitor is also satisfied that the benefits to stakeholders far outweighs the risk associated with this aspect of the Post-Filing Guarantee;
(f) the benefit to stakeholders and creditors of the DIP Financing outweighs any potential prejudice to unsecured creditors that may arise as a result of the granting of super-priority secured financing against the assets of the Applicants;
(g) the Pre-Filing Security has been reviewed by counsel to the Monitor and it appears that the unsecured creditors of the Canadian debtors will be in no worse position as a result of the Post-Filing Guarantee than they were otherwise, prior to the CCAA filing, as a result of the limitation of the Canadian guarantee set forth in the draft Amended and Restated Initial Order ... ; and
(h) the balancing of the prejudice weighs in favour of the approval of the DIP Financing. [para. 9]

59 Given that there was no alternative for a going-concern solution, it is difficult to accept the Court of Appeal's sweeping intimation that the DIP lenders would have accepted that their claim ranked below claims resulting from the deemed trust. There is no evidence in the record that gives credence to this suggestion. Not only is it contradicted by the *CCAA* judge's findings of fact, but case after case has shown that "the priming of the DIP facility is a key aspect of the debtor's ability to attempt a workout" (J. P. Sarra, *Rescue! The Companies' Creditors Arrangement Act* (2007), at p. 97). The harsh reality is that lending is governed by the commercial imperatives of the [page307] lenders, not by the interests of the plan members or the policy considerations that lead provincial governments to legislate in favour of pension fund beneficiaries. The reasons given by Morawetz J. in response to the first attempt of the Executive Plan's members to reserve their rights on June 12, 2009 are instructive. He indicated that any uncertainty as to whether the lenders would withhold advances or whether they would have priority if advances were made did "not represent a positive development". He found that, in the absence of any alternative, the relief sought was "necessary and appropriate" (2009 CanLII 37906, at paras. 7-8).

60 In this case, compliance with the provincial law necessarily entails defiance of the order made under federal law. On the one hand, s. 30(7) of the *PPSA* required a part of the proceeds from the sale related to assets described in the provincial statute to be paid to the plan's administrator before other secured creditors were paid. On the other hand, the Amended Initial Order provided that the DIP charge ranked in priority to "all other security interests, trusts, liens, charges and encumbrances, statutory or otherwise" (para. 45). Granting priority to the DIP lenders subordinates the claims of other stakeholders, including the Plan Members. This court-ordered priority based on the *CCAA* has the same effect as a statutory priority. The federal and provincial laws are inconsistent, as they give rise to different, and conflicting, orders of priority. As a result of the application of the doctrine of federal paramountcy, the DIP charge supersedes the deemed trust.

C. *Did Indalex Have Fiduciary Obligations to the Plan Members?*

61 The fact that the DIP financing charge supersedes the deemed trust or that the interests of the Executive Plan's members are not protected by the deemed trust does not mean that Plan Members have no right to receive money out of the reserve [page308] fund. What remains to be considered is whether an equitable remedy, which could override all priorities, can and should be granted for a breach by Indalex of a fiduciary duty.

62 The first stage of a fiduciary duty analysis is to determine whether and when fiduciary obligations arise. The Court has recognized that there are circumstances in which a pension plan administrator has fiduciary obligations to plan members both at common law and under statute (*Burke v. Hudson's Bay Co.*, 2010 SCC 34, [2010] 2 S.C.R. 273, at para. 41). It is clear that the indicia of a fiduciary relationship attach in this case between the Plan Members and Indalex as plan administrator. Sun Indalex and the Monitor do not dispute this proposition.

63 However, Sun Indalex and the Monitor argue that the employer has a fiduciary duty only when it acts as plan administrator - when it is wearing its administrator's "hat". They contend that, outside the plan administration context, when directors make decisions in the best interests of the corporation, the employer is wearing solely its "corporate hat". On this view, decisions made by the employer in its corporate capacity are not burdened by the corporation's fiduciary obligations to its pension plan members and, consequently, cannot be found to conflict with plan members' interests. This is not the correct approach to take in determining the scope of the fiduciary obligations of an employer acting as plan administrator.

64 Only persons or entities authorized by the *PBA* can act as plan administrators (ss. 1(1) and 8(1)(a)). The employer is one of them. A corporate employer that chooses to act as plan administrator accepts the fiduciary obligations attached to that function. Since the directors of a corporation also have a fiduciary duty to the corporation, the fact that the corporate employer can act as administrator [page309] of a pension plan means that s. 8(1)(a) of the *PBA* is based on the assumption that not all decisions taken by directors in managing a corporation will result in conflict with the corporation's duties to the plan's members. However, the corporate employer must be

prepared to resolve conflicts where they arise. Reorganization proceedings place considerable burdens on any debtor, but these burdens do not release an employer that acts as plan administrator from its fiduciary obligations.

65 Section 22(4) of the *PBA* explicitly provides that a plan administrator must not permit its own interest to conflict with its duties in respect of the pension fund. Thus, where an employer's own interests do not converge with those of the plan's members, it must ask itself whether there is a potential conflict and, if so, what can be done to resolve the conflict. Where interests do conflict, I do not find the two hats metaphor helpful. The solution is not to determine whether a given decision can be classified as being related to either the management of the corporation or the administration of the pension plan. The employer may well take a sound management decision, and yet do something that harms the interests of the plan's members. An employer acting as a plan administrator is not permitted to disregard its fiduciary obligations to plan members and favour the competing interests of the corporation on the basis that it is wearing a "corporate hat". What is important is to consider the consequences of the decision, not its nature.

66 When the interests the employer seeks to advance on behalf of the corporation conflict with interests the employer has a duty to preserve as plan administrator, a solution must be found to ensure that the plan members' interests are taken care of. This may mean that the corporation puts the members on notice, or that it finds a replacement administrator, appoints representative counsel or [page310] finds some other means to resolve the conflict. The solution has to fit the problem, and the same solution may not be appropriate in every case.

67 In the instant case, Indalex's fiduciary obligations as plan administrator did in fact conflict with management decisions that needed to be taken in the best interests of the corporation. Indalex had a number of responsibilities as plan administrator. For example, s. 56(1) of the *PBA* required it to ensure that contributions were paid when due. Section 56(2) required that it notify the Superintendent if contributions were not paid when due. It was also up to Indalex under s. 59 to commence proceedings to obtain payment of contributions that were due but not paid. Indalex, as an employer, paid all the contributions that were due. However, its insolvency put contributions that had accrued to the date of the wind up at risk. In an insolvency context, the administrator's claim for contributions that have accrued is a provable claim.

68 In the context of this case, the fact that Indalex, as plan administrator, might have to claim accrued contributions from itself means that it would have to simultaneously adopt conflicting positions on whether contributions had accrued as of the date of liquidation and whether a deemed trust had arisen in respect of wind-up deficiencies. This is indicative of a clear conflict between Indalex's interests and those of the Plan Members. As soon as it saw, or ought to have seen, a potential for conflict, Indalex should have taken steps to ensure that the interests of the Plan Members were protected. It did not do so. On the contrary, it contested the position the Plan Members advanced. At the very least, Indalex breached its duty to avoid conflicts of interest (s. 22(4) *PBA*).

69 Since the Plan Members seek an equitable remedy, it is important to identify the point at [page311] which Indalex should have moved to ensure that their interests were safeguarded. Before doing so, I would stress that factual contexts are needed to analyse conflicts between interests, and that it is neither necessary nor useful to attempt to map out all the situations in which conflicts may arise.

70 As I mentioned above, insolvency puts the employer's contributions at risk. This does not mean that the decision to commence insolvency proceedings entails on its own a breach of a fiduciary obligation. The commencement of insolvency proceedings in this case on April 3, 2009 in an emergency situation was explained by Timothy R. J. Stubbs, the then-president of Indalex. The company was in default to its lender, it faced legal proceedings for unpaid bills, it had received a termination notice effective April 6 from its insurers, and suppliers had stopped supplying on credit. These circumstances called for urgent action by Indalex lest a creditor start bankruptcy proceedings and in so doing jeopardize ongoing operations and jobs. Several facts lead me to conclude that the stay sought in this case did not, in and of itself, put Indalex in a conflict of interest.

71 First, a stay operates only to freeze the parties' rights. In most cases, stays are obtained *ex parte*. One of the reasons for refraining from giving notice of the initial stay motion is to avert a situation in which creditors race to court to secure benefits that they would not enjoy in insolvency. Subjecting as many creditors as possible to a single process is seen as a way to treat all of them more equitably. In this context, plan members are placed on the same footing as the other creditors and have no special entitlement to notice. Second, one of the conclusions of the order Indalex sought was that it was to be served on all creditors, with a few exceptions, within 10 days. The notice allowed any interested party to apply to vary the order. Third, Indalex was permitted to pay all pension benefits. Although the order excluded special solvency payments, no ruling was made at that point on the [page312] merits of the creditors' competing claims, and a stay gave the Plan Members the possibility of presenting their arguments on the deemed trust rather than losing it altogether as a result of a bankruptcy proceeding, which was the alternative.

72 Whereas the stay itself did not put Indalex in a conflict of interest, the proceedings that followed had adverse consequences. On April 8, 2009, Indalex brought a motion to amend and restate the initial order in order to apply for DIP financing. This motion had been foreseen. Mr. Stubbs had mentioned in the affidavit he signed in support of the initial order that the lenders had agreed to extend their financing, but that Indalex would be in need of authorization in order to secure financing to continue its operations. However, the initial order had not yet been served on the Plan Members as of April 8. Short notice of the motion was given to the USW rather than to all the individual Plan Members, but the USW did not appear. The Plan Members were quite simply not represented on the motion to amend the initial stay order requesting authorization to grant the DIP charge.

73 In seeking to have a court approve a form of financing by which one creditor was granted priority over all other creditors, Indalex was asking the *CCAA* court to override the Plan Members'

priority. This was a case in which Indalex's directors permitted the corporation's best interests to be put ahead of those of the Plan Members. The directors may have fulfilled their fiduciary duty to Indalex, but they placed Indalex in the position of failing to fulfil its obligations as plan administrator. The corporation's interest was to seek the best possible avenue to survive in an insolvency context. The pursuit of this interest was not compatible with the plan administrator's duty to the Plan Members to ensure that all contributions were paid into the funds. In the context of this case, the plan administrator's duty to the Plan Members meant, in particular, that it should at least have given them the opportunity to present their arguments. This duty [page313] meant, at the very least, that they were entitled to reasonable notice of the DIP financing motion. The terms of that motion, presented without appropriate notice, conflicted with the interests of the Plan Members. Because Indalex supported the motion asking that a priority be granted to its lender, it could not at the same time argue for a priority based on the deemed trust.

74 The Court of Appeal found a number of other breaches. I agree with Cromwell J. that none of the subsequent proceedings had a negative impact on the Plan Members' rights. The events that occurred, in particular the second DIP financing motion and the sale process, were predictable and, in a way, typical of reorganizations. Notice was given in all cases. The Plan Members were represented by able counsel. More importantly, the court ordered that funds be reserved and that a full hearing be held to argue the issues.

75 The Monitor and George L. Miller, Indalex U.S.'s trustee in bankruptcy, argue that the Plan Members should have appealed the Amended Initial Order authorizing the DIP charge, and were precluded from subsequently arguing that their claim ranked in priority to that of the DIP lenders. They take the position that the collateral attack doctrine bars the Plan Members from challenging the DIP financing order. This argument is not convincing. The Plan Members did not receive notice of the motion to approve the DIP financing. Counsel for the Executive Plan's members presented the argument of that plan's members at the first opportunity and repeated it each time he had an occasion to do so. The only time he withdrew their opposition was at the hearing of the motion for authorization to increase the DIP loan amount after being told that the only purpose of the motion was to increase the amount of the authorized loan. The *CCAA* judge set a hearing date for the very purpose of presenting the arguments that Indalex, as plan administrator, could have presented when it requested the amendment to the initial order. [page314] It cannot now be argued, therefore, that the Plan Members are barred from defending their interests by the collateral attack doctrine.

D. *Would an Equitable Remedy Be Appropriate in the Circumstances?*

76 The definition of "secured creditor" in s. 2 of the *CCAA* includes a trust in respect of the debtor's property. The Amended Initial Order (at para. 45) provided that the DIP lenders' claims ranked in priority to all trusts, "statutory or otherwise". Indalex U.S. was subrogated to the DIP lenders' claim by operation of the guarantee in the DIP lending agreement.

77 Counsel for the Executive Plan's members argues that the doctrine of equitable subordination

should apply to subordinate Indalex U.S.'s subrogated claim to those of the Plan Members. This Court discussed the doctrine of equitable subordination in *Canada Deposit Insurance Corp. v. Canadian Commercial Bank*, [1992] 3 S.C.R. 558, but did not endorse it, leaving it for future determination (p. 609). I do not need to endorse it here either. Suffice to say that there is no evidence that the lenders committed a wrong or that they engaged in inequitable conduct, and no party has contested the validity of Indalex U.S.'s payment of the US$10 million shortfall.

78 This leaves the constructive trust remedy ordered by the Court of Appeal. It is settled law that proprietary remedies are generally awarded only with respect to property that is directly related to a wrong or that can be traced to such property. I agree with my colleague Cromwell J. that this condition is not met in the case at bar. I adopt his reasoning on this issue.

79 Moreover, I am of the view that it was unreasonable for the Court of Appeal to reorder the priorities in this case. The breach of fiduciary duty identified in this case is, in substance, the lack of notice. Since the Plan Members were allowed to fully argue their case at a hearing specifically held [page315] to adjudicate their rights, the *CCAA* court was in a position to fully appreciate the parties' positions.

80 It is difficult to see what gains the Plan Members would have secured had they received notice of the motion that resulted in the Amended Initial Order. The *CCAA* judge made it clear, and his finding is supported by logic, that there was no alternative to the DIP loan that would allow for the sale of the assets on a going-concern basis. The Plan Members presented no evidence to the contrary. They rely on conjecture alone. The Plan Members invoke other cases in which notice was given to plan members and in which the members were able to fully argue their positions. However, in none of those cases were plan members able to secure any additional benefits. Furthermore, the Plan Members were allowed to fully argue their case. As a result, even though Indalex breached its fiduciary duty to notify the Plan Members of the motion that resulted in the Amended Initial Order, their claim remains subordinate to that of Indalex U.S.

IV. Conclusion

81 There are good reasons for giving special protection to members of pension plans in insolvency proceedings. Parliament considered doing so before enacting the most recent amendments to the *CCAA*, but chose not to (*An Act to amend the Bankruptcy and Insolvency Act, the Companies' Creditors Arrangement Act, the Wage Earner Protection Program Act and chapter 47 of the Statutes of Canada, 2005*, S.C. 2007, c. 36, in force September 18, 2009, SI/2009-68; see also Bill C-501, *An Act to amend the Bankruptcy and Insolvency Act and other Acts (pension protection)*, 3rd Sess., 40th Parl., March 24, 2010 (subsequently amended by the Standing Committee on Industry, Science and Technology, March 1, 2011)). A report of the Standing Senate Committee on Banking, Trade and Commerce gave the following reasons for this choice:

[page316]

> Although the Committee recognizes the vulnerability of current pensioners, we do not believe that changes to the BIA regarding pension claims should be made at this time. Current pensioners can also access retirement benefits from the Canada/Quebec Pension Plan, and the Old Age Security and Guaranteed Income Supplement programs, and may have private savings and Registered Retirement Savings Plans that can provide income for them in retirement. The desire expressed by some of our witnesses for greater protection for pensioners and for employees currently participating in an occupational pension plan must be balanced against the interests of others. As we noted earlier, insolvency - at its essence - is characterized by insufficient assets to satisfy everyone, and choices must be made.
>
> The Committee believes that granting the pension protection sought by some of the witnesses would be sufficiently unfair to other stakeholders that we cannot recommend the changes requested. For example, we feel that super priority status could unnecessarily reduce the moneys available for distribution to creditors. In turn, credit availability and the cost of credit could be negatively affected, and all those seeking credit in Canada would be disadvantaged.

(*Debtors and Creditors Sharing the Burden: A Review of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act* (2003), at p. 98; see also p. 88.)

82 In an insolvency process, a *CCAA* court must consider the employer's fiduciary obligations to plan members as their plan administrator. It must grant a remedy where appropriate. However, courts should not use equity to do what they wish Parliament had done through legislation.

83 In view of the fact that the Plan Members were successful on the deemed trust and fiduciary duty issues, I would not order costs against them either in the Court of Appeal or in this Court.

84 I would therefore allow the main appeals without costs in this Court, set aside the orders [page317] made by the Court of Appeal, except with respect to orders contained in paras. 9 and 10 of the judgment of the Court of Appeal in the former executive members' appeal and restore the orders of Campbell J. dated February 18, 2010. I would dismiss USW's costs appeal without costs.

The reasons of McLachlin C.J. and Rothstein and Cromwell JJ. were delivered by

CROMWELL J.:--

I. <u>Introduction</u>

85 When a business becomes insolvent, many interests are at risk. Creditors may not be able to recover their debts, investors may lose their investments and employees may lose their jobs. If the business is the sponsor of an employee pension plan, the benefits promised by the plan are not immune from that risk. The circumstances leading to these appeals show how that risk can materialize. Pension plans and creditors find themselves in a zero-sum game with not enough money to go around. At a very general level, this case raises the issue of how the law balances the interests of pension plan beneficiaries with those of other creditors.

86 Indalex Limited, the sponsor and administrator of employee pension plans, became insolvent and sought protection from its creditors under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*"). Although all current contributions were up to date, the company's pension plans did not have sufficient assets to fulfill the pension promises made to their members. In a series of court-sanctioned steps, which were judged to be in the best interests of all stakeholders, the company borrowed a great deal of money to allow it to continue to operate. The parties injecting the operating money were given a super priority over the claims by other creditors. When the business was sold, thereby preserving hundreds of [page318] jobs, there was a shortfall between the sale proceeds and the debt. The pension plan beneficiaries thus found themselves in a dispute about the priority of their claims. The appellant, Sun Indalex Finance, LLC, claimed it had priority by virtue of the super priority granted in the *CCAA* proceedings. The trustee in bankruptcy of the U.S. Debtors (George L. Miller) and the Monitor (FTI Consulting) joined in the appeal. The plan beneficiaries claimed that they had priority by virtue of a statutory deemed trust under the *Pension Benefits Act*, R.S.O. 1990, c. P.8 ("*PBA*"), and a constructive trust arising from the company's alleged breaches of fiduciary duty.

87 The Ontario Court of Appeal sided with the plan beneficiaries and Sun Indalex, the trustee in bankruptcy and the Monitor all appeal. The specific legal points in issue are:

A. Did the Court of Appeal err in finding that the statutory deemed trust provided for in s. 57(4) of the *PBA* applied to the salaried plan's wind-up deficiency?

B. Did the Court of Appeal err in finding that Indalex breached the fiduciary duties it owed to the pension plan beneficiaries as the plans' administrator and in imposing a constructive trust as a remedy?

C. Did the Court of Appeal err in concluding that the super priority granted in the *CCAA* proceedings did not have priority by virtue of the doctrine of federal paramountcy?

D. Did the Court of Appeal err in its cost endorsement respecting the United Steelworkers ("USW")?

88 My view is that the deemed trust does not apply to the disputed funds, and even if it did, the

super priority would override it. I conclude that [page319] the corporation failed in its duty to the plan beneficiaries as their administrator and that the beneficiaries ought to have been afforded more procedural protections in the *CCAA* proceedings. However, I also conclude that the Court of Appeal erred in using the equitable remedy of a constructive trust to defeat the super priority ordered by the *CCAA* judge. I would therefore allow the main appeals.

II. Facts and Proceedings Below

A. *Overview*

89 These appeals concern claims by pension fund members for amounts owed to them by the plans' sponsor and administrator which became insolvent.

90 Indalex Limited is the parent company of three non-operating Canadian companies. I will refer to both Indalex Limited individually and to the group of companies collectively as "Indalex", unless the context requires further clarity. Indalex Limited is the wholly owned subsidiary of its U.S. parent, Indalex Holding Corp. which owned and conducted related operations in the U.S. through its U.S. subsidiaries which I will refer to as the "U.S. debtors".

91 In late March and early April of 2009, Indalex and the U.S. debtors were insolvent and sought protection from their creditors, the former under the Canadian *CCAA*, and the latter under the United States Bankruptcy Code, 11 U.S.C., Chapter 11. The dispute giving rise to these appeals concern the priority granted to lenders in the *CCAA* process for funds advanced to Indalex and whether that priority overrides the claims of two of Indalex's pension plans for funds owed to them.

92 Indalex was the sponsor and administrator of two registered pension plans relevant to these proceedings, one for salaried employees and [page320] the other for executive employees. At the time of seeking *CCAA* protection, the salaried plan was being wound up (with a wind-up date of December 31, 2006) and was estimated to have a wind-up deficiency (as of the end of 2007) of roughly $2.252 million. The executive plan, while it was not being wound up, had been closed to new members since 2005. It was estimated to have a deficiency of roughly $2.996 million on wind up. At the time the *CCAA* proceedings were started, all regular current service contributions had been made to both plans.

93 Shortly after Indalex received *CCAA* protection, the *CCAA* judge authorized the company to enter into debtor in possession ("DIP") financing in order to allow it to continue to operate. The court granted the DIP lenders, a syndicate of banks, a "super priority" over "all other security interests, trusts, liens, charges and encumbrances, statutory or otherwise": initial order, at para. 35 (Joint A.R., vol. I, at pp. 123-24). Repayment of these amounts was guaranteed by the U.S. debtors.

94 Ultimately, with the approval of the *CCAA* court, Indalex sold its business; the purchaser did not assume pension liabilities. A reserve fund was established by the *CCAA* Monitor to answer any outstanding claims. The proceeds of the sale were not sufficient to pay back the DIP lenders and so

the U.S. debtors, as guarantors, paid the shortfall and stepped into the shoes of the DIP lenders in terms of priority.

95 The appellant Sun Indalex is a pre-*CCAA* secured creditor of both Indalex and the U.S. debtors. It claims the reserve fund on the basis that the US$10.75 million paid by the guarantors would otherwise have been available to Sun Indalex as a secured creditor of the U.S. debtors in the U.S. bankruptcy proceedings. The respondent plan beneficiaries claim the reserve fund on the basis that [page321] they have a wind-up deficiency which is covered by a deemed trust created by s. 57(4) of the *PBA*. This deemed trust includes "an amount of money equal to employer contributions accrued to the date of the wind up but not yet due under the plan or regulations" (s. 57(4)). They also claim the reserve fund on the basis of a constructive trust arising from Indalex's failure to live up to its fiduciary duties as plan administrator.

96 The reserve fund is not sufficient to pay back both Sun Indalex and the pension plans and so the main question on the main appeals is which of the creditors is entitled to priority for their respective claims.

97 The judge at first instance rejected the plan beneficiaries' deemed trust arguments and held that, with respect to the wind-up deficiency, the plan beneficiaries were unsecured creditors, ranking behind those benefitting from the "super priority" and secured creditors (2010 ONSC 1114, 79 C.C.P.B. 301). The Court of Appeal reversed this ruling and held that pension plan deficiencies were subject to deemed and constructive trusts which had priority over the DIP financing and over other secured creditors (2011 ONCA 265, 104 O.R. (3d) 641). Sun Indalex, the trustee in bankruptcy and the Monitor appeal.

B. *Indalex's CCAA Proceedings*

(1) The Initial Order (Joint A.R., vol. I, at p. 112)

98 As noted earlier, Indalex was in financial trouble and, on April 3, 2009, sought and obtained protection from its creditors under the *CCAA*. The order (which I will refer to as the initial order) also contained directions for service on creditors and [page322] others: paras. 39-41. The order also contained a so-called "comeback clause" allowing any interested party to apply for a variation of the order, provided that that party served notice on any other party likely to be affected by any such variation: para. 46. It is common ground that the plan beneficiaries did not receive notice of the application for the initial order but the *CCAA* court nevertheless approved the method of and time for service. Full particulars of the deficiencies in the pension plans were before the court in the motion material and the initial order addressed payment of the employer's current service pension contributions.

(2) The DIP Order (Joint A.R., vol. I, at p. 129)

99 On April 8, 2009, in what I will refer to as the DIP order, the *CCAA* judge, Morawetz J.,

authorized Indalex to borrow funds pursuant to a DIP credit agreement. The judge ordered among many other things, the following:

- He approved abridged notice: para. 1;
- He allowed Indalex to continue making current service contributions to the pension plans, but not special payments: paras. 7(a) and 9(b);
- He barred all proceedings against Indalex, except by consent of Indalex and the Monitor or leave of the court, until May 1, 2009: para. 15;
- He granted the DIP lenders a so-called super priority:

> THIS COURT ORDERS that each of the Administration Charge, the Directors' Charge and the DIP Lenders Charge (all as constituted and defined herein) shall constitute a charge on the Property and such Charges shall rank in priority to all other security interests, trusts, liens, charges and encumbrances, statutory or otherwise [page323] (collectively, "Encumbrances") in favour of any Person. [Emphasis added; para. 45.]

- He required Indalex to send notice of the order to all known creditors, other than employees and creditors to which Indalex owed less than $5,000 and stated that Indalex and the Monitor were "at liberty" to serve the Initial Order to interested parties: paras. 49-50.

100 In his endorsement for the DIP order, Morawetz J. found that "there is no other alternative available to the Applicants [Indalex] for a going concern solution" and that DIP financing was necessary: (2009), 52 C.B.R. (5th) 61 (Ont. S.C.J.), at para. 9(c). He noted that the Monitor in its report was of the view that approval of the DIP agreement was both necessary and in the best interests of Indalex and its stakeholders, including its creditors, employees, suppliers and customers: paras. 14-16.

101 The USW, which represented some of the members of the salaried plan, was served with notice of the motion that led to the DIP order, but did not appear. Morawetz J. specifically ordered as follows with regard to service:

> THIS COURT ORDERS that the time for service of the Notice of Application and the Application Record is hereby abridged so that this Application is properly returnable today and hereby dispenses with further service thereof. [DIP order, at para. 1]

(3) The DIP Extension Order (Joint A.R., vol. I, at p. 156)

102 On June 12, 2009, Morawetz J. heard and granted an application by Indalex to allow them to borrow approximately $5 million more from the DIP lenders, thus raising the allowed total to US$29.5 million.

103 Counsel for the former executives received the motion material the night before. Counsel for [page324] USW was also served with notice. At the motion, the former executives (along with second priority secured noteholders) sought to "reserve their rights with respect to the relief sought": 2009 CanLII 37906 (Ont. S.C.J.), at para. 4. Morawetz J. wrote that any "reservation of rights" would create uncertainty for the DIP lenders with regard to priority, and may prevent them from extending further advances. Moreover, the parties had presented no alternative to increased DIP financing, which was both "necessary and appropriate" and would, it was to be hoped, "improve the position of the stakeholders": paras. 5-9.

(4) The Bidding Order ((2009), 79 C.C.P.B. 101 (Ont. S.C.J.))

104 On July 2, 2009, Indalex brought a motion for approval of proposed bidding procedures for Indalex's assets. Morawetz J. decided that a stalking horse bid by SAPA Holding AB ("SAPA") for Indalex's assets could count as a qualifying bid. Counsel on behalf of the members of the executive plan appeared, with the concern that "their position and views have not been considered in this process": para. 8. In his decision, Morawetz J. decided that these arguments could be dealt with later, at a sale approval motion: para. 10. The judge said:

> The position facing the retirees is unfortunate. The retirees are currently not receiving what they bargained for. However, reality cannot be ignored and the nature of the Applicants' insolvency is such that there are insufficient assets to meet its liabilities. The retirees are not alone in this respect. The objective of these proceedings is to achieve the best possible outcome for the stakeholders. [Emphasis added; para. 9.]

[page325]

(5) The Sale Approval Order (Joint A.R., vol. I, at p. 166)

105 On July 20, 2009, Indalex brought two motions before Campbell J.

106 The first motion sought approval for the sale of Indalex's assets as a going concern to SAPA. SAPA was not to assume any pension liabilities. Campbell J. granted an order approving this sale.

107 The second motion sought approval for an interim distribution of the sale proceeds to the DIP lenders. Counsel on behalf of the executive plan members and the USW, representing some of

the salaried employees, objected to the planned distribution of the sale proceeds on grounds that a statutory deemed trust applied to the deficiencies in their plans and that Indalex had breached fiduciary duties that it owed to them. Campbell J. ordered the Monitor to pay the DIP agent from the sale proceeds, but also ordered the Monitor to set up a reserve fund in an amount sufficient to answer, among other things, the claims of the plan beneficiaries pending resolution of those matters. Campbell J. ordered that the U.S. debtors be subrogated to the DIP lenders to the extent that the U.S. debtors were required under the guarantee to satisfy the DIP lenders' claims: para. 14.

(6) The Sale and Distribution of Funds

108 SAPA bought Indalex's assets on July 31, 2009. Taking the reserve fund into account, the sale did not produce sufficient funds to repay the DIP lenders in full and so the U.S. debtors paid US$10,751,247 as guarantor to the DIP lenders: C.A. reasons, at para. 65.

(7) The Order Under Appeal

109 On August 28, 2009, Campbell J. heard claims by the USW (appearing on behalf of some members of the salaried plan) and counsel appearing on behalf of the executive plan members that the [page326] wind-up deficiency was subject to a deemed trust. He rejected these claims in a written decision on February 18, 2010. He decided that the s. 57(4) *PBA* deemed trust did not apply to wind-up deficiencies. The executive plan had not been wound up, and therefore there was no wind-up deficiency to be the subject of the deemed trust. As for the salaried plan, Campbell J. held that the wind-up deficiency was not an obligation that had "accrued to the date of the wind up" and as a result did not fall within the terms of the s. 57(4) deemed trust.

110 Indalex had asked for the stay granted under the initial order to be lifted so that it could assign itself into bankruptcy. Because he did not find a deemed trust, Campbell J. did not feel that he needed to decide on the motion to lift the stay.

(8) The Decision of the Ontario Court of Appeal

111 The Ontario Court of Appeal allowed an appeal from the decision of Campbell J.

112 Writing for a unanimous panel, Gillese J.A. decided that the s. 57(4) deemed trust is applicable to wind-up deficiencies. She took the view that s. 57(4)'s reference to "employer contributions accrued to the date of the wind up but not yet due" included all amounts that the employer owed on the wind-up of its pension plan: para. 101. In particular, she concluded that the deemed trust applied to the wind-up deficiency in the salaried plan. Gillese J.A. declined, however, to decide whether the deemed trust also applied to deficiencies in the executive plan, which had not been wound up by the relevant date: paras. 110-12. A decision on this latter point was unnecessary given her finding on the applicability of a constructive trust in this case.

113 Gillese J.A. found that the super priority provided for in the DIP order did not trump the

[page327] deemed trust over the salaried plan's wind-up deficiency. Morawetz J. had not "invoked" the issue of paramountcy or made an explicit finding that the requirements of federal law required that the provincially created deemed trust must be overridden: paras. 178-79. Gillese J.A. also took the view that this Court's decision in *Century Services Inc. v. Canada (Attorney General)*, 2010 SCC 60, [2010] 3 S.C.R. 379, did not mean that provincially created priorities that would be ineffective under the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("*BIA*"), were also ineffective under the *CCAA*: paras. 185-96. The deemed trust therefore ranked ahead of the DIP security.

114 In addition to her findings regarding deemed trusts, Gillese J.A. granted the plan beneficiaries a constructive trust over the amount of the reserve fund on the ground that Indalex, as pension plan administrator, had breached fiduciary duties that it owed to the plan beneficiaries during the *CCAA* proceedings.

115 She held that as a plan administrator who was also an employer, Indalex had fiduciary duties both to the plan beneficiaries and to the corporation: para. 129. In her view, Indalex was subject to both sets of duties throughout the *CCAA* proceedings and it had breached its duties to the plan beneficiaries in several ways. While Indalex had the right to initiate *CCAA* proceedings, this action made the plan beneficiaries vulnerable and therefore triggered its fiduciary obligations as plan administrator: paras. 132-33. Gillese J.A. enumerated the many ways in which she thought Indalex subsequently failed as plan administrator: it did nothing in the *CCAA* proceedings to fund the deficit in the underfunded plans; it applied for *CCAA* protection without notice to the beneficiaries; it obtained DIP financing on the condition that DIP lenders be granted a super priority over "statutory trusts"; it obtained this financing without notice to the plan beneficiaries; it sold its assets knowing the purchaser was not taking over the plans; and it attempted to enter into voluntary bankruptcy, which would defeat any deemed trust claims the beneficiaries might have asserted: [page328] para. 139. Gillese J.A. also noted that throughout the *CCAA* proceedings Indalex was in a conflict of interest because it was acting for both the corporation and the beneficiaries.

116 Indalex's failure to live up to its fiduciary duties meant that the plan beneficiaries were entitled to a constructive trust over the amount of the reserve fund: para. 204. Since the beneficiaries had been wronged by Indalex, and the U.S. debtors were not, with respect to Indalex, an "arm's length innocent third party" the appropriate response was to grant the beneficiaries a constructive trust: para. 204. Her conclusion on this point applied equally to the salaried and executive plans.

III. <u>Analysis</u>

A. *First Issue: Did the Court of Appeal Err in Finding That the Deemed Statutory Trust Provided for in Section 57(4) of the PBA Applied to the Salaried Plan's Wind-up Deficiency?*

(1) Introduction

117 The main issue addressed here concerns whether the statutory deemed trust provided for in s. 57(4) of the *PBA* applies to wind-up deficiencies, the payment of which is provided for in s. 75(1)(b).

118 The deemed trust created by s. 57(4) applies to "employer contributions accrued to the date of the wind up but not yet due under the plan or regulations". Thus, to be subject to the deemed trust, the pension plan must be wound up and the amounts in question must meet three requirements. They must be (1) "employer contributions", (2) "accrued to the date of the wind up" and (3) "not yet due". A wind-up deficiency arises "[w]here a pension plan is wound up": s. 75(1). I agree with my colleagues that there can be no deemed trust [page329] for the executive plan, because that plan had not been wound up at the relevant date. What follows, therefore, is relevant only to the salaried plan.

119 The wind-up deficiency payments are "employer contributions" which are "not yet due" as of the date of wind up within the meaning of the *PBA*. The main issue before us, therefore, boils down to the narrow interpretative question of whether the wind-up deficiency described in s. 75(1)(b) is "accrued to the date of the wind up".

120 Campbell J. at first instance found that it was not, while the Court of Appeal reached the opposite conclusion. In essence, the Court of Appeal reasoned that the deemed trust in s. 57(4) "applies to all employer contributions that are required to be made pursuant to s. 75", that is, to "all amounts owed by the employer on the wind-up of its pension plan": para. 101.

121 I respectfully disagree with the Court of Appeal's conclusion for three main reasons. First, the most plausible grammatical and ordinary sense of the words "accrued to the date of the wind up" is that the amounts referred to are precisely ascertained immediately before the effective date of the plan's wind up. The wind up deficiency only arises upon wind up and it is neither ascertained nor ascertainable on the date fixed for wind up. Second, the broader statutory context reinforces this view: the language of the deemed trusts in s. 57(3) and (4) is virtually exactly repeated in s. 75(1)(a), suggesting that both deemed trusts refer to the liability on wind up referred to in s. 75(1)(a) and not to the further and distinct wind-up deficiency liability created under s. 75(1)(b). Finally, the legislative evolution and history of these provisions show, in my view, that the legislature never intended to include the wind-up deficiency in a statutory deemed trust.

[page330]

122 Before turning to the precise interpretative issue, it will be helpful to provide some context about the employer's wind-up obligations and the deemed trust provisions that are the subject of this dispute.

(2) <u>Employer Obligations on Wind Up</u>

123 A "wind up" means that the plan is terminated and the plan assets are distributed: see *PBA*, s. 1(1), definition of "wind up". The employer's liability on wind-up consists of two main components. The first is provided for in s. 75(1)(a) and includes "an amount equal to the total of all payments that, under this Act, the regulations and the pension plan, are due or that have accrued and that have not been paid into the pension fund". This liability applies to contributions that were due as at the wind-up date but does *not* include payments required by s. 75(1)(b) that arise as a result of the wind up: A. N. Kaplan, *Pension Law* (2006), at pp. 541-42. This second liability is known as the wind-up deficiency amount. The employer must pay all additional sums to the extent that the assets of the pension fund are insufficient to cover the value of all immediately vested and accelerated benefits and grow-in benefits: Kaplan, at p. 542. Without going into detail, there are certain statutory benefits that may arise only on wind up, such as certain benefit enhancements and the potential for acceleration of pension entitlements. Thus, wind up will usually result in additional employer liabilities over and above those arising from the obligation to pay all benefits provided for in the plan itself: see, e.g., ss. 73-74; Kaplan, at p. 542. As the Court of Appeal concluded, the payments provided for under s. 75(1)(a) are those which the employer had to make while the plan was ongoing, while s. 75(1)(b) refers to the employer's obligation to make up for any wind-up deficiency: paras. 90-91.

124 For convenience, the provision as it then stood is set out here.

> **75.** (1) Where a pension plan is wound up in whole or in part, the employer shall pay into the pension fund,

[page331]

> (a) an amount equal to the total of all payments that, under this Act, the regulations and the pension plan, are due or that have accrued and that have not been paid into the pension fund; <u>and</u>
> (b) an amount equal to the amount by which,
>
> > (i) the value of the pension benefits under the pension plan that would be guaranteed by the Guarantee Fund under this Act and the regulations if the Superintendent declares that the Guarantee Fund applies to the pension plan,
> > (ii) the value of the pension benefits accrued with respect to employment in Ontario vested under the pension plan, and
> > (iii) the value of benefits accrued with respect to employment in

Ontario resulting from the application of subsection 39 (3) (50 per cent rule) and section 74,

exceed the value of the assets of the pension fund allocated as prescribed for payment of pension benefits accrued with respect to employment in Ontario.

125 While a wind up is effective as of a fixed date, a wind up is nonetheless best thought of not simply as a moment or a single event, but as a process. It begins by a triggering event and continues until all of the plan assets have been distributed. To oversimplify somewhat, the wind-up process involves the following components.

126 The assets and liabilities of the plan as of the wind-up date must be determined. As noted earlier, the precise extent of the liability, while *fixed as of that date*, will not be ascertained or ascertainable *on that date*. The extent of the liability may depend on choices open to plan beneficiaries under the plan and on the exercise by them of certain statutory rights beyond the options that would otherwise have been available under the plan itself. The plan members must be notified of the wind-up and have their entitlements and options set out for them and given an opportunity to make their choices. The plan administrator must file a wind-up report which includes a statement of the plan's assets and liabilities, the benefits payable under the [page332] terms of the plan, and the method of allocating and distributing the assets including the priorities for the payment of benefits: *PBA*, s. 70(1), and R.R.O. 1990, Reg. 909, s. 29 (the "*PBA* Regulations").

127 Benefits to members may take the form of "cash refunds, immediate or deferred annuities, transfers to registered retirement saving plans, ... In principle, the value of these benefits is the present value of the benefits accrued to the date of plan termination": *The Mercer Pension Manual* (loose-leaf), vol. 1, at p. 10-41. That present value is an actuarial calculation performed on the basis of various assumptions including assumptions about investment return, mortality and so forth.

128 If, when the assets and liabilities are calculated, the assets are insufficient to satisfy the liabilities, the employer (i.e. the plan sponsor) must make up for any wind-up deficiency: *PBA*, s. 75(1)(b). An employer can elect to space these payments out over the course of five years: *PBA* Regulations, s. 31(2). Because these payments are based on the extent to which there is a deficit between assets in the pension plan and the benefits owed to beneficiaries, their amount varies with the market and other assumed elements of the calculation over the course of the permitted five years.

129 To take the salaried plan as an example, at the time of wind-up, all regular current service contributions had been made: C.A. reasons, at para. 33. The wind-up deficiency was initially estimated to be $1,655,200. Indalex made special wind-up payments of $709,013 in 2007 and $875,313 in 2008, but as of December 31, 2008, the wind-up deficiency was $1,795,600 - i.e. higher than it had been two years before, notwithstanding that payments of roughly $1.6 million had been made: C.A. reasons, at para. 32. Indalex made another payment of $601,000 in April 2009:

C.A. reasons, at para. 32.

[page333]

(3) The Deemed Trust Provisions

130 The *PBA* contains provisions whose purpose is to exempt money owing to a pension plan, and which is held or owing by the employer, from being seized or attached by the employer's other creditors: Kaplan, at p. 395. This is accomplished by creating a "deemed trust" with respect to certain pension contributions such that these amounts are held by the employer in trust for the employees or pension beneficiaries.

131 There are two deemed trusts that we must examine here, one relating to employer contributions that are *due but have not been paid* and another relating to employer contributions *accrued but not due*. This second deemed trust is the one in issue here, but it is important to understand how the two fit together.

132 The deemed trust relating to employer contributions "due and not paid" is found in s. 57(3). The *PBA* and *PBA* Regulations contain many provisions relating to contributions required by employers, the due dates for which are specified. Briefly, the required contributions are these.

133 When a pension is ongoing, employers need to make regular current service cost contributions. These are made monthly, within 30 days after the month to which they relate: *PBA* Regulations, s. 4(4)3. There are also special payments, which relate to deficiencies between a pension plan's assets and liabilities. There are "going-concern" deficiencies and "solvency" deficiencies, the distinction between which is unimportant for the purposes of these appeals. A plan administrator must regularly file actuarial reports, which may disclose deficiencies: *PBA* Regulations, s. 14. Where there is a going-concern deficiency the employer must make equal monthly payments over a 15-year period to rectify it: *PBA* Regulations, [page334] s. 5(1)(b). Where there is a solvency deficiency, the employer must make equal monthly payments over a five-year period to rectify it: *PBA* Regulations, s. 5(1)(e). Once these regular or special payments become due but have not been paid, they are subject to the s. 57(3) deemed trust.

134 I turn next to the s. 57(4) deemed trust, which gives rise to the question before us. The subsection provides that "[w]here a pension plan is wound up ..., an employer who is required to pay contributions to the pension fund shall be deemed to hold in trust for the beneficiaries of the pension plan an amount of money equal to employer contributions accrued to the date of the wind up but not yet due under the plan or regulations".

135 When a pension plan is wound up there will be an interrupted monthly payment period,

which is sometimes referred to as the stub period. During this stub period regular and special liabilities will have accrued but not yet become due. Section 58(1) provides that money that an employer is required to pay "accrues on a daily basis". Because the amounts referred to in s. 57(4) are not yet due, they are not covered by the s. 57(3) deemed trust, which applies only to payments that are *due*. The two provisions, then, operate in tandem to create a trust over an employer's unfulfilled obligations, which are "due and not paid" as well as those which have "accrued to the date of the wind up but [are] not yet due".

(4) The Interpretative Approach

136 The issue we confront is one of statutory interpretation and the well-settled approach is that "the words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament": E. A. Driedger, *Construction of Statutes* (2nd ed. 1983), at p. 87; *Bell ExpressVu Limited Partnership v. Rex*, 2002 SCC 42, [2002] 2 S.C.R. 559, at para. 26. Taking this approach it is clear to me that the [page335] sponsor's obligation to pay a wind-up deficiency is not covered by the statutory deemed trust provided for in s. 57(4) of the *PBA*. In my view, the deficiency neither "accrued", nor did it arise within the period referred to by the words "to the date of the wind up".

(a) *Grammatical and Ordinary Sense of the Words "Accrued" and "to the Date of the Wind Up"*

137 The Court of Appeal failed to take sufficient account of the ordinary and grammatical meaning of the text of the provisions. It held that "the deemed trust in s. 57(4) applies to all employer contributions that are required to be made pursuant to s. 75": para. 101 (emphasis added). However, the plain words of the section show that this conclusion is erroneous. Section 75(1)(a) refers to liability for employer contributions that "are due ... and that have not been paid". These amounts are thus *not* included in the s. 57(4) deemed trust, because it addresses only amounts that have "accrued to the date of the wind up but [are] not yet due". Amounts "due" are covered by the s. 57(3) deemed trust and not, as the Court of Appeal concluded by the deemed trust created by s. 57(4). The Court of Appeal therefore erred in finding, in effect, that amounts which "are due" could be included in a deemed trust covering amounts "not yet due".

138 In my view, the most plausible grammatical and ordinary sense of the phrase "accrued to the date of the wind up" in s. 57(4) is that it refers to the sums that are ascertained immediately before the effective wind-up date of the plan.

139 In the context of s. 57(4), the grammatical and ordinary sense of the term "accrued" is that the amount of the obligation is "fully constituted" and "ascertained" although it may not yet be payable. The amount of the wind-up deficiency is not fully constituted or ascertained (or even ascertainable) before or even on the date fixed for wind up and therefore cannot fall under s. 57(4).

[page336]

140 Of course, the meaning of the word "accrued" may vary with context. In general, when the term "accrued" is used in relation to legal rights, its common meaning is that the right has become fully constituted even though the monetary implications of its enforcement are not yet known or knowable. Thus, we speak of the "accrual" of a cause of action in tort when all of the elements of the cause of action come into existence, even though the extent of the damage may well not be known or knowable at that time: see, e.g., *Ryan v. Moore*, 2005 SCC 38, [2005] 2 S.C.R. 53. However, when the term is used in relation to a sum of money, it will generally refer to an amount that is at the present time either quantified or exactly quantifiable but which may or may not be due.

141 In some contexts, a liability is said to accrue when it becomes due. An accrued liability is said to be "properly chargeable" or "owing on a given day" or "completely constituted": see, e.g., *Black's Law Dictionary* (9th ed. 2009), at p. 997, "accrued liability"; D. A. Dukelow, *The Dictionary of Canadian Law* (4th ed. 2011), at p. 13, "accrued liability"; *Hydro-Electric Power Commission of Ontario v. Albright* (1922), 64 S.C.R. 306, at p. 312.

142 In other contexts, an amount which has accrued may not yet be due. For example, we speak of "accrued interest" meaning a precise, quantified amount of interest that has been earned but may not yet be payable. The term "accrual" is used in the same way in "accrual accounting". In accrual method accounting, "transactions that give rise to revenue or costs are recognized in the accounts when they are earned and incurred respectively": B. J. Arnold, *Timing and Income Taxation: The Principles of Income Measurement for Tax Purposes* (1983), at p. 44. Revenue is earned when the recipient "substantially completes performance of everything he or she is required to do as long as the amount due is ascertainable and there is no uncertainty about its collection": P. W. Hogg, J. E. Magee and J. Li, *Principles of Canadian Income Tax Law* (7th ed. 2010), at s. 6.5(b); see [page337] also Canadian Institute of Chartered Accountants, *CICA Handbook - Accounting*, Part II, s. 1000, at paras. 41-44. In this context, the amount must be ascertained at the time of accrual.

143 The *Hydro-Electric Power Commission* case offers a helpful definition of the word "accrued" in this sense. On a sale of shares, the vendor undertook to provide on completion "a sum estimated by him to be equal to sinking fund payments [on the bonds and debentures] which shall have accrued but shall not be due at the time for completion": p. 344 (emphasis added). The bonds and debentures required the company to pay on July 1 of each year a fixed sum for each electrical horsepower sold and paid for during the preceding calendar year. A dispute arose as to what amounts were payable in this respect on completion. Duff J. held that in this context accrued meant "completely constituted", referring to this as a "well recognized usage": p. 312. He went on:

> Where ... a lump sum is made payable on a specified date and where, having regard to the purposes of the payment or to the terms of the instrument, this sum must be considered to be made up of an accumulation of sums in respect of

> which the right to receive payment is completely constituted before the date fixed for payment, then it is quite within the settled usage of lawyers to describe each of such accumulated parts as a sum accrued or accrued due before the date of payment. [p. 316]

Thus, at every point at which a liability to pay a fixed sum arose under the terms of the contract, that liability accrued. It was fully constituted even though not yet due because the obligation to make the payment was in the future. In reaching this conclusion, Duff J. noted that the bonds and debentures used the word "accrued" in contrast to [page338] "due" and that this strengthened the interpretation of "accrued" as an obligation fully constituted but not yet payable. Similarly in s. 57(4), the word "accrued" is used in contrast to the word "due".

144 Given my understanding of the ordinary meaning of the word "accrued", I must respectfully disagree with my colleague, Justice Deschamps' position that the wind-up deficiency can be said to have "accrued" to the date of wind up. In her view, "[s]ince the employees cease to accumulate entitlements when the plan is wound up, the entitlements that are used to calculate the contributions have all been accumulated before the wind-up date" (para. 34) and "no new liabilities accrue at the time of or after the wind up" (para. 36). My colleague maintains that "[t]he fact that the precise amount of the contribution is not determined as of the time of the wind up does not make it a contingent contribution that cannot have accrued for accounting purposes" (para. 37, referring to *Canadian Pacific Ltd. v. M.N.R.* (1998), 41 O.R. (3d) 606 (C.A.)).

145 I cannot agree that no new liability accrues on or after the wind up. As discussed in more detail earlier, the wind-up deficiency in s. 75(1)(b) is made up of the difference between the plan's assets and liabilities calculated as of the date of wind up. On wind up, the *PBA* accords statutory entitlements and protections to employees that would not otherwise be available: Kaplan, at p. 532. Wind up therefore gives rise to new liabilities. In particular, on wind up, and only on wind up, plan beneficiaries are entitled, under s. 74, to make elections regarding the payment of their benefits. The plan's liabilities cannot be determined until those elections are made. Contrary to what my colleague Justice Deschamps suggests, the extent of the wind-up deficiency depends on employee rights that arise only upon wind up and with respect to which employees make elections only after wind up.

[page339]

146 Moreover, the wind-up deficiency will vary after wind up because the amount of money necessary to provide for the payment of the plan sponsor's liabilities will vary with the market. Section 31 of the *PBA* Regulations allows s. 75 payments to be spaced out over the course of five years. As we have seen, the amount of the wind-up deficiency will fluctuate over this period (I set out earlier how this amount in fact fluctuated markedly in the case of the salaried plan in issue here). Thus, while estimates are periodically made and reported after the wind up to determine how

much the employer needs to pay, the precise amount of the wind-up deficiency is not ascertained or ascertainable on the date of the wind up.

147 I turn next to the ordinary and grammatical sense of the words "to the date of the wind up" in s. 57(4). In my view, these words indicate that only those contributions that accrue before the date of wind up, and not those amounts the liability for which arises only on the day of wind up - that is, the wind-up deficiency - are included.

148 Where the legislature intends to include the date of wind up, it has used suitable language to effect that purpose. For example, the English version of a provision amending the *PBA* in 2010 (c. 24, s. 21(2)), s. 68(2)(c), indicates which trade unions are entitled to notice of the wind up:

> **68...** .
>
> (2) If the employer or the administrator, as the case may be, intends to wind up the pension plan, the administrator shall give written notice of the intended wind up to,
>
> ...
>
> (c) each trade union that represents members of the pension plan or that, on the date of the wind up, represented the members, former members or retired members of the pension plan;

[page340]

In contrast to the phrase "to the date of wind up", "on the date of wind up" clearly includes the date of wind up. (The French version does not indicate a different intention.) Similarly, s. 70(6), which formed part of the *PBA* until 2012 (rep. S.O. 2010, c. 9, s. 52(5)), read as follows:

> **70...** .
>
> (6) On the partial wind up of a pension plan, members, former members and other persons entitled to benefits under the pension plan shall have rights and benefits that are not less than the rights and benefits they would have on a full wind up of the pension plan on the effective date of the partial wind up.

The words "on the effective date of the partial wind up" indicate that the members are entitled to those benefits from the date of the partial wind up, in the sense that members can claim their benefits beginning on the date of the wind up itself. This is how the legislature expresses itself when

it wants to speak of a period of time including a specific date. By comparison, "to the date of the wind up" is devoid of language that would include the actual date of wind up. This conclusion is further supported by the structure of the *PBA* and its legislative history and evolution, to which I will turn shortly.

149 To sum up with respect to the ordinary and grammatical meaning of the phrase "accrued to the date of the wind up", the most plausible ordinary and grammatical meaning is that such amounts are fully constituted and precisely ascertained immediately before the date fixed as the date of wind up. Thus, according to the ordinary and grammatical meaning of the words, the wind-up deficiency obligation set out in s. 75(1)(b) has not "accrued to the date of the wind up" as required by s. 57(4). Moreover, the liability for the wind-up deficiency arises where a pension plan is wound up (s. 75(1)(b)) and so it cannot be a liability that "accrued to the date of the wind up" (s. 57(4)).

[page341]

(b) *The Scheme of the Act*

150 As discussed earlier, s. 57 establishes deemed trusts over funds which must be contributed to a pension plan, including the one in s. 57(4), which is at issue here. It is helpful to consider these deemed trusts in the context of the obligations to pay funds which give rise to them. Specifically, the relationship between the deemed trust provisions in s. 57(3) and (4), on one hand, and s. 75(1), which sets out liabilities on wind up on the other. According to my colleague Justice Deschamps, s. 75(1) "elegantly parallels the wind-up deemed trust provision" (para. 42) such that the deemed trusts must include the wind-up deficiency. I disagree. In my view, the deemed trusts parallel only s. 75(1)(a), which does not relate to the wind-up deficiency. The correspondence between the deemed trusts and s. 75(1)(a), and the absence of any such correspondence with s. 75(1)(b), makes it clear that the wind-up deficiency is not covered by the deemed trust provisions.

151 I would recall here the difference between the deemed trusts created by s. 57(3) and (4). While a plan is ongoing, there may be payments which the employer is required to, but has failed to make. The s. 57(3) trust applies to these payments because they are "due and not paid". When a plan is wound up, however, there will be payments that are outstanding in the sense that they are fully constituted, but not yet due. This occurs with respect to the so-called stub period referred to earlier. During this stub period, regular and special liabilities will accrue on a daily basis, as provided for in s. 58(1), but may not be due at the time of wind up. While s. 57(3) cannot apply to these payments because they are not yet due, the deemed trust under s. 57(4) applies to these payments because liability for them has "accrued to the date of the wind up" and they are "not yet due".

152 The important point is how these two deemed trust provisions relate to the wind-up liabilities as described in ss. 75(1)(a) and 75(1)(b). [page342] The two paragraphs refer to sums of money that

are different in kind: while s. 75(1)(a) refers to liabilities that accrue before wind up and that are created elsewhere in the Act, s. 75(1)(b) creates a completely new liability that comes into existence only once the plan is wound up. There is no dispute, as I understand it, that these two paragraphs refer to different liabilities and that it is the liability described in s. 75(1)(b) that is the wind-up deficiency in issue here. The parties do not dispute that s. 75(1)(a) does *not* include wind-up deficiency payments.

153 It is striking how closely the text of s. 75(1)(a) - which does not relate to the wind-up deficiency - tracks the language of the deemed trust provisions in s. 57(3) and (4). As noted, s. 57(3) deals with "employer contributions due and not paid", while s. 57(4) deals with "employer contributions accrued to the date of the wind up but not yet due". Section 75(1)(a) includes both of these types of employer contributions. It refers to "payments that ... are due ... and that have not been paid" (i.e. subject to the deemed trust under s. 57(3)) or that have "accrued and that have not been paid" (i.e. subject to the deemed trust under s. 57(4) to the extent that these payments accrued to the date of wind up). This very close tracking of the language between s. 57(3) and (4) on the one hand and s. 75(1)(a) on the other, and the absence of any correspondence between the language of these deemed trust provisions with s. 75(1)(b), suggests that the s. 57(3) and (4) deemed trusts refer to the liability described in s. 75(1)(a) and not to the wind-up deficiency created by s. 75(1)(b). It is difficult to understand why, if the intention had been for s. 57(4) to capture the wind-up deficiency liability under s. 75(1)(b), the legislature would have so closely tracked the language of s. 75(1)(a) alone in creating the deemed trusts. Thus, in my respectful view, the elegant parallel to which my colleague, Justice Deschamps refers exists only between the deemed trust and s. 75(1)(a), and not between the deemed trust and the wind-up deficiency.

[page343]

154 I conclude that the scheme of the *PBA* reinforces my conclusion that the ordinary grammatical sense of the words in s. 57(4) does not extend to the wind-up deficiency provided for in s. 75(1)(b).

(c) *Legislative History and Evolution*

155 Legislative history and evolution may form an important part of the overall context within which a provision should be interpreted. Legislative evolution refers to the various formulations of the provision while legislative history refers to evidence about the provision's conception, preparation and enactment: see, e.g., *Canada (Canadian Human Rights Commission) v. Canada (Attorney General)*, 2011 SCC 53, [2011] 3 S.C.R. 471, at para. 43.

156 Both the legislative evolution and history of the *PBA* show that it was never the legislature's intention to include the wind-up deficiency in the deemed trust. The evolution and history of the *PBA* are rather intricate and sometimes difficult to follow so I will review them briefly here before

delving into a more detailed analysis.

157 The deemed trust was first introduced into the *PBA* in 1973. At that time, it covered employee contributions held by the employer and employer contributions that were due but not paid. In 1980, the *PBA* was amended so that the deemed trust was expanded to include employer contributions whether they were due or not. Also, new provisions were added allowing for employee elections and requiring additional payments by the employer where a plan was wound up. The 1980 amendments gave rise to confusion on two fronts: first, it was unclear whether the payments that were required on wind up were subject to the deemed trust; second, it was unclear whether a lien over some employer contributions covered the same amount as the deemed trust. In 1983, both these points were clarified. The sections were reworded and rearranged to make it clear that the wind-up deficiency was distinct from the amounts covered by the deemed trust, and that the lien and the [page344] deemed trust covered the same amount. A statement by the responsible Minister in 1982 confirms that *the deemed trusts were never intended to cover the wind-up deficiency*.

158 My colleague, Justice Deschamps maintains that this history suggests an evolution in the intention of the legislature from protecting "only the service contributions that were due ... to all amounts due and accrued upon wind up" (para. 42). I respectfully disagree. In my view, the history and evolution of the *PBA* leading up to and including 1983 show that the legislature never intended to include the wind-up deficiency in the deemed trust. Moreover, legislative evolution after 1983 confirms that this intention did not change.

(i) *The Pension Benefits Amendment Act, 1973*, S.O. 1973, c. 113

159 So far as I can determine, statutory deemed trusts were first introduced into the *PBA* by *The Pension Benefits Amendment Act, 1973*, S.O. 1973, c. 113, s. 6. Those amendments created deemed trusts over two amounts: employee pension contributions received by employers (s. 23*a* (1), similar to the deemed trust in the current s. 57(1)) and employer contributions that had fallen due under the plan (s. 23*a* (3), similar to the current s. 57(3) deemed trust for employer contributions "due and not paid"). The full text of these provisions and those referred to below, up to the current version of the 1990 Act, are found in the Appendix.

(ii) *The Pension Benefits Amendment Act, 1980*, S.O. 1980, c. 80

160 Ontario undertook significant pension reform leading to *The Pension Benefits Amendment Act, 1980*, S.O. 1980, c. 80; see Kaplan, at pp. 54-56. I will concentrate on the deemed trust provisions and how they related to the liabilities on [page345] wind up and, for ease of reference, I will refer to the sections as they were renumbered in the 1980 consolidation: R.S.O. 1980, c. 373. The 1980 legislation expanded the deemed trust relating to employer contributions. Although far from clear, the new provisions appear to have created a deemed trust and lien over the employer contributions whether otherwise payable or not and calculated as if the plan had been wound up on the relevant date.

161 It was unclear after the reforms of 1980 whether the deemed trust applied to all employer contributions that arose on wind up. According to s. 23(4), on any given date, the trust extended to an amount to be determined "as if the plan had been wound up on that date". However, the provisions of the 1980 version of the Act did not explicitly state what such a calculation would include. Under s. 21(2) of the 1980 statute, the employer was obligated to pay on wind up "all amounts that would otherwise have been required to be paid to meet the tests for solvency ..., up to the date of such termination or winding up". Under s. 32, however, the employer had to make a payment on wind up that was to be "[i]n addition" to that due under s. 21(2). Whether the legislature intended that the trust should cover this latter payment was left unclear.

162 It was also unclear whether the lien applied to a different amount than was subject to the deemed trust. According to s. 23(3), "the members have a lien upon the assets of the employer in such amount that in the ordinary course of business would be entered into the books of account whether so entered or not". This comes in the middle of two portions of the provision which explicitly refer to the deemed trust, but it is not clear whether the legislature intended to refer to the same amount throughout the provision.

[page346]

(iii) *The Pension Benefits Amendment Act, 1983*, S.O. 1983, c. 2

163 The 1983 amendments substantially clarified the scope of the deemed trust and lien for employer contributions. They make clear that neither the deemed trust nor the lien applied to the wind-up deficiency; the responsible Minister confirmed that this was the intention of the amendments.

164 The new provision was amended by s. 3 of the 1983 amendments and is found in s. 23(4) which provided:

> **23...** .
>
> (4) An employer who is required by a pension plan to contribute to the pension plan shall be deemed to hold in trust for the members of the pension plan an amount of money equal to the total of,
>
> (a) all moneys that the employer is required to pay into the pension plan to meet,

(i) the current service cost, and
(ii) the special payments prescribed by the regulations,

that are due under the pension plan or the regulations and have not been paid into the pension plan; and

(b) where the pension plan is terminated or wound up, any other money that the employer is liable to pay under clause 21 (2) (a).

Section 21(2)(a) provides that on wind up, the employers must pay an amount equal to *the current service cost and the special payments* that "have accrued to and including the date of the termination winding up but, under the terms of the pension plan or the regulations, are not due on that date"; the provision adds that these amounts shall be deemed to accrue on a daily basis. These provisions make it clear that the s. 23(4) deemed trust applies only to the special payments and current service costs that have accrued, on a daily basis, up to and including [page347] the date of wind up. The deemed trust clearly does not extend to the wind-up deficiency.

165 The provision referring to the additional payments required on wind up also makes clear that those payments are not within the scope of the deemed trust. These additional liabilities were described by s. 32, a provision very similar to s. 75(1)(b). These amounts are first, the amount guaranteed by the Guarantee Fund and, second, the value of pension benefits vested under the plan that exceed the value of the assets of the plan. Section 32(2) specifies that these amounts *are* "in addition to the amounts that the employer is liable to pay under subsection 21 (2)" (which are the payments comparable to the current s. 75(1)(a) payments) and that *only the latter* fall within the deemed trust. The inevitable conclusion is that, in 1983, the wind-up deficiency was not included in the scope of the deemed trust.

166 The 1983 amendments also clarified the scope of the lien. They indicated that the scope of the lien was identical to the scope of the deemed trust. Section 23(5) specified that the lien extended only to the amounts that were deemed to be held in trust under s. 23(4) (i.e. the *current service costs and special payments that had accrued to and including the date of the wind up but are not yet due*).

167 This makes two things clear: that the lien covers the same amounts as the deemed trust, and that neither covers the wind-up deficiency.

168 A brief, but significant piece of legislative history seems to me to dispel any possible doubt. In speaking at first reading of the 1983 amendments, the Minister responsible, the Honourable Robert Elgie said this:

> The first group of today's amendments makes up the housekeeping changes needed for us to do what we set out to do in late 1980; that is, to guarantee

> pension benefits following the windup of a defined pension [page348] benefit plan. These amendments will clarify the ways in which we can attain that goal.
>
> In Bill 214 [i.e. the 1980 amendments] the employees were given a lien on the employer's assets for employee contributions to a pension plan collected by the employer, as well as accrued employer contributions... .
>
> Unfortunately, this protection has resulted in different legal interpretations on the extent of the lien. An argument has been advanced that the amount of the lien includes an employer's potential future liability on the windup of a pension plan. This was never intended and is not necessary to provide the required protection. The amendment to section 23 clarifies the intent of Bill 214. [Emphasis added.]

(Ontario (Hansard), No. 99, 2nd Sess., 32nd Parl., July 7, 1982, p. 3568)

The 1983 amendments made the scope of the lien correspond precisely to the scope of the deemed trust over the employer's accrued contributions. It is thus clear from this statement that it was never the legislative intention that either should apply to "an employer's potential future liability" on wind up (i.e. the wind-up deficiency). In 1983, there is therefore, in my view, virtually irrefutable evidence of legislative intent to do exactly the opposite of what the Court of Appeal held in this case had been done.

169 Subsequent legislative evolution shows no change in this legislative intent. In fact, subsequent amendments demonstrate a clear legislative intent to exclude from the deemed trust employer liabilities that arise only upon wind up of the plan.

(iv) *Pension Benefits Act,1987*, S.O. 1987, c. 35

170 Amendments to the *PBA* in 1987 resulted in it being substantially in its current form. With those amendments, the extent of the deemed trusts was further clarified. The provision in the 1983 [page349] version of the Act combined within a single subsection a deemed trust for employer contributions that were due and not paid (s. 23(4)(a)) and employer contributions that had accrued to and including the date of wind up but which were not yet due (s. 23(4)(b), referring to s. 21(2)(a)). In the 1987 amendments, these two trusts were each given their own subsection and their scope was further clarified. Moreover, after the 1987 revision, one no longer had to refer to a separate provision (formerly s. 21(2)(a)) to determine the scope of the trust covering payments that were accrued but not yet due. Thus, while the substance of the provisions did not change in 1987, their form was simplified.

171 The new s. 58(3) (which is exactly the same as the current s. 57(3)) replaced the former s.

23(4)(a). This created a trust for employer contributions due and not paid. Section 58(4) (which is exactly the same as s. 57(4) as it stood at the time) replaced the former s. 23(4)(b) and part of s. 21(2)(a) and created a trust that arises on wind up and covers "employer contributions accrued to the date of the wind up but not yet due".

172 The 1987 amendment also shows that the legislature adverted to the difference between "to the date of the wind up" and "to and including" the date of wind up and chose the former. This is reflected in a small but significant change in the wording of the relevant provisions. The former provision, s. 23(4)(b), by referring to s. 21(2)(a) captured current service costs and special payments that "have accrued to and including the date of the termination or winding up." The new version in s. 58(4) deletes the words "and including", putting the section in its present form. This deletion, to my way of thinking, reinforces the legislative intent to *exclude* from the deemed trust liabilities that arise only *on* the date of wind up. Respectfully, the legislative record does not support Deschamps J.'s view that there was a legislative evolution towards a more expanded deemed trust. Quite the opposite.

[page350]

173 To sum up, I draw the following conclusions from this review of the legislative evolution and history. The legislation differentiates between two types of employer liability relevant to this case. The first is the contributions required to cover current service costs and any other payments that are either due or have accrued on a daily basis up to the relevant time. These are the payments referred to in the current s. 75(1)(a), that is, payments due or accrued but not paid. The second relates to additional contributions required when a plan is wound up which I have referred to as the wind-up deficiency. These payments are addressed in s. 75(1)(b). The legislative history and evolution show that the deemed trusts under s. 57(3) and (4) were intended to apply only to the former amounts and that it was never the intention that there should be a deemed trust or a lien with respect to an employer's potential future liabilities that arise once the plan is wound up.

(d) *The Purpose of the Legislation*

174 Excluding the wind-up deficiency from the deemed trust is consistent with the broader purposes of the legislation. Pension legislation aims at important protective purposes. These protective purposes, however, are not pursued at all costs and are clearly intended to be balanced with other important interests within the context of a carefully calibrated scheme: *Monsanto Canada Inc. v. Ontario (Superintendent of Financial Services)*, 2004 SCC 54, [2004] 3 S.C.R. 152, at paras. 13-14.

175 In this instance, the legislature has created trusts over contributions that were due or accrued to the date of the wind up in order to protect, to some degree, the rights of pension plan beneficiaries and employees from the claims of the employer's other creditors. However, there is

also good reason to think that the legislature had in mind other competing objectives in not extending the deemed trust to the wind-up deficiency.

[page351]

176 First, if there were to be a deemed trust over all employer liabilities that arise when a plan is wound up, much simpler and clearer words could readily be found to achieve that objective.

177 Second, extending the deemed trust protections to the wind-up deficiency might well be viewed as counter-productive in the greater scheme of things. A deemed trust of that nature might give rise to considerable uncertainty on the part of other creditors and potential lenders. This uncertainty might not only complicate creditors' rights, but it might also affect the availability of funds from lenders. The wind-up liability is potentially large and, while the business is ongoing, the extent of the liability is unknown and unknowable for up to five years. Its amount may, as the facts of this case disclose, fluctuate dramatically during this time. A liability of this nature could make it very difficult to assess the creditworthiness of a borrower and make an appropriate apportionment of payment among creditors extremely difficult.

178 While I agree that the protection of pension plans is an important objective, it is not for this Court to decide the extent to which that objective will be pursued and at what cost to other interests. In her conclusion, Justice Deschamps notes that although the protection of pension plans is a worthy objective, courts should not use the law of equity to re-arrange the priorities that Parliament has established under the *CCAA*. This is a matter of policy where courts must defer to legislatures (reasons of Justice Deschamps, at para. 82). In my view, my colleague's comments on this point are equally applicable to the policy decisions reflected in the text of the *PBA*. The decision as to the level of protection that should be provided to pension beneficiaries is one to be left to the Ontario legislature. Faced with the language in the *PBA*, I would be slow to infer that the broader protective purpose, with all its potential disadvantages, was intended. In short, the interpretation I would adopt is consistent with a balanced approach to protection of benefits which the legislature intended.

[page352]

179 For these reasons, I am of the respectful view that the Court of Appeal erred in finding that the s. 57(4) deemed trust applied to the wind-up deficiency.

B. *Second Issue: Did the Court of Appeal Err in Finding That Indalex Breached the Fiduciary Duties it Owed to the Pension Beneficiaries as the Plans' Administrator and in Imposing a Constructive Trust as a Remedy?*

(1) Introduction

180 The Court of Appeal found that during the *CCAA* proceedings Indalex breached its fiduciary obligations as administrator of the pension plans: para. 116. As a remedy, it imposed a remedial constructive trust over the reserve fund, effectively giving the plan beneficiaries recovery of 100 cents on the dollar in priority to all other creditors, including creditors entitled to the super priority ordered by the *CCAA* court.

181 The breaches identified by the Court of Appeal fall into three categories. First, Indalex breached the prohibition against a fiduciary being in a position of conflict of interest because its interests in dealing with its insolvency conflicted with its duties as plan administrator to act in the best interests of the plans' members and beneficiaries: para. 142. According to the Court of Appeal, the simple fact that Indalex found itself in this position of conflict of interest was, of itself, a breach of its fiduciary duty as plan administrator. Second, Indalex breached its fiduciary duty by applying, without notice to the plans' beneficiaries, for *CCAA* protection: para. 139. Third, Indalex [page353] breached its fiduciary duty by seeking and/or obtaining various relief in the *CCAA* proceedings including the "super priority" in favour of the DIP lenders, approval of the sale of the business knowing that no payment would be made to the underfunded plans over the statutory deemed trusts and seeking to be put into bankruptcy with the intention of defeating the deemed trust claims: para. 139. As a remedy for these breaches of fiduciary duty the court imposed a constructive trust.

182 In my view, the Court of Appeal took much too expansive a view of the fiduciary duties owed by Indalex as plan administrator and found breaches where there were none. As I see it, the only breach of fiduciary duty committed by Indalex occurred when, upon insolvency, Indalex's corporate interests were in obvious conflict with its fiduciary duty as plan administrator to ensure that all contributions were made to the plans when due. The breach was not in failing to avoid this conflict - the conflict itself was unavoidable. Its breach was in failing to address the conflict to ensure that the plan beneficiaries had the opportunity to have representation in the *CCAA* proceedings as if there were independent plan administrators. I also conclude that a remedial constructive trust is not available as a remedy for this breach.

183 This part of the appeals requires us to answer two questions which I will address in turn:

(i) What fiduciary duties did Indalex have in its role as plan administrator and did it breach them?

(ii) If so, was imposition of a constructive trust an appropriate remedy?

[page354]

(2) What Fiduciary Duties Did Indalex Have in its Role as Plan Administrator

and Did it Breach Those Duties?

(a) *Legal Principles*

184 The appellants do not dispute that Indalex, in its role of administrator of the plans, had fiduciary duties to the members of the plan and that when it is acting in that role it can only act in the interests of the plans' beneficiaries. It is not necessary for present purposes to decide whether a pension plan administrator is a *per se* or *ad hoc* fiduciary, although it must surely be rare that a pension plan administrator would not have fiduciary duties in carrying out that role: *Burke v. Hudson's Bay Co.*, 2010 SCC 34, [2010] 2 S.C.R. 273, at para. 41, aff'g 2008 ONCA 394, 67 C.C.P.B. 1, at para. 55.

185 However, the conclusion that Indalex as plan administrator had fiduciary duties to the plan beneficiaries is the beginning, not the end of the inquiry. This is because fiduciary duties do not exist at large, but arise from and relate to the specific legal interests at stake: *Alberta v. Elder Advocates of Alberta Society*, 2011 SCC 24, [2011] 2 S.C.R. 261, at para. 31. As La Forest J. put it in *Lac Minerals Ltd. v. International Corona Resources Ltd.*, [1989] 2 S.C.R. 574:

> The obligation imposed [on a fiduciary] may vary in its specific substance depending on the relationship .... [N]ot every legal claim arising out of a relationship with fiduciary incidents will give rise to a claim for breach of fiduciary duty.... .
>
> ...
>
> It is only in relation to breaches of the specific obligations imposed because the relationship is one characterized as fiduciary that a claim for breach of fiduciary duty can be founded. ...[Emphasis added; pp. 646-47.]

186 The nature and scope of the fiduciary duty must, therefore, be assessed in the legal framework governing the relationship out of which the [page355] fiduciary duty arises: see, e.g., *Sharbern Holding Inc. v. Vancouver Airport Centre Ltd.*, 2011 SCC 23, [2011] 2 S.C.R. 175, at para. 141; *Galambos v. Perez*, 2009 SCC 48, [2009] 3 S.C.R. 247, at paras. 36-37; *K.L.B. v. British Columbia*, 2003 SCC 51, [2003] 2 S.C.R. 403, at para. 41. So, for example, as a general rule, a fiduciary has a duty of loyalty including the duty to avoid conflicts of interest: see, e.g., *Strother v. 3464920 Canada Inc.*, 2007 SCC 24, [2007] 2 S.C.R. 177, at para. 35; *Lac Minerals*, at pp. 646-47. However, this general rule may have to be modified in light of the legal framework within which a particular fiduciary duty must be exercised. In my respectful view, this is such a case.

(b) *The Legal Framework of Indalex's Dual Role as a Plan Administrator and Employer*

187 In order to define the nature and scope of Indalex's role and fiduciary obligations as a plan administrator, we must examine the legal framework within which the administrator functions. This framework is established primarily by the plan documents and the relevant provisions of the *PBA*. It is to these sources, first and foremost, that we look in order to shape the specific fiduciary duties owed in this context.

188 Turning first to the plan documents, I take the salaried plan as an example. Under it, the company is appointed the plan administrator: art. 13.01. The term "Company" is defined to mean Indalex Limited and any reference in the plan to actions taken or discretion to be exercised by the Company means Indalex acting through the board of directors or any person authorized by the board for the purposes of the plan: art. 2.09. Article 13.01 provides that the "Management Committee of the Board of Directors of the Company will appoint a Pension and Benefits Committee to act on behalf of the Company in its capacity as administrator of the Plan. The Pension and Benefits Committee will decide conclusively all matters relating to the operation, interpretation and application of the Plan". [page356] Thus, the Pension and Benefits Committee is to act on behalf of the company and by virtue of art. 2.09 its acts are considered those of the company. Article 13.02 sets out the duties of the Pension and Benefits Committee which include the "performance of all administrative functions not performed by the Funding Agent, the Actuary or any group annuity contract issuer": art. 13.02(1).

189 The plan administrator also has statutory powers and duties by virtue of the *PBA*. Section 22 lists the general duties of plan administrators, three of which are particularly relevant to these appeals:

> **22.** (1) [Care, diligence and skill] The administrator of a pension plan shall exercise the care, diligence and skill in the administration and investment of the pension fund that a person of ordinary prudence would exercise in dealing with the property of another person.
>
> (2) [Special knowledge and skill] The administrator of a pension plan shall use in the administration of the pension plan and in the administration and investment of the pension fund all relevant knowledge and skill that the administrator possesses or, by reason of the administrator's profession, business or calling, ought to possess.
>
> ...
>
> (4) [Conflict of interest] An administrator or, if the administrator is a pension committee or a board of trustees, a member of the committee or board that is the administrator of a pension plan shall not knowingly permit the administrator's interest to conflict with the administrator's duties and powers in respect of the pension fund.

190 Not surprisingly, the powers and duties conferred on the administrator by the legislation are administrative in nature. For the most part they pertain to the internal management of the pension fund and to the relationship among the pension administrator, the beneficiaries, and the Superintendent of Financial Services ("Superintendent"). The list includes: applying [page357] to the Superintendent for registration of the plan and any amendments to it as well as filing annual information returns: ss. 9, 12 and 20 of the *PBA*; providing beneficiaries and eligible potential beneficiaries with information and documents: s. 10(1)12 and 25; ensuring that the plan is administered in accordance with the *PBA* and its regulations and plan documents: s. 19; notifying beneficiaries of proposed amendments to the plan that would reduce benefits: s. 26; paying commuted value for pensions: s. 42; and filing wind-up reports if the plan is terminated: s. 70.

191 Of special relevance for this case are two additional provisions. Under s. 56, the administrator has a duty to ensure that pension payments are made when due and to notify the Superintendent if they are not and, under s. 59, the administrator has the authority to commence court proceedings when pension payments are not made.

192 The fiduciary duties that employer-administrators owe to plan beneficiaries relate to the statutory and other tasks described above; these are the "specific legal interests" with respect to which the employer-administrator's fiduciary duties attach.

193 Another important aspect of the legal context for Indalex's fiduciary duties as a plan administrator is that it was acting in the dual role of an employer-administrator. This dual role is expressly permitted under s. 8(1)(a) of the *PBA*, but this provision creates a situation where a single entity potentially owes two sets of fiduciary duties (one to the corporation and the other to the plan members).

194 This was the case for Indalex. As an employer-administrator, Indalex acted through its board of directors and so it was that body which owed fiduciary duties to the plan members. The board of directors also owed a fiduciary duty to the company to act in its best interests: *Canada Business Corporations Act*, R.S.C. 1985, c. C-44, s. 122(1)(*a*); *BCE Inc. v. 1976 Debentureholders*, [page358] 2008 SCC 69, [2008] 3 S.C.R. 560, at para. 36. In deciding what is in the best interests of the corporation, a board may look to the interests of shareholders, employees, creditors and others. But where those interests are not aligned or may conflict, it is for the directors, acting lawfully and through the exercise of business judgment, to decide what is in the overall best interests of the corporation. Thus, the board of Indalex, as an employer-administrator, could not always act exclusively in the interests of the plan beneficiaries; it also owed duties to Indalex as a corporation.

(c) *Breaches of Fiduciary Duty*

195 Against the background of these legal principles, I turn to consider the Court of Appeal's findings in relation to Indalex's breach of its fiduciary duties as administrator of the plans. As noted, they fall into three categories: being in a conflict of interest position; taking steps to reduce pension obligations in the *CCAA* proceedings; and seeking bankruptcy status.

(i) Conflict of Interest

196 The questions here are first what constitutes a conflict of interest or duty between Indalex as business decision-maker and Indalex as plan administrator and what must be done when a conflict arises?

197 The Court of Appeal in effect concluded that a conflict of interest arises whenever Indalex makes business decisions that have "the potential to affect the Plans beneficiaries' rights" (para. 132) and that whenever such a conflict of interest arose, the employer-administrator was immediately in breach of its fiduciary duties to the plan members. Respectfully, this position puts the matter far too broadly. It cannot be the case that a conflict [page359] arises simply because the employer, exercising its management powers in the best interests of the corporation, does something that has the potential to affect the plan beneficiaries.

198 This conclusion flows inevitably from the statutory context. The existence of apparent conflicts that are inherent in the two roles being performed by the same party cannot be a breach of fiduciary duty because those conflicts are specifically authorized by the statute which permits one party to play both roles. As noted earlier, the *PBA* specifically permits employers to act as plan administrators (s. 8(1)(a)). Moreover, the broader business interests of the employer corporation and the interests of pension beneficiaries in getting the promised benefits are almost always at least potentially in conflict. Every important business decision has the potential to put at risk the solvency of the corporation and therefore its ability to live up to its pension obligations. The employer, within the limits set out in the plan documents and the legislation generally, has the authority to amend the plan unilaterally and even to terminate it. These steps may well not serve the best interests of plan beneficiaries.

199 Similarly, the simple existence of the sort of conflicts of interest identified by the Court of Appeal - those inherent in the employer's exercise of business judgment - cannot of themselves be a breach of the administrator's fiduciary duty. Once again, that conclusion is inconsistent with the statutory scheme that expressly permits an employer to act as plan administrator.

200 How, then, should we identify conflicts of interest in this context?

201 In *R. v. Neil*, 2002 SCC 70, [2002] 3 S.C.R. 631, Binnie J. referred to the *Restatement Third, The Law Governing Lawyers* (2000), at s. 121, to explain when a conflict of interest occurs in the [page360] context of the lawyer-client relationship: para. 31. In my view, the same general principle, adapted to the circumstances, applies with respect to employer-administrators. Thus, a situation of conflict of interest occurs when there is a substantial risk that the employer-administrator's representation of the plan beneficiaries would be materially and adversely affected by the employer-administrator's duties to the corporation. I would recall here, however, that the employer-administrator's obligation to represent the plan beneficiaries extends only to those tasks and duties that I have described above.

202 In light of the foregoing, I am of the view that the Court of Appeal erred when it found, in effect, that a conflict of interest arose whenever Indalex was making decisions that "had the potential to affect the Plans beneficiaries' rights": para. 132. The Court of Appeal expressed both the potential for conflict of interest or duty and the fiduciary duty of the plan administrator much too broadly.

(ii) Steps in the *CCAA* Proceedings to Reduce Pension Obligations and Notice of Them

203 The Court of Appeal found that Indalex breached its fiduciary duty simply by commencing *CCAA* proceedings knowing that the plans were underfunded and by failing to give the plan beneficiaries notice of the proceedings: para. 139. As I understand the court's reasons, the decision to commence *CCAA* proceedings was solely the responsibility of the corporation and not part of the administration of the pension plan: para. 131. The difficulty which the Court of Appeal saw arose from the potential of the *CCAA* proceedings to result in a reduction of the corporation's pension obligations to the prejudice of the beneficiaries: paras. 131-32.

204 I respectfully disagree. Like Justice Deschamps, I find that seeking an initial order protecting the corporation from actions by its creditors did not, on its own, give rise to any conflict of interest or duty on the part of Indalex (reasons of Justice Deschamps, at para. 72).

[page361]

205 First, it is important to remember that the purpose of *CCAA* proceedings is not to disadvantage creditors but rather to try to provide a constructive solution for all stakeholders when a company has become insolvent. As my colleague, Deschamps J. observed in *Century Services*, at para. 15:

> ... the purpose of the *CCAA* ... is to permit the debtor to continue to carry on business and, where possible, avoid the social and economic costs of liquidating its assets.

In the same decision, at para. 59, Deschamps J. also quoted with approval the following passage from the reasons of Doherty J.A. in *Elan Corp. v. Comiskey* (1990), 41 O.A.C. 282, at para. 57 (dissenting):

> The legislation is remedial in the purest sense in that it provides a means whereby the devastating social and economic effects of bankruptcy or creditor initiated termination of ongoing business operations can be avoided while a court-supervised attempt to reorganize the financial affairs of the debtor company is made.

For this reason, I would be very reluctant to find that, simply by virtue of embarking on *CCAA* proceedings, an employer-administrator breaches its duties to plan members.

206 Second, the facts of this case do not support the contention that the interests of the plan beneficiaries and the employer were in conflict with respect to the decision to seek *CCAA* protection. It cannot seriously be suggested that some other course would have protected more fully the rights of the plan beneficiaries. The Court of Appeal did not suggest an alternative to seeking *CCAA* protection from creditors, nor did any of the parties. Indalex was in serious financial difficulty and its options were limited: either make a proposal to its creditors (under the *CCAA* or under the *BIA*), or go bankrupt. Moreover, the plan administrator's duty and authority do not extend to ensuring the solvency of the corporation and an independent administrator could not reasonably expect to be [page362] consulted about the plan sponsor's decision to seek *CCAA* protection. Finally, the application for *CCAA* proceedings did not reduce pension obligations other than to temporarily relieve the corporation of making special payments and it was the only step with any prospect of the pension funds obtaining from the insolvent corporation the money that would become due. There was thus no conflict of duty or interest between the administrator and the employer when protective action was taken for the purpose of preserving the *status quo* for the benefit of all stakeholders.

207 The Court of Appeal also found that it was a breach of fiduciary duty not to give the plan beneficiaries notice of the initial application for *CCAA* protection. Again, here, I must join Deschamps J. in disagreeing with the Court of Appeal's conclusion. Section 11(1) of the *CCAA*, as it stood at the time of the proceedings, provided that parties could commence *CCAA* proceedings without giving notice to interested persons:

> **11.** (1) Notwithstanding anything in the *Bankruptcy and Insolvency Act* or the *Winding-up Act*, where an application is made under this Act in respect of a company, the court, on the application of any person interested in the matter, may, subject to this Act, on notice to any other person or without notice as it may see fit, make an order under this section.

208 This provision was renumbered but not substantially changed when the Act was amended in September of 2009 (S.C. 2005, c. 47, s. 128, in force Sept. 18, 2009, SI/2009-68). Although it is not appropriate in every case, *CCAA* courts have discretion to make initial orders on an *ex parte* basis. This may be an appropriate - even necessary - step in order to prevent "creditors from moving to realize on their claims, essentially a 'stampede to the assets' once creditors learn of the debtor's financial distress": J. P. Sarra, *Rescue! The Companies' Creditors Arrangement [page363] Act* (2007), at p. 55 ("*Rescue!*"); see also *Algoma Steel Inc., Re* (2001), 25 C.B.R. (4th) 194, at para. 7. The respondents did not challenge Morawetz J.'s decision to exercise his discretion to make an *ex parte* order in this case.

209 This is not to say, however, that *ex parte* initial orders will always be required or acceptable.

Without attempting to be exhaustive or to express any final view on these issues, I simply note that there have been at least three ways in which courts have mitigated the possible negative effect on creditors of making orders without notice to potentially affected parties. First, courts have been reluctant to grant *ex parte* orders where the situation of the debtor company is not urgent. In *Rescue!*, Janis P. Sarra explains that courts are increasingly expecting applicants to have given notice before applying for a stay under the *CCAA*: p. 55. An example is *Marine Drive Properties Ltd., Re*, 2009 BCSC 145, 52 C.B.R. (5th) 47, a case in which Butler J. held that "[i]nitial applications in *CCAA* proceedings should not be brought without notice merely because it is an application under that Act. The material before the court must be sufficient to indicate an emergent situation": para. 27. Second, courts have included "come-back" clauses in their initial orders so that parties could return to court at a later date to seek to set aside some or all of the order: *Rescue!*, at p. 55. Note that such a clause was included in the initial order by Morawetz J.: para. 46. Finally, courts have limited their initial orders to the issues that need to be resolved immediately and have left other issues to be resolved after all interested parties have been given notice. Thus, in *Timminco Ltd., Re*, 2012 ONSC 506, 85 C.B.R. (5th) 169, Morawetz J. limited the initial *CCAA* order so that priorities were only granted over the party that had been given notice. The discussion of suspending special payments or granting creditors priority over pension beneficiaries was left to a later date, after the parties that would be affected had been given notice. A similar approach was taken in the case of *AbitibiBowater inc. (Arrangement relatif à)*, 2009 QCCS 6459 (CanLII). In his initial *CCAA* order, Gascon J. put off the decision regarding the [page364] suspension of past service contributions or special payments to the pension plans in question until the parties likely to be affected could be advised of the applicant's request: para. 7.

210 Failure to give notice of the initial *CCAA* proceedings was not a breach of fiduciary duty in this case. Indalex's decision to act as an employer-administrator cannot give the plan beneficiaries any greater benefit than they would have if their plan was managed by a third party administrator. Had there been a third party administrator in this case, Indalex would not have been under an obligation to tell the administrator that it was planning to enter *CCAA* proceedings. The respondents are asking this Court to give the advantage of Indalex's knowledge as employer to Indalex as the plan administrator in circumstances where the employer would have been unlikely to disclose the information itself. I am not prepared to blur the line between employers and administrators in this way.

211 I conclude that Indalex did not breach its fiduciary duty by commencing *CCAA* proceedings or by not giving notice to the plan beneficiaries of its intention to seek the initial *CCAA* order.

212 I turn next to the Court of Appeal's conclusion that seeking and obtaining the DIP orders without notice to the plan beneficiaries and seeking and obtaining the sale approval order constituted breaches of fiduciary duty.

[page365]

213 To begin, I agree with the Court of Appeal that "just because the initial decision to commence *CCAA* proceedings is solely a corporate one ... does not mean that all subsequent decisions made during the proceedings are also solely corporate ones": para. 132. It was at this point that Indalex's interests as a corporation came into conflict with its duties as a pension plan administrator.

214 The DIP orders could easily have the effect of making it impossible for Indalex to satisfy its funding obligations to the plan beneficiaries. When Indalex, through the exercise of business judgment, sought *CCAA* orders that would or might have this effect, it was in conflict with its duty as plan administrator to ensure that all contributions were paid when due.

215 I do not think, however, that the simple existence of this conflict of interest and duty, on its own, was a breach of fiduciary duty in these circumstances. As discussed earlier, the *PBA* expressly permits an employer to be a pension administrator and the statutory provisions about conflict of interest must be understood and applied in light of that fact. Moreover, an independent plan administrator would have no decision-making role with respect to the conduct of *CCAA* proceedings. So in my view, the difficulty that arose here was not the existence of the conflict itself, but Indalex's failure to take steps so that the plan beneficiaries would have the opportunity to have their interests protected in the *CCAA* proceedings as if the plans were administered by an independent administrator. In short, the difficulty was not the existence of the conflict, but the failure to address it.

216 Despite Indalex's failure to address its conflict of interest, the plan beneficiaries, through their own efforts, were represented at subsequent steps in the *CCAA* proceedings. The effect of Indalex's [page366] breach was therefore mitigated, a point which I will discuss in greater detail when I turn to the issue of the constructive trust.

217 Nevertheless, for the purposes of providing some guidance for future *CCAA* proceedings, I take this opportunity to briefly address what an employer-administrator can do to respond to these sorts of conflicts. First and foremost, an employer-administrator who finds itself in a conflict must bring the conflict to the attention of the *CCAA* judge. It is not enough to include the beneficiaries in the list of creditors; the judge must be made aware that the debtor, as an administrator of the plan is, or may be, in a conflict of interest.

218 Given their expertise and their knowledge of particular cases, *CCAA* judges are well placed to decide how best to ensure that the interests of the plan beneficiaries are fully represented in the context of "real-time" litigation under the *CCAA*. Knowing of the conflict, a *CCAA* judge might consider it appropriate to appoint an independent administrator or independent counsel as *amicus curiae* on terms appropriate to the particular case. Indeed, there have been cases in which representative counsel have been appointed to represent tort claimants, clients, pensioners and non-unionized employees in *CCAA* proceedings on terms determined by the judge: *Rescue!*, at p. 278; see, e.g., *First Leaside Wealth Management Inc. (Re)*, 2012 ONSC 1299 (CanLII); *Nortel*

Networks Corp., Re (2009), 75 C.C.P.B. 206 (Ont. S.C.J.). In other circumstances, a *CCAA* judge might find that it is feasible to give notice directly to the pension beneficiaries. In my view, notice, though desirable, may not always be feasible and decisions on such matters should be left to the judicial discretion of the *CCAA* judge. Alternatively, the judge might consider limiting draws on the DIP facility until notice can be given to the beneficiaries: *Royal Oak Mines Inc., Re* (1999), 6 C.B.R. (4th) 314 (Ont. Ct. J. (Gen. Div.)), at para. 24. Ultimately, the appropriate response or combination of responses should be left to the discretion of the *CCAA* judge in a particular case. [page367] The point, as well expressed by the Court of Appeal, is that the insolvent corporation which is also a pension plan administrator cannot "simply ignore its obligations as the Plans' administrator once it decided to seek *CCAA* protection": para. 132.

219 I conclude that the Court of Appeal erred in finding that Indalex breached its fiduciary duties as plan administrator by taking the various steps it did in the *CCAA* proceedings. However, I agree with the Court of Appeal that it breached its fiduciary duty by failing to take steps to ensure that the plan beneficiaries had the opportunity to be as fully represented in those proceedings as if there had been an independent plan administrator.

(iii) The Bankruptcy Motion

220 Indalex also applied to lift the *CCAA* stay so that it could file an assignment into bankruptcy. As Campbell J. put it, this was done "to ensure the priority regime [it] urged as the basis for resisting the deemed trust": para. 52. The Court of Appeal concluded that this was a breach of Indalex's fiduciary duties because the motion was brought "with the intention of defeating the deemed trust claims and ensuring that the Reserve Fund was transferred to [the U.S. debtors]": para. 139. I respectfully disagree.

221 It was certainly open to Indalex as an employer to bring a motion to voluntarily enter into bankruptcy. A pension plan administrator has no responsibility or authority in relation to that step. The problem here is not that the motion was brought, but that Indalex failed to meaningfully address the conflict between its corporate interests and its duties as plan administrator.

[page368]

222 To sum up, I conclude that Indalex did not breach any fiduciary duty by undertaking *CCAA* proceedings or seeking the relief that it did. The breach arose from Indalex's failure to ensure that its pension plan beneficiaries had the opportunity to have their interests effectively represented in the insolvency proceedings, particularly when Indalex sought the DIP financing approval, the sale approval and the motion for bankruptcy.

(3) Was Imposing a Constructive Trust Appropriate in This Case?

223 The next issue is whether a remedial constructive trust is, as the Court of Appeal concluded, an appropriate remedy in response to the breach of fiduciary duty.

224 The Court of Appeal exercised its discretion to impose a constructive trust and its exercise of this discretion is entitled to deference. Only if the discretion has been exercised on the basis of an erroneous principle should the order be overturned on appeal: *Donkin v. Bugoy*, [1985] 2 S.C.R. 85, cited in *Soulos v. Korkontzilas*, [1997] 2 S.C.R. 217, at para. 54, by Sopinka J. (dissenting, but not on this point). In my respectful view, the Court of Appeal's erroneous conclusions about the scope of a plan administrator's fiduciary duties require us to examine the constructive trust issue anew. Moreover, the Court of Appeal, in my respectful opinion, erred in principle in finding that the asset in this case resulted from the breach of fiduciary duty such that it would be unjust for the party in breach to retain it.

225 As noted earlier, the Court of Appeal imposed a constructive trust in favour of the plan beneficiaries with respect to funds retained in the reserve fund equal to the total amount of the wind-up deficiency for both plans. In other words, upon insolvency of Indalex, the plan beneficiaries received 100 cents on the dollar as a result of a judicially imposed trust taking priority over [page369] secured creditors, and indeed over other unsecured creditors, assuming there was no deemed trust for the executive plan.

226 I have explained earlier why I take a different view than did the Court of Appeal of Indalex's breach of fiduciary duty. In light of what I conclude was the breach which could give rise to a remedy, my view is that the constructive trust cannot properly be imposed in this case and the Court of Appeal erred in principle in exercising its discretion to impose this remedy.

227 I part company with the Court of Appeal with respect to several aspects of its constructive trust analysis; it is far from clear to me that any of the conditions for imposing a constructive trust were present here. However, I will only address one of them in detail. As I will explain, a remedial constructive trust for a breach of fiduciary duty is only appropriate if the wrongdoer's acts give rise to an identifiable asset which it would be unjust for the wrongdoer (or sometimes a third party) to retain. In my view, Indalex's failure to meaningfully address conflicts of interest that arose during the *CCAA* proceedings did not result in any such asset.

228 As the Court of Appeal recognized, the governing authority concerning the remedial constructive trust outside the domain of unjust enrichment is *Soulos*. In *Soulos*, McLachlin J. (as she then was) wrote that a constructive trust may be an appropriate remedy for breach of fiduciary duty: paras. 19-45. She laid out four requirements that should generally be satisfied before a constructive trust will be imposed: para. 45. Although, in *Soulos*, McLachlin J. was careful to indicate that these are conditions that "generally" must be present, all parties in this case accept that these four conditions must be present before a remedial constructive trust may be ordered for [page370] breach of fiduciary duty. The four conditions are these:

(1) The defendant must have been under an equitable obligation, that is, an

obligation of the type that courts of equity have enforced, in relation to the activities giving rise to the assets in his hands;

(2) The assets in the hands of the defendant must be shown to have resulted from deemed or actual agency activities of the defendant in breach of his equitable obligation to the plaintiff;

(3) The plaintiff must show a legitimate reason for seeking a proprietary remedy, either personal or related to the need to ensure that others like the defendant remain faithful to their duties and;

(4) There must be no factors which would render imposition of a constructive trust unjust in all the circumstances of the case; e.g., the interests of intervening creditors must be protected. [para. 45]

229 My concern is with respect to the second requirement, that is, whether the breach resulted in an asset in the hands of Indalex. A constructive trust arises when the law imposes upon a party an obligation to hold specific property for another: D. W. M. Waters, M. R. Gillen and L. D. Smith, *Waters' Law of Trusts in Canada* (3rd ed. 2005), at p. 454 ("*Waters*"). The purpose of imposing a constructive trust as a remedy for a breach of duty or unjust enrichment is to prevent parties "from retaining property which in 'good conscience' they should not be permitted to retain": *Soulos*, at para. 17. It follows, therefore, that while the remedial constructive trust may be appropriate in a variety of situations, the wrongdoer's conduct toward the plaintiff must generally have given rise to assets in the hands of the wrongdoer (or of a third party in some situations) which cannot in justice and good conscience be retained. That cannot be said here.

[page371]

230 The Court of Appeal held that this second condition was present because "[t]he assets [i.e. the reserve fund monies] are directly connected to the process in which Indalex committed its breaches of fiduciary obligation": para. 204. Respectfully, this conclusion is based on incorrect legal principles. To satisfy this second condition, it must be shown that the breach *resulted in* the assets being in Indalex's hands, not simply, as the Court of Appeal thought, that there was a "connection" between the assets and "the process" in which Indalex breached its fiduciary duty. Recall that in *Soulos* itself, *the defendant's acquisition of the disputed property was a direct result of his breach of his duty of loyalty* to the plaintiff: para. 48. This is not our case. As the Court observed, in the context of an unjust enrichment claim in *Peter v. Beblow*, [1993] 1 S.C.R. 980, at p. 995:

> ... for a constructive trust to arise, the plaintiff must establish a direct link to the property which is the subject of the trust by reason of the plaintiff's contribution.

231 While cases of breach of fiduciary duty are different in important ways from cases of unjust enrichment, La Forest J. (with Lamer J. concurring on this point) applied a similar standard for

proprietary relief in *Lac Minerals*, a case in which wrongdoing was the basis for the constructive trust: p. 678, quoted in *Waters*, at p. 471. His comments demonstrate the high standard to be met in order for a constructive trust to be awarded:

> The constructive trust awards a right in property, but that right can only arise once a right to relief has been established. In the vast majority of cases a constructive trust will not be the appropriate remedy... . [A] constructive trust should only be awarded if there is reason to grant to the plaintiff the additional rights that flow from recognition of a right of property. [p. 678]

232 The relevant breach in this case was the failure of Indalex to meaningfully address the conflicts of interest that arose in the course of the [page372] *CCAA* proceedings. (The breach that arose with respect to the bankruptcy motion is irrelevant because that motion was not addressed and therefore could not have given rise to the assets.) The "assets" in issue here are the funds in the reserve fund which were retained from the proceeds of the sale of Indalex as a going concern. Indalex's breach in this case did not give rise to the funds which were retained by the Monitor in the reserve fund.

233 Where does the respondents' claim of a procedural breach take them? Taking their position at its highest, it would be that the DIP approval proceedings and the sale would not have been approved. This position, however, is fatally flawed. Turning first to the DIP approval, there is no evidence to support the view that, had Indalex addressed its conflict in the DIP approval process, the DIP financing would have been rejected or granted on different terms. The *CCAA* judge, being fully aware of the pension situation, ruled that the DIP financing was "required", that there was "no other alternative available to the Applicants for a going concern solution", and that "the benefit to stakeholders and creditors of the DIP Financing outweighs any potential prejudice to unsecured creditors that may arise as a result of the granting of super-priority secured financing": endorsement of Morawetz J., April 8, 2009, at paras. 6 and 9. In effect, the respondents are claiming funds which arose only because of the process to which they now object. Taking into account that there was an absence of any evidence that more favourable financing terms were available, that the judge's decision was made with full knowledge of the plan beneficiaries' claims, and that he found that the DIP financing was necessary, the respondents' contention is not only speculative, it also directly contradicts the conclusions of the *CCAA* judge.

234 Turning next to the sale approval and the approval of the distribution of the assets, it is clear that the plan beneficiaries had independent representation but that this did not change the result. [page373] Although, perhaps with little thanks to Indalex, the interests of both plans were fully and ably represented before Campbell J. at the sale approval and interim distribution motions in July of 2009.

235 The executive plan retirees, through able counsel, objected to the sale on the basis that the liquidation values set out in the Monitor's seventh report would provide greater return for unsecured

creditors. The motions judge dismissed this objection "on the basis that there was no clear evidence to support the proposition and in any event the transaction as approved did preserve value for suppliers, customers and preserve approximately 950 jobs": trial reasons of Campbell J., at para. 13 (emphasis added). Both the executive plan retirees and the USW, which represented some members of the salaried plan, objected to the proposed distribution of the sale proceeds. In response to this objection, it was agreed that those objections would be heard promptly and that the Monitor would retain sufficient funds to satisfy the pensioners' claims if they were upheld: trial reasons of Campbell J., at paras. 14-16.

236 There is no evidence to support the contention that Indalex's breach of its fiduciary duty as pension administrator resulted in the assets retained in the reserve fund. I therefore conclude that the Court of Appeal erred in law in finding that the second condition for imposing a constructive trust - i.e. that the assets in the defendant's hands must be shown to have resulted from the defendant's breaches of duty to the plaintiff - had been established.

237 I would add only two further comments with respect to the constructive trust. A major concern of the Court of Appeal was that unless a constructive trust were imposed, the reserve funds would end up in the hands of other Indalex entities which were not operating at arm's length from Indalex. The U.S. debtors claimed the reserve fund [page374] because it had paid on its guarantee of the DIP loans and thereby stepped into the shoes of the DIP lender with respect to priority. Sun Indalex claims in the U.S. bankruptcy proceedings as a secured creditor of the U.S. debtors. The Court of Appeal put its concern this way: "To permit Sun Indalex to recover on behalf of [the U.S. debtors] would be to effectively permit the party who breached its fiduciary obligations to take the benefit of those breaches, to the detriment of those to whom the fiduciary obligations were owed": para. 199.

238 There are two difficulties with this approach, in my respectful view. The U.S. debtors paid real money to honour their guarantees. Moreover, unless there is a legal basis for ignoring the separate corporate personality of separate corporate entities, those separate corporate existences must be respected. Neither the parties nor the Court of Appeal advanced such a reason.

239 Finally, I would note that imposing a constructive trust was wholly disproportionate to Indalex's breach of fiduciary duty. Its breach - the failure to meaningfully address the conflicts of interest that arose during the *CCAA* process - had no adverse impact on the plan beneficiaries in the sale approval process which gave rise to the "asset" in issue. Their interests were fully represented and carefully considered before the sale was approved and the funds distributed. The sale was nonetheless judged to be in the best interests of the corporation, all things considered. In my respectful view, imposing a $6.75 million penalty on the other creditors as a remedial response to this breach is so grossly disproportionate to the breach as to be unreasonable.

240 A judicially ordered constructive trust, imposed long after the fact, is a remedy that tends to destabilize the certainty which is essential for [page375] commercial affairs and which is

particularly important in financing a workout for an insolvent corporation. To impose a constructive trust in response to a breach of fiduciary duty to ensure for the plan beneficiaries some procedural protections that they in fact took advantage of in any case is an unjust response in all of the circumstances.

241 I conclude that a constructive trust is not an appropriate remedy in this case and that the Court of Appeal erred in principle by imposing it.

C. *Third Issue: Did the Court of Appeal Err in Concluding That the Super Priority Granted in the CCAA Proceedings Did Not Have Priority by Virtue of the Doctrine of Federal Paramountcy?*

242 Although I disagree with my colleague Justice Deschamps with respect to the scope of the s. 57(4) deemed trust, I agree that if there was a deemed trust in this case, it would be superseded by the DIP loan because of the operation of the doctrine of federal paramountcy: paras. 48-60.

D. *Fourth Issue: Did the Court of Appeal Err in its Cost Endorsement Respecting the USW?*

(1) Introduction

243 The disposition of costs in the Court of Appeal was somewhat complex. Although the costs appeal relates only to the costs of the USW, it is necessary in order to understand their position to set out the costs order below in full.

244 With respect to the costs of the appeal to the Court of Appeal, no order was made for or against the Monitor due to its prior agreement with the former executives and the USW. However, the court ordered that the former executives and the USW, as successful parties, were each entitled to [page376] costs on a partial indemnity basis fixed at $40,000 inclusive of taxes and disbursements from Sun Indalex and the U.S. Trustee, payable jointly and severally: costs endorsement, 2011 ONCA 578, 81 C.B.R. (5th) 165, at para. 7.

245 Morneau Shepell Ltd., the Superintendent, and the former executives reached an agreement with respect to legal fees and disbursements and the Court of Appeal approved that agreement. The former executives received full indemnity legal fees and disbursements in the amount of $269,913.78 to be paid from the executive plan attributable to each of the 14 former executives' accrued pension benefits, allocated among the 14 former executives in relation to their pension entitlement from the executive plan. In other words, the costs would not be borne by the other three members of the executive plan who did not participate in the proceedings: C.A. costs endorsement, at para. 2. The costs of the appeal payable by Sun Indalex and the U.S. Trustee were to be paid into the fund of the executive plan and allocated among the 14 former executives in relation to their pension entitlement from the executive plan.

246 USW sought an order for payment of its costs from the fund of the salaried plan. However, the Court of Appeal declined to make such an order because the USW was in a "materially different position" than that of the former executives: costs endorsement, at para. 3. The latter were beneficiaries to the pension fund (14 of the 17 members of the plan), and they consented to the payment of costs from their individual benefit entitlements. Those who had not consented would not be affected by the payment. In contrast, the USW was the bargaining agent (not the beneficiary) for only 7 of the 169 beneficiaries of the salaried plan, none of whom was given notice of, or consented to, the payment of legal costs from the salaried plan. Moreover, the USW sought and seeks an order that its costs be paid out of the fund. This request is significantly different than the order made in favour of the former executives. The former executives explicitly ensured that their choice to pursue the litigation would not put at risk the pension benefits of those members who did not retain counsel even though of course those members would benefit in the [page377] event the litigation was successful. The USW is not proposing to insulate the 162 members whom it does not represent from the risk of litigation; it seeks an order requiring all members to share the risk of the litigation even though it represents only 7 of the 169. The proposition advanced by the USW was thus materially different from that advanced on behalf of the executive plan and approved by the court.

(2) Standard of Review

247 In *Nolan v. Kerry (Canada) Inc.*, 2009 SCC 39, [2009] 2 S.C.R. 678, Rothstein J. held that "costs awards are quintessentially discretionary": para. 126. Discretionary costs decisions should only be set aside on appeal if the court below "has made an error in principle or if the costs award is plainly wrong": *Hamilton v. Open Window Bakery Ltd.*, 2004 SCC 9, [2004] 1 S.C.R. 303, at para. 27.

(3) Analysis

248 I do not see any basis to interfere with the Court of Appeal's costs endorsement in this case. In my view, the USW's submissions are largely based on an inaccurate reading of the Court of Appeal's costs endorsement. Contrary to what the USW submits, the Court of Appeal did *not* require the consent of plan beneficiaries as a prerequisite to ordering payment of costs from the fund. Nor is it correct to suggest that the costs endorsement would "restrict recovery of beneficiary costs to instances when there is a surplus in the pension trust fund" or "preclude financing of beneficiary action when a fund is in deficit": USW factum, at paras. 71 and 76. Nor would I read the Court of Appeal's brief costs endorsement as laying down a rule that a union representing pension beneficiaries cannot recover costs from the fund because the union itself is not a beneficiary.

[page378]

249 The premise of the USW's appeal appears to be that it was entitled to costs because it met what it refers to in its submissions as the Costs Payment Test and that if the executive plan members

got their costs out of their pension fund, the union should get its costs out of the salaried employees' pension fund. Respectfully, I do not accept the validity of either premise.

250 The decision whether to award costs from the pension fund remains a discretionary matter. In *Nolan*, Rothstein J. surveyed the various factors that courts have taken into account when deciding whether to award a litigant its costs out of a pension trust. The first broad inquiry considered in *Nolan* was into whether the litigation concerned the due administration of the trust. In connection with this inquiry, courts have considered the following factors: (1) whether the litigation was primarily about the construction of the plan documents; (2) whether it clarified a problematic area of the law; (3) whether it was the only means of clarifying the parties' rights; (4) whether the claim alleged maladministration; and (5) whether the litigation had no effect on other beneficiaries of the trust fund: *Nolan*, at para. 126.

251 The second broad inquiry discussed in *Nolan* was whether the litigation was ultimately adversarial: para. 127. The following factors have been considered: (1) whether the litigation included allegations by an unsuccessful party of a breach of fiduciary duty; (2) whether the litigation only benefited a class of members and would impose costs on other members if successful; and (3) whether the litigation had any merit.

252 I do not think that it is correct to elevate these two inquiries (which constitute the Costs Payment Test articulated by the USW) to a test for entitlement to costs in the pension context. The factors set out in *Nolan* and other cases cited therein are best understood as highly relevant [page379] considerations guiding the exercise of judicial discretion with respect to costs.

253 The litigation undertaken here raised novel points of law with all of the uncertainty and risk inherent in such an undertaking. The Court of Appeal in essence decided that the USW, representing only 7 of 169 members of the plan, should not without consultation be able to in effect impose the risks of that litigation on all of the plan members, the vast majority of whom were not union members. Whatever arguments might be raised against the Court of Appeal's decision in light of the success of the litigation and the sharing by all plan members of the benefits, the failure of the litigation seems to me to leave no basis to impose the cost consequences of taking that risk on all of the plan members of an already underfunded plan.

254 The second premise of the USW appeal appears to be that if the executive plan members have their costs paid out of the fund, so too should the salaried plan members. Respectfully, however, this is not an accurate statement of the order made with respect to the executive plan.

255 The Court of Appeal's order with respect to the executive plan meant that only the pension fund attributable to those members of the plan who actually supported the litigation - the vast majority I would add - would contribute to the costs of the litigation even though all members of the plan would benefit in the case of success. As the Court of Appeal noted:

> The individual represented Retirees, who comprise 14 of 17 members of the

> Executive Plan, have consented to the payment of costs from their individual benefit entitlements. Those who have not consented will not be affected by the payment. [Costs endorsement, at para. 3]

[page380]

256 The Court of Appeal therefore approved an agreement as to costs which did not put at further risk the pension funds available to satisfy the pension entitlements of those who did not support the litigation. Thus, the Court of Appeal did not apply what the USW refers to as the Costs Payment Test to the executive plan because the costs order was the product of agreement and did not order payment of costs out of the fund as a whole.

257 In the case of the USW request, there was no such agreement and no such limitation of risk to the supporters of the litigation.

258 I see no error in principle in the Court of Appeal's refusal to order the USW costs to be paid out of the pension fund, particularly in light of the disposition of the appeal to this Court. I would dismiss the USW costs appeal but without costs.

IV. Disposition

259 I would allow the Sun Indalex, FTI Consulting and George L. Miller appeals and, except as noted below, I would set aside the orders of the Ontario Court of Appeal and restore the February 18, 2010 orders of Campbell J.

260 With respect to costs, I would set aside the Court of Appeal's orders with respect to the costs of the appeals before that court and order that all parties bear their own costs in the Court of Appeal and in this Court.

261 I would not disturb paras. 9 and 10 of the order of the Court of Appeal in the former executives' appeal so that the full indemnity legal fees and disbursements of the former executives in the amount of $269,913.78 shall be paid from the fund of the executive plan attributable to each of the 14 former executives' accrued pension benefits, and [page381] specifically such amounts shall be allocated among the 14 former executives in relation to their pension entitlement from the executive plan and will not be borne by the other three members of the executive plan.

262 I would dismiss the USW costs appeal, but without costs.

The reasons of LeBel and Abella JJ. were delivered by

LeBEL J. (dissenting):--

I. Introduction

263 The members of two pension plans set up by Indalex Limited ("Indalex") stand to lose half or more of their pension benefits as a consequence of the insolvency of their employer and of the arrangement approved by the Ontario Superior Court of Justice under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*"). The Court of Appeal for Ontario found that the members were entitled to a remedy. For different and partly conflicting reasons, my colleagues Justices Deschamps and Cromwell would hold that no remedy is available to them. With all due respect for their opinions, I would conclude, like the Court of Appeal, that the remedy of a constructive trust is open to them and should be imposed in the circumstances of this case, for the following reasons.

264 I do not intend to summarize the facts of this case, which were outlined by my colleagues. I will address these facts as needed in the course of my reasons. Before moving to my areas of disagreement with my colleagues, I will briefly indicate where and to what extent I agree with them on the relevant legal issues.

265 Like my colleagues, I conclude that no deemed trust could arise under s. 57(4) of the *Pension Benefits Act*, R.S.O. 1990, c. P.8 ("*PBA*"), in the case of the Executive Plan because this plan had not been wound up when the *CCAA* [page382] proceedings were initiated. In the case of the Salaried Employees Plan, I agree with Deschamps J. that a deemed trust arises in respect of the wind-up deficiency. But, like her, I accept that the debtor-in-possession ("DIP") super priority prevails by reason of the application of the federal paramountcy doctrine. I also agree that the costs appeal of the United Steelworkers should be dismissed.

266 But, with respect for the opinions of my colleagues, I take a different view of the nature and extent of the fiduciary duties of an employer who elects to act as administrator of a pension plan governed by the *PBA*. This dual status does not entitle the employer to greater leniency in the determination and exercise of its fiduciary duties or excuse wrongful actions. On the contrary, as we shall see below, I conclude that Indalex not only neglected its obligations towards the beneficiaries, but actually took a course of action that was actively inimical to their interests. The seriousness of these breaches amply justified the decision of the Court of Appeal to impose a constructive trust. To that extent, I propose to uphold the opinion of Gillese J.A. and the judgment of the Court of Appeal (2011 ONCA 265, 104 O.R. (3d) 641).

II. The Employer as Administrator of a Pension Plan: Its Fiduciary Duties

267 Before entering into an analysis of the obligations of an employer as administrator of a pension plan under the *PBA*, it is necessary to consider the position of the beneficiaries. Who are they? At what stage are they in their lives? What are their vulnerabilities? A fiduciary relationship is a relationship, grounded in fact and law, between a vulnerable beneficiary and a fiduciary who

holds and may exercise power over the beneficiary in situations recognized by law. Any analysis of such a relationship requires careful consideration of the characteristics of the beneficiary. It ought not stop at the level of a theoretical and detached approach that fails to address how, very concretely, [page383] this relationship works or can be twisted, perverted or abused, as was the situation in this case.

268 The beneficiaries were in a very vulnerable position relative to Indalex. They did not enjoy the protection that the existence of an independent administrator might have given them. They had no say and no input in the management of the plans. The information about the plans and their situation came from Indalex in its dual role as employer and manager of the plans. Their particular vulnerability arose from their relationship with Indalex, acting both as their employer and as the administrator of their retirement plans. Their vulnerability was substantially a consequence of that specific relationship (*Galambos v. Perez*, 2009 SCC 48, [2009] 3 S.C.R. 247, at para. 68, *per* Cromwell J.). The nature of this relationship had very practical consequences on their interests. For example, as Gillese J.A. noted in her reasons (at para. 40) the consequences of the decisions made in the course of management of the plan and during the *CCAA* proceedings signify that the members of the Executive Plan stand to lose one-half to two-thirds of their retirement benefits, unless additional money is somehow paid into the plan. These losses of benefits are, in all probability, permanent in the case of the beneficiaries who have already retired or who are close to retirement. They deeply affect their lives and expectations. For most of them, what is lost is lost for good. No arrangement will allow them to get a start on a new life. We should not view the situation of the beneficiaries as regrettable but unavoidable collateral damage arising out of the ebbs and tides of the economy. In my view, the law should give the members some protection, as the Court of Appeal intended when it imposed a constructive trust.

269 Indalex was in a conflict of interest from the moment it started to contemplate putting itself under the protection of the *CCAA* and proposing an arrangement to its creditors. From the corporate perspective, one could hardly find fault with such a decision. It was a business decision. But the trouble is that at the same time, Indalex was a [page384] fiduciary in relation to the members and retirees of its pension plans. The "two hats" analogy offers no defence to Indalex. It could not switch off the fiduciary relationship at will when it conflicted with its business obligations or decisions. Throughout the arrangement process and until it was replaced by an independent administrator (Morneau Shepell Ltd.) it remained a fiduciary.

270 It is true that the *PBA* allows an employer to act as an administrator of a pension plan in Ontario. In such cases, the legislature accepts that conflicts of interest may arise. But, in my opinion, nothing in the *PBA* allows that the employer *qua* administrator will be held to a lower standard or will be subject to duties and obligations that are less stringent than those of an independent administrator. The employer remains a fiduciary under the statute and at common law (*PBA*, s. 22(4)). The employer is under no obligation to assume the burdens of administering the pension plans that it has agreed to set up or that are the legacy of previous decisions. However, if it decides to do so, a fiduciary relationship is created with the expectation that the employer will be

able to avoid or resolve the conflicts of interest that might arise. If this proves to be impossible, the employer is still "seized" with fiduciary duties, and cannot ignore them out of hand.

271 Once Indalex had considered the *CCAA* process and decided to proceed in that manner, it should have been obvious that such a move would trigger conflicts of interest with the beneficiaries of the pension plans and that these conflicts would become untenable, as per the terms of s. 22(4) of the *PBA*. Given the nature of its obligations as administrator and fiduciary, it was impossible to wear the "two hats". Indalex had to discharge its corporate duties, but at the same time it had to address its fiduciary obligations to the members and beneficiaries of the plans. I do not fault it for applying under the *CCAA*, but rather for not relinquishing its position as administrator of the plans at the time of the application. It even retained [page385] this position once it engaged in the arrangement process. Other conflicts and breaches of fiduciary duties and of fundamental rules of procedural equity in the Superior Court flowed from this first decision. Moreover, Indalex maintained a strongly adversarial attitude towards the interest of the beneficiaries throughout the arrangement process, while it was still, at least in form, the administrator of the plans.

272 The option given to employers to act as administrators of pension plans under the *PBA* does not constitute a licence to breach the fiduciary duties that flow from this function. It should not be viewed as an invitation for the courts to whitewash the consequences of such breaches. The option is predicated on the ability of the employer-administrator to avoid the conflicts of interests that cause these breaches. An employer deciding to assume the position of administrator cannot claim to be in the same situation as the Crown when it discharges fiduciary obligations towards certain groups in society under the Constitution or the law. For those cases, the Crown assumes those duties because it is obligated to do so by virtue of its role, not because it chooses to do so. In such circumstances, the Crown must often balance conflicting interests and obligations to the broader society in the discharge of those fiduciary duties (*Alberta v. Elder Advocates of Alberta Society*, 2011 SCC 24, [2011] 2 S.C.R. 261, at paras. 37-38). If Indalex found itself in a situation where it had to balance conflicting interests and obligations, as it essentially argues, it could not retain the position of administrator that it had willingly assumed. The solution was not to place its function as administrator and its associated fiduciary duties in abeyance. Rather, it had to abandon this role and diligently transfer its function as manager to an independent administrator.

273 Indalex could apply for protection under the *CCAA*. But, in so doing, it needed to make arrangements to avoid conflicts of interests. As nothing was done, the members of the plans were [page386] left to play catch up as best they could when the process that put in place the DIP financing and its super priority was initiated. The process had been launched in such a way that it took significant time before the beneficiaries could effectively participate in the process. In practice, the United Steelworkers union, which represented only a small group of the members of the Salaried Employees Plan, acted for them after the start of the procedures. The members of the Executive Plan hired counsel who appeared for them. But, throughout, there were problems with notices, delays and the ability to participate in the process. Indeed, during the *CCAA* proceedings, the Monitor and Indalex seemed to have been more concerned about keeping the members of the

plans out of the process rather than ensuring that their voices could be heard. Two paragraphs of the submissions to this Court by Morneau Shepell Ltd., the subsequently appointed administrator of the plan, aptly sums up the behaviour of Indalex and the Monitor towards the beneficiaries, whose representations were always deemed to be either premature or late:

> When counsel for the Retirees again appeared at a motion to approve the bidding procedure, his objections were considered premature:
>
> In my view, the issues raised by the retirees do not have any impact on the Bidding Procedures. The issues can be raised by the retirees on any application to approve a transaction - but that is for another day.
>
> Only when counsel appeared at the sale approval motion, as directed by the motions judge, were the concerns of the pension plan beneficiaries heard. At that time, the Appellants complain, the beneficiaries were too late and their motion constituted a collateral attack on the original DIP Order. However, it cannot be the case that stakeholder groups are too early, until they are too late. [R.F., at paras. 54-55]

274 I must also mention the failed attempt to assign Indalex in bankruptcy once the sale of its [page387] business had been approved. One of the purposes of this action was essentially to harm the interests of the members of the plans. At the time, Indalex was still wearing its two hats, at least from a legal perspective. But its duties as a fiduciary were clearly not at the forefront of its concerns. There were constant conflicts of interest throughout the process. Indalex did not attempt to resolve them; it brushed them aside. In so acting, it breached its duties as a fiduciary and its statutory obligations under s. 22(4) *PBA*.

III. Procedural Fairness in *CCAA* Proceedings

275 The manner in which this matter was conducted in the Superior Court was, at least partially, the result of Indalex disregarding its fiduciary duties. The procedural issues that arose in that court did not assist in mitigating the consequences of these breaches. It is true that, in the end, the beneficiaries obtained, or were given, some information pertaining to the proceedings and that counsel appeared on their behalf at various stages of the proceedings. However, the basic problem is that the proceedings were not conducted according to the spirit and principles of the Canadian system of civil justice.

276 I accept that those procedures are often urgent. The situation of a debtor requires quick and efficient action. The turtle-like pace of some civil litigation would not meet the needs of the application of the *CCAA*. However, the conduct of proceedings under this statute is not solely an administrative process. It is also a judicial process conducted according to the tenets of the

adversarial system. The fundamentals of such a system must not be ignored. All interested parties are entitled to a fair procedure that allows their voices to be raised and heard. It is not an answer to these concerns to say that nothing else could be done, that no other solution would have been better, that, in substance, hearing the members would have been a waste of time. In all branches of procedure whether in administrative law, criminal law or civil action, the rights to be informed and to be heard in some [page388] way remain fundamental principles of justice. Those principles retain their place in the *CCAA*, as some authors and judges have emphasized (J. P. Sarra, *Rescue! The Companies' Creditors Arrangement Act* (2007), at pp. 55-56; *Royal Oak Mines Inc., Re* (1999), 7 C.B.R. (4th) 293 (Ont. C.J. (Gen. Div.)), at para. 5, *per* Farley J.). This was not done in this case, as my colleagues admit, while they downplay the consequences of these procedural flaws and breaches.

IV. Imposing a Constructive Trust

277 In this context, I see no error in the decision of the Court of Appeal to impose a constructive trust (paras. 200-207). It was a fair decision that met the requirements of justice, under the principles set out by our Court in *Canson Enterprises Ltd. v. Boughton & Co.*, [1991] 3 S.C.R. 534, and in *Soulos v. Korkontzilas*, [1997] 2 S.C.R. 217. The remedy of a constructive trust was justified in order to correct the wrong caused by Indalex (*Soulos*, at para. 36, *per* McLachlin J. (as she then was)). The facts of the situation met the four conditions that generally justify the imposition of a constructive trust (*Soulos*, at para. 45), as determined by Justice Gillese in her reasons, at paras. 203-4: (1) the defendant was under an equitable obligation in relation to the activities giving rise to the assets in his or her hands; (2) the assets in the hands of the defendant were shown to have resulted from deemed or actual agency activities of the defendant in breach of his or her equitable obligation to the plaintiff; (3) the plaintiff has shown a legitimate reason for seeking a proprietary remedy, either personal or related to the need to ensure that others like the defendants remain faithful to their duties; and (4) there are no factors which would render imposition of a constructive trust unjust in all the circumstances of the case, such as the protection of the interests of intervening creditors.

[page389]

278 In crafting such a remedy, the Court of Appeal was relying on the inherent powers of the courts to craft equitable remedies, not only in respect of procedural issues, but also of substantive questions. Section 9 of the *CCAA* is broadly drafted and does not deprive courts of their power to fill in gaps in the law when this is necessary in order to grant justice to the parties (G. R. Jackson and J. Sarra, "Selecting the Judicial Tool to get the Job Done: An Examination of Statutory Interpretation, Discretionary Power and Inherent Jurisdiction in Insolvency Matters", in J. P. Sarra, ed., *Annual Review of Insolvency Law, 2007* (2008), 41, at pp. 78-79).

279 The imposition of the trust did not disregard the different corporate personalities of Indalex and Indalex U.S. It properly acknowledged the close relationship between the two companies, the second in effect controlling the first. This relationship could and needed to be taken into consideration in order to determine whether a constructive trust was a proper remedy.

280 For these reasons, I would uphold the imposition of a constructive trust and I would dismiss the appeal with costs to the respondents.

* * * * *

APPENDIX

The Pension Benefits Amendment Act, 1973, S.O. 1973, c. 113

> **6.** The said Act is amended by adding thereto the following sections:
>
> 23*a*.-(1) Any sum received by an employer from an employee pursuant to an arrangement for the payment of such sum by the employer into a pension plan as the employee's contribution thereto shall be deemed to be held by the employer in trust for payment of the same after his receipt thereof into the pension plan as the employee's contribution thereto and the employer shall not appropriate or convert any part thereof to his own use or to any use not authorized by the trust.

[page390]

> (2) For the purposes of subsection 1, any sum withheld by an employer, whether by payroll deduction or otherwise, from moneys payable to an employee shall be deemed to be a sum received by the employer from the employee.
>
> (3) Any sum required to be paid into a pension plan by an employer as the employer's contribution to the plan shall, when due under the plan, be deemed to be held by the employer in trust for payment of the same into the plan in accordance with the plan and this Act and the regulations as the employer's contribution and the employer shall not appropriate or convert any part of the amount required to be paid to the fund to his own use or to any use not authorized by the terms of the pension plan.

Pension Benefits Act, R.S.O. 1980, c. 373

21... .

(2) Upon the termination or winding up of a pension plan filed for registration as required by section 17, the employer is liable to pay all amounts that would otherwise have been required to be paid to meet the tests for solvency prescribed by the regulations, up to the date of such termination or winding up, to the insurer, administrator or trustee of the pension plan.

...

23.-(1) Where a sum is received by an employer from an employee under an arrangement for the payment of the sum by the employer into a pension plan as the employee's contribution thereto, the employer shall be deemed to hold the sum in trust for the employee until the sum is paid into the pension plan whether or not the sum has in fact been kept separate and apart by the employer and the employee has a lien upon the assets of the employer for such amount that in the ordinary course of business would be entered in books of account whether so entered or not.

...

(3) Where an employer is required to make contributions to a pension plan, he shall be deemed to hold in trust for the members of the plan an amount calculated in accordance with subsection (4), whether or not,

[page391]

(*a*) the employer contributions are payable into the plan under the terms of the plan or this Act; or

(*b*) the amount has been kept separate and apart by the employer,

and the members have a lien upon the assets of the employer in such amount that in the ordinary course of business would be entered into the books of account whether so entered or not.

(4) For the purpose of determining the amount deemed to be held in trust under subsection (3) on a specific date, the calculation shall be made as if the plan had been wound up on that date.

...

32. In addition to any amounts the employer is liable to pay under subsection 21 (2), where a defined benefit pension plan is terminated or wound up or the plan is amended so that it is no longer a defined benefit pension plan, the employer is liable to the plan for the difference between,

(*a*) the value of the assets of the plan; and

(*b*) the value of pension benefits guaranteed under subsection 31 (1) and any other pension benefit vested under the terms of the plan,

and the employer shall make payments to the insurer, trustee or administrator of the pension plan to fund the amount owing in such manner as is prescribed by regulation.

Pension Benefits Amendment Act, 1983, S.O. 1983, c. 2

2. Subsection 21 (2) of the said Act is repealed and the following substituted therefor:

(2) Upon the termination or winding up of a registered pension plan, the employer of employees covered by the pension plan shall pay to the administrator, insurer or trustee of the pension plan,

(a) an amount equal to,

[page392]

(i) the current service cost, and
(ii) the special payments prescribed by the regulations,

that have accrued to and including the date of the termination or winding up but, under the terms of the pension plan or the regulations, are not due on that date; and

(b) all other payments that, by the terms of the pension plan or the regulations, are due from the employer to the pension plan but have not been paid at the date of the termination or winding up.

(2a) For the purposes of clause (2) (a), the current service cost and special payments shall be deemed to accrue on a daily basis.

3. Section 23 of the said Act is repealed and the following substituted therefor:

23.-(1) Where an employer receives money from an employee under an arrangement that the employer will pay the money into a pension plan as the employee's contribution to the pension plan, the employer shall be deemed to hold the money in trust for the employee until the employer pays the money into the pension plan.

(2) For the purposes of subsection (1), money withheld by an employer, whether by payroll deduction or otherwise, from moneys payable to an employee shall be deemed to be money received by the employer from the employee.

(3) The administrator or trustee of the pension plan has a lien and charge upon the assets of the employer in an amount equal to the amount that is deemed to be held in trust under subsection (1).

(4) An employer who is required by a pension plan to contribute to the pension plan shall be deemed to hold in trust for the members of the pension plan an amount of money equal to the total of,

(a) all moneys that the employer is required to pay into the pension plan

to meet,

(i) the current service cost, and
(ii) the special payments prescribed by the regulations,

that are due under the pension plan or the regulations and have not been paid into the pension plan; and

[page393]

(b) where the pension plan is terminated or wound up, any other money that the employer is liable to pay under clause 21 (2) (a).

(5) The administrator or trustee of the pension plan has a lien and charge upon the assets of the employer in an amount equal to the amount that is deemed to be held in trust under subsection (4).

(6) Subsections (1) and (4) apply whether or not the moneys mentioned in those subsections are kept separate and apart from other money.

...

8. Sections 32 and 33 of the said Act are repealed and the following substituted therefor:

32.-(1) The employer of employees who are members of a defined benefit pension plan that the employer is bound by or to which the employer is a party and that is partly or wholly wound up shall pay to the administrator, insurer or trustee of the plan an amount of money equal to the amount by which the value of the pension benefits guaranteed by section 31 plus the value of the pension benefits vested under the defined benefit pension plan exceeds the value of the assets of the plan allocated in accordance with the regulations for payment of pension benefits accrued with respect to service in Ontario.

(2) The amount that the employer is required to pay under subsection (1) is

in addition to the amounts that the employer is liable to pay under subsection 21 (2).

(3) The employer shall pay the amount required under subsection (1) to the administrator, insurer or trustee of the defined benefit pension plan in the manner prescribed by the regulations.

Pension Benefits Act, 1987, S.O. 1987, c. 35

58.-(1) Where an employer receives money from an employee under an arrangement that the employer will pay the money into a pension fund as the employee's contribution under the pension plan, the employer shall be deemed to hold the money in trust for the employee until the employer pays the money into the pension fund.

...

[page394]

(3) An employer who is required to pay contributions to a pension fund shall be deemed to hold in trust for the beneficiaries of the pension plan an amount of money equal to the employer contributions due and not paid into the pension fund.

(4) Where a pension plan is wound up in whole or in part, an employer who is required to pay contributions to the pension fund shall be deemed to hold in trust for the beneficiaries of the pension plan an amount of money equal to employer contributions accrued to the date of the wind up but not yet due under the plan or regulations.

...

59.-(1) Money that an employer is required to pay into a pension fund accrues on a daily basis.

(2) Interest on contributions shall be calculated and credited at a rate not less than the prescribed rates and in accordance with prescribed requirements.

...

75.-(1) A member in Ontario of a pension plan whose combination of age plus years of continuous employment or membership in the pension plan equals at least fifty-five, at the effective date of the wind up of the pension plan in whole or in part, has the right to receive,

(a) a pension in accordance with the terms of the pension plan, if, under the pension plan, the member is eligible for immediate payment of the pension benefit;

(b) a pension in accordance with the terms of the pension plan, beginning at the earlier of,

  (i) the normal retirement date under the pension plan, or

  (ii) the date on which the member would be entitled to an unreduced pension under the pension plan if the pension plan were not wound up and if the member's membership continued to that date; or

(c) a reduced pension in the amount payable under the terms of the pension plan beginning on the date on which the member would be entitled to [page395] the reduced pension under the pension plan if the pension plan were not wound up and if the member's membership continued to that date.

...

76.-(1) Where a pension plan is wound up in whole or in part, the employer shall pay into the pension fund,

(a) an amount equal to the total of all payments that, under this Act, the regulations and the pension plan, are due or that have accrued and that have not been paid into the pension fund; and

(b) an amount equal to the amount by which,

  (i) the value of the pension benefits under the pension plan that would be guaranteed by the Guarantee Fund under this Act and the regulations if the Commission declares that the

Guarantee Fund applies to the pension plan,

(ii) the value of the pension benefits accrued with respect to employment in Ontario vested under the pension plan, and

(iii) the value of benefits accrued with respect to employment in Ontario resulting from the application of subsection 40 (3) (50 per cent rule) and section 75,

exceed the value of the assets of the pension fund allocated as prescribed for payment of pension benefits accrued with respect to employment in Ontario.

Pension Benefits Act, R.S.O. 1990, c. P.8

57. (1) [Trust property] Where an employer receives money from an employee under an arrangement that the employer will pay the money into a pension fund as the employee's contribution under the pension plan, the employer shall be deemed to hold the money in trust for the employee until the employer pays the money into the pension fund.

(2) [Money withheld] For the purposes of subsection (1), money withheld by an employer, whether by payroll deduction or otherwise, from money payable to an employee shall be deemed to be money received by the employer from the employee.

[page396]

(3) [Accrued contributions] An employer who is required to pay contributions to a pension fund shall be deemed to hold in trust for the beneficiaries of the pension plan an amount of money equal to the employer contributions due and not paid into the pension fund.

(4) [Wind up] Where a pension plan is wound up in whole or in part, an employer who is required to pay contributions to the pension fund shall be deemed to hold in trust for the beneficiaries of the pension plan an amount of money equal to employer contributions accrued to the date of the wind up but not yet due under the plan or regulations.

...

58. (1) [Accrual] Money that an employer is required to pay into a pension fund accrues on a daily basis.

(2) [Interest] Interest on contributions shall be calculated and credited at a rate not less than the prescribed rates and in accordance with prescribed requirements.

...

74. (1) [Activating events] This section applies if a person ceases to be a member of a pension plan on the effective date of one of the following activating events:

1. The wind up of a pension plan, if the effective date of the wind up is on or after April 1, 1987.
2. The employer's termination of the member's employment, if the effective date of the termination is on or after July 1, 2012. However, this paragraph does not apply if the termination occurs in any of the circumstances described in subsection (1.1).
3. The occurrence of such other events as may be prescribed in such circumstances as may be specified by regulation.

(1.1) [Same, termination of employment] Termination of employment is not an activating event if the termination is a result of wilful misconduct, disobedience or wilful neglect of duty by the member that is not trivial and has not been condoned by the employer or if the termination occurs in such other circumstances as may be prescribed.

[page397]

(1.2) [Exceptions, election by certain pension plans] This section does not apply with respect to a jointly sponsored pension plan or a multi-employer pension plan while an election made under section 74.1 for the plan and its members is in effect.

(1.3) [Benefit] A member in Ontario of a pension plan whose combination of age plus years of continuous employment or membership in the pension plan equals at least 55 on the effective date of the activating event has the right to receive,

(a) a pension in accordance with the terms of the pension plan, if, under the pension plan, the member is eligible for immediate payment of the pension benefit;
(b) a pension in accordance with the terms of the pension plan, beginning at the earlier of,

(i) the normal retirement date under the pension plan, or
(ii) the date on which the member would be entitled to an unreduced pension under the pension plan if the activating event had not occurred and if the member's membership continued to that date; or

(c) a reduced pension in the amount payable under the terms of the pension plan beginning on the date on which the member would be entitled to the reduced pension under the pension plan if the activating event had not occurred and if the member's membership continued to that date.

(2) [Part year] In determining the combination of age plus employment or membership, one-twelfth credit shall be given for each month of age and for each month of continuous employment or membership on the effective date of the activating event.

(3) [Member for 10 years] Bridging benefits offered under the pension plan to which a member would be entitled if the activating event had not occurred and if his or her membership were continued shall be included in calculating the pension benefit under subsection (1.3) of a person who has at least 10 years of continuous employment with the employer or has been a member of the pension plan for at least 10 years.

[page398]

(4) [Prorated bridging benefit] For the purposes of subsection (3), if the bridging benefit offered under the pension plan is not related to periods of employment or membership in the pension plan, the bridging benefit shall be prorated by the ratio that the member's actual period of employment bears to the period of employment that the member would have to the earliest date on which the member would be entitled to payment of pension benefits and a full bridging benefit under the pension plan if the activating event had not occurred.

(5) [Notice of termination of employment] Membership in a pension plan that is wound up includes the period of notice of termination of employment required under Part XV of the *Employment Standards Act, 2000*.

(6) [Application of subs. (5)] Subsection (5) does not apply for the purpose of calculating the amount of a pension benefit of a member who is required to make contributions to the pension fund unless the member makes the contributions in respect of the period of notice of termination of employment.

(7) [Consent of employer] For the purposes of this section, where the consent of an employer is an eligibility requirement for entitlement to receive an ancillary benefit, the employer shall be deemed to have given the consent.

(7.1) [Consent of administrator, jointly sponsored pension plans] For the purposes of this section, where the consent of the administrator of a jointly sponsored pension plan is an eligibility requirement for entitlement to receive an ancillary benefit, the administrator shall be deemed to have given the consent.

(8) [Use in calculating pension benefit] A benefit described in clause (1.3) (a), (b) or (c) for which a member has met all eligibility requirements under this section shall be included in calculating the member's pension benefit or the commuted value of the pension benefit.

...

75. (1) [Liability of employer on wind up] Where a pension plan is wound up, the employer shall pay into the pension fund,

(a) an amount equal to the total of all payments that, under this Act, the regulations and the pension [page399] plan, are due or that have accrued and that have not been paid into the pension fund; and

(b) an amount equal to the amount by which,

(i) the value of the pension benefits under the pension plan that would be guaranteed by the Guarantee Fund under this Act and the regulations if the Superintendent declares that the Guarantee Fund applies to the pension plan,

(ii) the value of the pension benefits accrued with respect to employment in Ontario vested under the pension plan, and

(iii) the value of benefits accrued with respect to employment in Ontario resulting from the application of subsection 39 (3) (50 per cent rule) and section 74,

exceed the value of the assets of the pension fund allocated as prescribed for payment of pension benefits accrued with respect to employment in Ontario.

Appeals of Sun Indalex Finance, George L. Miller and FTI Consulting allowed, LEBEL *and* ABELLA JJ. *dissenting. Appeal of USW dismissed.*

Solicitors:

Solicitors for the appellant Sun Indalex Finance, LLC: Goodmans, Toronto.

Solicitors for the appellant George L. Miller, the Chapter 7 Trustee of the Bankruptcy Estates of the U.S. Indalex Debtors: Chaitons, Toronto.

Solicitors for the appellant FTI Consulting Canada ULC, in its capacity as court-appointed monitor of Indalex Limited, on behalf of Indalex Limited: Stikeman Elliott, Toronto.

Solicitors for the appellant/respondent United Steelworkers: Sack Goldblatt Mitchell, Toronto.

Solicitors for the respondents Keith Carruthers, et al.: Koskie Minsky, Toronto.

Solicitors for the respondent Morneau Shepell Ltd. (formerly known as Morneau Sobeco Limited [page400] Partnership): Cavalluzzo Hayes Shilton McIntyre & Cornish, Toronto.

Solicitor for the respondent/intervener the Superintendent of Financial Services: Attorney General of Ontario, Toronto.

Solicitors for the intervener the Insolvency Institute of Canada: Thornton Grout Finnigan, Toronto.

Solicitors for the intervener the Canadian Labour Congress: Sack Goldblatt Mitchell, Toronto.

Solicitors for the intervener the Canadian Federation of Pensioners: Paliare, Roland, Rosenberg, Rothstein, Toronto.

Solicitors for the intervener the Canadian Association of Insolvency and Restructuring Professionals: McMillan, Montréal.

Solicitors for the intervener the Canadian Bankers Association: Osler, Hoskin & Harcourt, Toronto.

United States District Court,
S.D. New York.
In re IMAX Securities Litigation.

No. 06 Civ. 6128 (NRB).
June 20, 2012.

Background: Lead plaintiff in investors' consolidated class action against entertainment corporation, its officers, and accounting firm for securities fraud moved for final approval of settlement and proposed plan of allocation, final certification of the class for purposes of settlement, and award of attorneys' fees and reimbursement of expenses.

Holdings: The District Court, Naomi Reice Buchwald, J., held that:
(1) notice of settlement was adequate;
(2) commonality and typicality requirements for certification of settlement class were met;
(3) adequacy requirement was met;
(4) common questions predominated over those affecting only individual members;
(5) class action was superior to other methods of adjudicating claims;
(6) proposed settlement was procedurally fair;
(7) proposed settlement was substantively fair; and
(8) plan of allocation was fair and adequate.

Ordered accordingly.

West Headnotes

[1] Constitutional Law 92 ⚷3981

92 Constitutional Law
92XXVII Due Process
92XXVII(E) Civil Actions and Proceedings
92k3980 Class Actions
92k3981 k. In general. Most Cited Cases

When notice to potential class members satisfies requirements of federal class action rule, the requirements of due process are also satisfied. U.S.C.A. Const.Amend. 5; Fed.Rules Civ.Proc.Rule 23(c)(2)(B), 28 U.S.C.A.

[2] Compromise and Settlement 89 ⚷68

89 Compromise and Settlement
89II Judicial Approval
89k66 Proceedings
89k68 k. Notice and communications. Most Cited Cases

Federal Civil Procedure 170A ⚷177.1

170A Federal Civil Procedure
170AII Parties
170AII(D) Class Actions
170AII(D)2 Proceedings
170Ak177 Notice and Communications
170Ak177.1 k. In general. Most Cited Cases

In the context of a securities class action settlement, the PSLRA imposes notice requirements which must be provided to members of the class in addition to those required by federal class action rule. Private Securities Litigation Reform Act of 1995, § 101(b), 15 U.S.C.A. § 78u–4(a)(7); Fed.Rules Civ.Proc.Rule 23(e), 28 U.S.C.A.

[3] Compromise and Settlement 89 ⚷68

89 Compromise and Settlement
89II Judicial Approval
89k66 Proceedings
89k68 k. Notice and communications. Most Cited Cases

Constitutional Law 92 ⚷3983

92 Constitutional Law
92XXVII Due Process
92XXVII(E) Civil Actions and Proceedings
92k3980 Class Actions

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92k3983 k. Compromise and settlement. Most Cited Cases

Federal Civil Procedure 170A ⚷179

170A Federal Civil Procedure
170AII Parties
170AII(D) Class Actions
170AII(D)2 Proceedings
170Ak177 Notice and Communications
170Ak179 k. Sufficiency. Most Cited Cases

Notice of settlement provided to possible class members in investors' class action against entertainment corporation for securities fraud was adequate, since it satisfied requirements of class action rule, PSLRA, and due process; claims services company had been retained to supervise and administer dissemination of notice to 87,934 individuals and institutional investors by mail, and had launched a settlement website that contained notice and approved forms, and it also published notice in national editions of newspapers in both United States and Canada, and on electronic newswires. U.S.C.A. Const.Amend. 5; Private Securities Litigation Reform Act of 1995, § 101(b), 15 U.S.C.A. § 78u–4(a)(7); Fed.Rules Civ.Proc.Rule 23(e), 28 U.S.C.A.; Securities Exchange Act of 1934, §§ 10(b), 20(a), 15 U.S.C.A. §§ 78j(b), 78t(a); 17 C.F.R. § 240.10b–5.

[4] Federal Civil Procedure 170A ⚷187

170A Federal Civil Procedure
170AII Parties
170AII(D) Class Actions
170AII(D)3 Particular Classes Represented
170Ak187 k. Stockholders, investors, and depositors. Most Cited Cases

Commonality and typicality requirements for certification of settlement class in investors' class action against entertainment corporation alleging securities fraud were met where class and lead plaintiff shared many common questions of law and fact bearing on central issues of case, including whether corporation's public statements regarding income recognition contained material misstatements or omissions and whether corporation had acted with scienter in the issuance of those statements. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b–5; Fed.Rules Civ.Proc.Rule 23(a)(3, 4), (e), 28 U.S.C.A.

[5] Federal Civil Procedure 170A ⚷187

170A Federal Civil Procedure
170AII Parties
170AII(D) Class Actions
170AII(D)3 Particular Classes Represented
170Ak187 k. Stockholders, investors, and depositors. Most Cited Cases

Adequacy requirement for certification of settlement class in investors' class action against entertainment corporation alleging securities fraud was satisfied, since lead plaintiff's interest were not antagonistic to interests of class and plaintiff's counsel had secured a well-received settlement in light of maximum potential recovery; all class members' interests centered around damages sustained as a result of corporation's alleged material misstatements or omissions, and counsel had procured a $12 million settlement which was within range of possible damages estimated to be between $5 and $91 million. Securities Exchange Act of 1934, §§ 10(b), 20(a), 15 U.S.C.A. §§ 78j(b), 78t(a); 17 C.F.R. § 240.10b–5; Fed.Rules Civ.Proc.Rule 23(a)(4), (e), 28 U.S.C.A.

[6] Federal Civil Procedure 170A ⚷187

170A Federal Civil Procedure
170AII Parties
170AII(D) Class Actions
170AII(D)3 Particular Classes Represented

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170Ak187 k. Stockholders, investors, and depositors. Most Cited Cases

Common questions predominated over those affecting only individual members, as required for certification of settlement class in investors' class action against entertainment corporation alleging securities fraud, since corporation's allegedly fraudulent public statements had caused damages to all members of the settlement class by decreasing stock's price. Securities Exchange Act of 1934, §§ 10(b), 20(a), 15 U.S.C.A. §§ 78j(b), 78t(a); 17 C.F.R. § 240.10b–5; Fed.Rules Civ.Proc.Rule 23(b)(3), (e), 28 U.S.C.A.

[7] Federal Civil Procedure 170A 187

170A Federal Civil Procedure
170AII Parties
170AII(D) Class Actions
170AII(D)3 Particular Classes Represented
170Ak187 k. Stockholders, investors, and depositors. Most Cited Cases

Class action was superior to other available methods for adjudicating investors' claims against entertainment corporation for securities fraud, as required for certification of settlement class; potential class included more than 87,000 individual and institutional investors of which only seven had filed requests for exclusion, and although a somewhat parallel action had been filed in a Canadian court, class action in the United States, rather than Canada, provided class members access to additional defendants, allowed for domestic interpretation of securities laws, and secured a recovery of millions of dollars, while Canadian suit was still pending. Securities Exchange Act of 1934, §§ 10(b), 20(a), 15 U.S.C.A. §§ 78j(b), 78t(a); 17 C.F.R. § 240.10b–5; Fed.Rules Civ.Proc.Rule 23(b)(3), (e), 28 U.S.C.A.

[8] Compromise and Settlement 89 65

89 Compromise and Settlement
89II Judicial Approval
89k56 Factors, Standards and Considerations; Discretion Generally
89k65 k. Securities law actions. Most Cited Cases

Proposed settlement of $12 million in investors' class action against entertainment corporation for securities fraud was procedurally fair, as required for court's approval, where all parties were represented throughout settlement negotiations by able counsel experienced in class action and securities litigation, and settlement had been achieved only after completion of merits-related discovery and mediation conducted by retired judge. Securities Exchange Act of 1934, §§ 10(b), 20(a), 15 U.S.C.A. §§ 78j(b), 78t(a); 17 C.F.R. § 240.10b–5; Fed.Rules Civ.Proc.Rule 23(e)(2), 28 U.S.C.A.

[9] Compromise and Settlement 89 65

89 Compromise and Settlement
89II Judicial Approval
89k56 Factors, Standards and Considerations; Discretion Generally
89k65 k. Securities law actions. Most Cited Cases

Proposed settlement of $12 million in investors' class action against entertainment corporation for securities fraud was substantively fair, as required for court's approval, where absent settlement, a complicated, expensive, and likely protracted trial would result, only one of more than 87,000 possible class members had objected to proposed settlement and only seven had opted out, extensive merits discovery had been completed over course of six years of litigation so counsel's recommendation of settlement was informed, risk of establishing scienter existed if matter went to trial, damage calculations were complicated and uncertain, settlement amount represented 13% of maximum damages conceivably possible, and although corporation could withstand a greater judgment than $12 million, that factor standing alone did not preclude finding of substantive fairness. Securities Exchange

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Act of 1934, §§ 10(b), 20(a), 15 U.S.C.A. §§ 78j(b), 78t(a); Fed.Rules Civ.Proc.Rule 23(e)(2), 28 U.S.C.A.

[10] Compromise and Settlement 89 65

89 Compromise and Settlement
89II Judicial Approval
89k56 Factors, Standards and Considerations; Discretion Generally
89k65 k. Securities law actions. Most Cited Cases

Plan of allocation in proposed settlement of investors' securities fraud class action against entertainment corporation was fair and adequate, as required for court's approval where plan reflected advice of lead plaintiff's counsel's damage expert to divide settlement class period into two parts, assign an inflation factor per share in one part to account for considerable difficulty of establishing damages, and set inflation at a constant rate in other part throughout class period. Securities Exchange Act of 1934, §§ 10(b), 20(a), 15 U.S.C.A. §§ 78j(b), 78t(a); 17 C.F.R. § 240.10b–5; Fed.Rules Civ.Proc.Rule 23(e), 28 U.S.C.A.

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MEMORANDUM AND ORDER

NAOMI REICE BUCHWALD, District Judge.

I. Introduction

On March 28, 2012, we preliminarily certified a class for the purpose of settlement and preliminarily approved an amended settlement of this long-running securities class action against defendants IMAX Corporation ("IMAX"), Richard L. Gelfond, Bradley J. Wechsler, Francis T. Joyce, Kathryn A. Gamble (the "individual defendants"), and PricewaterhouseCoopers LLP ("PwC") (collectively "defendants"). *See* Amended Order, *In re IMAX Corp. Sec. Litig.,* Master File No. 06 Civ. 6128 (S.D.N.Y. Mar. 28, 2012) (hereinafter the "Preliminary Order"). Following the provision of notice to the members of the preliminarily certified class, on June 14, 2012, we held a hearing on the motion of lead plaintiff The Merger Fund ("TMF" or "lead plaintiff") for final approval of the amended settlement and the proposed plan of allocation, final certification of the class for the purpose of settlement, and the award of attorneys' fees and reimbursement of expenses. For the reasons stated below as well as those reasons that we articulated at the hearing, which are incorporated here by reference, we (1) find that the notice provided to members of the class was adequate; (2) certify the class for the purpose of settlement; (3) approve the settlement; (4) approve the plan of allocation; and (5) reserve decision on the requested attorneys' fees and expenses pending further briefing on these issues from lead plaintiff's counsel Abbey Spanier Rodd & Abrams, LLP ("Abbey Spanier" or "lead plaintiff's counsel").

II. Background[FN1]

FN1. The facts recited here are drawn from the following sources: (1) the Stipulation and Agreement Between Settlement Class Members and IMAX Corporation, Richard L. Gelfond, Bradley J. Wechsler, Francis T. Joyce, Kathryn A. Gamble, and PricewaterhouseCoopers LLP, dated January 26, 2012 ("Settlement"); (2) the Amended Stipulation and Agreement Between Settlement Class Members and IMAX Corporation, Richard L. Gelfond, Bradley J.

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Wechsler, Francis T. Joyce, Kathryn A. Gamble, and PricewaterhouseCoopers LLP, dated March 20, 2012 ("Am. Settlement"); (3) the Preliminary Order; (4) the Declaration of Arthur N. Abbey in Support of Lead Plaintiff's Motion for Final Approval of the Settlement with Defendants, etc. ("Abbey Decl."); and (5) the Affidavit of Paul Mulholland Concerning Mailing of Notice ("Mulholland Aff.").

A. The Class Action

Almost six years have passed since the eight cases that were consolidated to form this class action were originally filed with this Court. *See Kaplan v. Gelfond,* 240 F.R.D. 88, 90 (S.D.N.Y.2007). It has similarly been almost six years since the parallel class action that remains pending in Canada (the "Canadian Action") was originally filed with the Ontario Superior Court. *See* Abbey Decl. ¶ 11.[FN2] During the intervening years, we have appointed three different entities as lead plaintiff, denied one motion to dismiss and two motions for class certification, and at the time that the parties entered into a memorandum of understanding ("MOU") to settle this litigation on November 2, 2011 we were preparing to decide a third motion for class certification. *See id.* at ¶¶ 10–57, 68. In the course of addressing these various issues, we have previously set out the facts underlying the allegations of securities fraud in this case in multiple decisions and will not rearticulate them in detail here. *See, e.g., In re IMAX Sec. Litig.,* 272 F.R.D. 138, 142–45 (S.D.N.Y.2010); *In re IMAX Sec. Litig.,* 587 F.Supp.2d 471, 474–78 (S.D.N.Y.2008). It is enough for our present purpose to repeat the following passages:

FN2. The eight cases—06 Civ. 6128, 06 Civ. 6235, 06 Civ. 6313, 06 Civ. 6349, 06 Civ. 6449, 06 Civ. 6693, 06 Civ. 7057, and 06 Civ. 7162—were filed between August 11, 2006 and September 18, 2006. The Canadian Action commenced thereafter on September 20, 2006. Abbey Decl. ¶ 11.

IMAX is an entertainment technology company specializing in digital and film-based motion picture technologies and large-format film presentations. The Company's main business is the design, ***182** manufacture, sale and lease of theater systems. As of December 31, 2006, the IMAX theater network included 284 theaters operating in 40 countries.

The majority of IMAX's revenue [between February 27, 2003 and July 20, 2007] was derived from the sale and lease of theater systems to third-party owners of large-format theaters. Throughout [this time period], IMAX reported upward-trending financial results: 16 theater system installations ("installs") and $71 million revenue for fiscal year 2002; 21 installs and $75.8 million revenue for 2003; 22 installs and $86.6 million revenue for 2004; and 39 installs and $99.7 million revenue for 2005.

On February 17, 2006, IMAX issued a press release announcing its 2005 financials and reporting that the Company had completed 14 [installs] during the fourth quarter of 2005. On March 9, 2006, IMAX filed its Form 10–K for fiscal year 2005 ("2005 10–K"), describing a "record" 14 [installs] and $35.1 million revenue in the fourth quarter.

Five months later, on August 9, 2006, IMAX announced that it was responding to an informal inquiry from the Securities and Exchange Commission ("SEC") concerning the timing of revenue recognition and, specifically, its application of multiple element arrangement ... accounting derived from theater system sales and leases.

...

In addition to disclosing the SEC investigation, the August 9th announcement stated that [IMAX]'s discussions with potential buyers and strategic partners had faltered. The following day, the price of IMAX shares fell from $9.63 to $5.73.

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On March 29, 2007, IMAX announced that, based on comments it had received from the SEC and the Ontario Securities Commission, it was expanding its [internal] review [of its accounting practices], "primarily in connection with its revenue recognition for certain theater system installations in previous periods, including the fourth quarter of 2005." Because of this "expanded review," IMAX stated that it "may determine that it is necessary to restate additional items beyond the previously identified errors."

Four months later, on July 20, 2007, IMAX filed its Form 10–K for fiscal year 2006 ..., which included a restatement of its financial results for fiscal years 2002 through the first three quarters of 2006.[FN3]

FN3. Following this restatement, the price of IMAX shares actually closed up $0.45. *See* Abbey Decl. ¶ 132.

...

As a result of the restatement of theater system revenue, 16 installation transactions representing $25.4 million in revenue shifted between quarters in their originally reported years, and 14 installation transactions representing $27.1 million in revenue shifted between fiscal years. Of the 14 transactions for which revenue shifted between fiscal years, one was originally recorded as revenue in fiscal year 2002, two were recorded in fiscal year 2004, ten in fiscal year 2005, and one in fiscal year 2006.

In re IMAX, 272 F.R.D. at 142–43 (internal footnotes omitted).

Bringing claims of securities fraud under §§ 10(b) and 20(a) of the Securities Exchange Act, 15 U.S.C. §§ 78j(b) and 78t(a), and Rule 10b–5, 17 C.F.R. § 240.10b–5, the Consolidated Class Action Complaint, which was filed on October 2, 2007, essentially alleges that (i) IMAX, (ii) the individual defendants, who were among IMAX's directors and officers, and (iii) PwC, which served as IMAX's accountant, were responsible for the issuance of materially false and misleading statements concerning IMAX's recognition of revenue from theater system installations during the period from February 27, 2003 through July 20, 2007. *See id.* at 143–44.

B. Discovery and Settlement Proceedings

In September 2008, following the denial of defendants' motions to dismiss, the parties agreed to engage in discovery on the merits as well as discovery related to the forthcoming class certification proceedings. Abbey Decl. ¶ 20. In January 2009, IMAX and the ***183** individual defendants produced approximately 150,000 pages of documents. *Id.* at ¶ 32. In February 2009, Abbey Spanier, having reviewed this production, served interrogatories on IMAX and the individual defendants to which these defendants responded in March 2009. *Id.* at ¶ 33. Also in February 2009, PwC produced another approximately 12,000 pages of documents. *Id.* at ¶ 34. It appears that defendants made further productions over the ensuing months because both Abbey Spanier and Robbins Geller Rudman & Dowd LLP ("Robbins Geller"), which served as lead plaintiff's counsel between June 2009 and December 2010, make reference in their submissions to the review of hundreds of thousands of pages of documents. *See id.* at ¶ 78 ("[l]ead [c]ounsel have reviewed and analyzed hundreds of thousands of pages of documents produced by [d]efendants"); *id.* at Ex. E ("Rudman Decl.") ¶ 15 (prior to the appointment of Robbins Geller as lead plaintiff's counsel in June 2009 "[d]efendants had previously produced approximately 500,000 pages of documents to plaintiffs"). In addition to the discovery that they obtained from defendants, it appears that both Abbey Spanier and Robbins Geller subpoenaed documents from third parties during the course of the litigation, some of which had previously expressed an interest in acquiring IMAX prior to August 2006. *See* Abbey Decl. ¶¶ 30, 45.

We understand that neither Abbey Spanier nor Robbins Geller conducted any merits depositions

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during this litigation. *See* June 14, 2012 Hr'g Tr. 5:24–6:12. However, Abbey Spanier has reviewed transcripts from interviews conducted by the SEC of the individual defendants as well as eleven other persons and has also gained access to transcripts from depositions conducted by plaintiffs' counsel in the Canadian Action of eleven persons, including a member of PwC. *See* Abbey Decl. ¶¶ 11, 78; Amended Settlement ¶ EE. In addition, further confirmatory discovery was conducted in January 2012 after the parties entered into a MOU to settle on November 2, 2011. *See* Abbey Decl. ¶¶ 70, 78.

At a number of earlier points during the litigation, the parties explored settlement. Specifically, on December 2, 2008, Abbey Spanier participated in a mediation session with counsel for defendants presided over by the Honorable E. Leo Milonas (Ret.), formerly of the New York Supreme Court, Appellate Division. *Id.* at ¶ 28. As part of this mediation, the parties exchanged confidential mediation statements. *Id.* On July 16, 2010, Robbins Geller participated in a further mediation with counsel for defendants presided over by the Honorable Daniel Weinstein (Ret.), formerly of the California Superior Court. *Id.* at ¶ 44. In preparation for this mediation, Robbins Geller also prepared a mediation statement. Rudman Decl. ¶ 26. While these earlier efforts at mediation proved unsuccessful, once Abbey Spanier was reappointed lead plaintiff's counsel in April 2011, it restarted settlement discussions with counsel for defendants that involved numerous meetings which successfully culminated in the parties entering the MOU to settle on November 2, 2011. *See* Abbey Decl. ¶ 67. Following further negotiations and the production of confirmatory discovery, the parties entered into a settlement on January 26, 2012, which we preliminarily approved on February 1, 2012. *See id.* at ¶¶ 71–73. In response to proposed revisions from plaintiffs' counsel in the Canadian Action, the parties agreed to amend the notice proposed in connection with their settlement of the 26th and approved in this Court's Order of the 1st, changing the notice to provide *inter alia* fuller contact information for plaintiffs' counsel in the Canadian Action. *See id.* at ¶ 73. On March 20, 2012, the parties ultimately entered into an amended settlement, which reflected this alteration, among other changes, as well as a structural modification of the settlement terms, which is discussed immediately below. *See id.* at ¶¶ 73–74.

C. The Amended Settlement

Pursuant to the amended settlement, lead plaintiff and defendants have agreed to resolve this litigation through a cash settlement of $12,000,000. *Id.* at ¶ 1.[FN4] This cash settlement***184** lies within the range of possible damages forecast by the parties, which extended as high as $91,000,000 pursuant to lead plaintiff's estimation and as low as $5,000,000 according to defendants' calculation, assuming *arguendo* defendants' liability. *See id.* at ¶ 127. The proposed class on whose behalf lead plaintiff seeks to enter the amended settlement (the "settlement class" or "American Class") includes all investors that acquired the common shares of IMAX on the NASDAQ Stock Market (the "NASDAQ") from February 27, 2003 through July 20, 2007 (the "settlement class period" or "American Class Period"). *Id.* at ¶ 1 n. 1. The settlement class and settlement class period differ from their analogues in the Canadian Action, which is being actively litigated on behalf of all investors that acquired IMAX's common stock on the NASDAQ or Toronto Stock Exchange on or after February 17, 2006 and held some or all of those securities on August 9, 2006 (the "Canadian Class" and the "Canadian Class Period"). *See id.* at ¶ 59. In order to address the overlap between the American Class and the Canadian Class, which was previously certified in the Canadian Action on December 14, 2009, the amended settlement is conditioned on the entry of an order in the Canadian Action that excludes from the Canadian Class those investors who do not opt out of the American Class (the "Canadian Order"). *See id.* at ¶¶ 59, 75. We understand that counsel for IMAX and the individual defendants in the Canadian Action have filed a motion seeking to redefine the Canadian Class in this

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manner and that oral argument on that motion is now set to begin on July 30, 2012 in the Ontario Superior Court. *See* IMAX and Individual Defs.' Letter of June 12, 2012. While the settlement contemplated entry of the Canadian Order prior to our final approval of the settlement, the amended settlement reflects a structural modification of the settlement terms insofar as it reverses this sequence of events and seeks our final approval of the settlement prior to entry of the Canadian Order. *Compare* Settlement ¶ 5 *with* Amended Settlement ¶ 5. The amended settlement, however, remains contingent on entry of the Canadian Order. *See* Amended Settlement ¶ 8. In light of this contingency, there is an unaccustomed uncertainty as to the finality of our "final" approval of the amended settlement between the parties; however, we proceed to address that settlement on the assumption that the negotiated resolution of this litigation will not be further disturbed should we approve it, as we do.

FN4. The $12,000,000 has already been deposited in an escrow account where it is earning interest. *See* Abbey Decl. ¶ 71 n. 3.

D. The Preliminary Order and the Provision of Notice

On March 28, 2012, we preliminarily certified the settlement class for the purpose of settlement, approved the amended settlement, and approved the form and content of the notice to be provided to the members of the settlement class (the "notice"). Preliminary Order 2–3. We further set out the procedures by which the notice was to be disseminated to the settlement class and the deadlines by which any members of the settlement class who wished to object to or be excluded from the amended settlement must act ahead of the hearing that we set for June 14, 2012 to finally approve the amended settlement. *Id.* at 3–12.

In accordance with our direction, lead plaintiff's counsel retained Strategic Claims Services ("SCS") to supervise and administer the dissemination of the notice pursuant to the approved notice procedure. *See* Preliminary Order ¶ 5. SCS arranged for the notice to be provided via mail to 426 individuals and organizations identified on a list of shareholders provided by IMAX. *See* Mulholland Aff. ¶¶ 4, 8, Ex. A. In addition, SCS mailed the notice to a further 1,813 banks, brokerage companies, and institutional investors, which may have traded the common shares of IMAX in their clients' or their own accounts during the settlement class period. *See id.* These initial mailings were completed by April 23, 2012. *Id.* at ¶ 4. Following receipt of the notice, the banks, brokerage companies, and institutional investors mentioned above as well other individuals requested that an additional 85,695 copies of the notice be disseminated to possible additional members of the settlement class. *Id.* at ¶ 8. Thus, in total, 87,934 copies of the notice have been mailed to possible members of the settlement class. *See id.* ¶¶ 4, 8–9. Where a mailing was returned as undeliverable, SCS has followed up where possible to ***185** obtain updated addresses. *Id.* at ¶ 9. In addition to the mailing of the notice, SCS launched a settlement website that contained the notice, among other relevant documents, and further published an approved form of summary notice through the national editions of newspapers in both the United States and Canada as well as via electronic newswires. *See id.* at ¶¶ 5–6.

The hearing to address the amended settlement was held on June 14, 2012, as scheduled. No members of the settlement class appeared. As of that date, we were informed that only seven investors had sought to be excluded from the settlement class and only one investor, Mr. Skip Ames, had filed an objection to the amended settlement (the "objection"), which we discuss below. *See* June 14, 2012 Hr'g Tr. 4:22–5:8.

III. Discussion

A. Adequacy of the Notice

[1][2] Federal Rule of Civil Procedure 23(c)(2)(B) provides the notice that is required to be given to members of a class when it is certified pursuant to Federal Rule of Civil Procedure 23(b)(3), which is the case here.[FN5] Federal Rule

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of Civil Procedure 23(e)(1) in turn provides the notice that is required to be given to members of a certified class in which a settlement has been proposed for court approval, which is also the case here.[FN6] "Where, as here, the parties seek simultaneously to certify a settlement class and to settle a class action, the elements of Rule 23(c) notice ... are combined with the elements of Rule 23(e) notice" and because "Rule 23(e)'s notice requirements are less specific than that of Rule 23(c)'s ... [we] will focus on Rule 23(c)'s requirements." *In re Global Crossing Sec. and ERISA Litig.,* 225 F.R.D. 436, 448 (S.D.N.Y.2004) (Lynch, J.). *See also* Fed.R.Civ.P. 23 advisory committee's note (emphasizing "[n]otice of a settlement binding on the class is required either when the settlement follows class certification or when the decisions on certification and settlement proceed simultaneously" before stating "[r]easonable settlement notice may require individual notice in the manner required by Rule 23(c)(2)(B) for certification notice to a Rule 23(b)(3) class"). Where there is compliance with Rule 23(c)(2)(B), the requirements of due process are satisfied. *See Eisen v. Carlisle and Jacquelin,* 417 U.S. 156, 172–174, 94 S.Ct. 2140, 40 L.Ed.2d 732 (1974) (discussing incorporation of due process requirements into Rule 23(c)(2)(B)'s predecessor provision). In addition, in the context of a securities class action settlement, the Private Securities Litigation Reform Act of 1995 (the "PSLRA") imposes additional notice that must be provided to members of the class. *See* 15 U.S.C. § 78u–4(a)(7).[FN7]

FN5. Rule 23(c)(2)(B) provides:

> For any class certified under Rule 23(b)(3), the court must direct to class members the best notice that is practicable under the circumstances, including individual notice to all members who can be identified through reasonable effort. The notice must clearly and concisely state in plain, easily understood language:
>
> (i) the nature of the action;
>
> (ii) the definition of the class certified;
>
> (iii) the class claims, issues, or defenses;
>
> (iv) that a class member may enter an appearance through an attorney if the member so desires;
>
> (v) that the court will exclude from the class any member who requests exclusion;
>
> (vi) the time and manner for requesting exclusion; and
>
> (vii) the binding effect of a class judgment on members under Rule 23(c)(3).
>
> FED. R. CIV. P. 23(c)(2)(B).

FN6. Rule 23(e)(1) provides that "[t]he court must direct notice in a reasonable manner to all class members who would be bound by the proposal." FED. R. CIV. P. 23(e)(1).

FN7. Pursuant to the PSLRA, the notice must contain the following information as well as a cover page summarizing it:

> (A) Statement of recovery—the amount of the settlement determined in the aggregate and on an average per share basis;
>
> (B) Statement of potential outcome of case—amount of damages per share recoverable if plaintiffs were to prevail on every claim. If the parties are unable to agree on damages, a statement concerning the issues on which the parties disagree;
>
> (C) Statement of attorneys' fees—statement of fees and costs to be applied for in the aggregate and on a per

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share basis;

(D) Identification of lawyers' representatives—the name, telephone number, and address of counsel available to answer questions; and

(E) Reasons for settlement—a brief statement explaining the reasons why the parties are proposing the settlement.

In re Indep. Energy Holdings PLC Sec. Litig., 302 F.Supp.2d 180, 184 (S.D.N.Y.2003).

***186** [3] We have reviewed the notice in the form in which it was disseminated to members of the settlement class, *see* Mulholland Aff. Ex. A, and also considered the procedure that we earlier approved. We find that the notice provided here was the best practicable under the circumstances, that it included all of the content necessary as a matter of law, and that it was accordingly adequate under Rule 23, due process, and the PSLRA.

B. Final Certification of the Settlement Class

"Certification of a settlement class 'has been recognized throughout the country as the best, most practical way to effectuate settlements involving large numbers of claims by relatively small claimants.' " *In re Giant Interactive Group, Inc. Sec. Litig.*, 279 F.R.D. 151, 158 (S.D.N.Y.2011) (quoting *In re Prudential Sec. Inc. Ltd. P'ships Litig.*, 163 F.R.D. 200, 205 (S.D.N.Y.1995)). *See also Weinberger v. Kendrick*, 698 F.2d 61, 72 (2d Cir.1982) ("[t]emporary settlement classes have proved to be quite useful in resolving major class action disputes") (internal quotation marks omitted). "Classes certified for settlement purposes, like all other classes, must meet the requirements of Rule 23(a) and at least one of three requirements set forth in Rule 23(b)." *In re Marsh & McLennan Cos., Inc. Sec. Litig.*, No. 04 Civ. 8144(CM), 2009 WL 5178546, at *8 (S.D.N.Y. Dec. 23, 2009). Here, we find that the settlement class satisfies the requirements of Federal Rule of Civil Procedure 23(a) and (b)(3) and accordingly certify it for the purpose of settlement.

1. Federal Rule of Civil Procedure 23(a)

Pursuant to Rule 23(a), certification of a class is proper where "(1) the class is so numerous that joinder of all members is impracticable; (2) there are questions of law or fact common to the class; (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class; and (4) the representative parties will fairly and adequately protect the interests of the class." FED. R. CIV. P. 23(a).

a. Numerosity

In a previous decision, we found that the settlement class as now constituted plainly met the numerosity requirement of Rule 23(a)(1). *See In re IMAX*, 272 F.R.D. at 146.

b. Commonality and Typicality

" 'The commonality requirement [of Rule 23(a)(2)] is met if plaintiffs' grievances share a common question of law or of fact.' " *Cent. States Se. & Sw. Areas Health & Welfare Fund v. Merck–Medco Managed Care, LLC*, 504 F.3d 229, 245 (2d Cir.2007) (quoting *Marisol A. v. Giuliani*, 126 F.3d 372, 376 (2d Cir.1997) (*per curiam*)). In turn, "[t]ypicality [pursuant to Rule 23(a)(3)] 'requires that the claims of the class representatives be typical of those of the class, and is satisfied when each class member's claim arises from the same course of events, and each class member makes similar legal arguments to prove the defendant's liability.' " *Id.* (quoting *Robinson v. Metro–N. Commuter R.R. Co.*, 267 F.3d 147, 155 (2d Cir.2001)). As the Supreme Court has observed, the commonality requirement "tend[s] to merge" with the typicality requirement because "[b]oth serve as guideposts for determining whether ... the named plaintiff's claim and the class claims are so interrelated that the interests of the class members will be fairly and adequately protected in their absence." *Gen. Tel. Co. of Sw. v. Falcon*, 457 U.S. 147, 158 n. 13, 102 S.Ct. 2364, 72 L.Ed.2d 740 (1982).

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[4] Here the commonality and typicality requirements are satisfied. The settlement class, and in particular TMF as lead plaintiff, share many common questions of law and fact bearing on for example the central issues of whether defendants' public statements regarding income recognition contained material misstatements or omissions and whether defendants acted with scienter in the issuance of those statements. In a previous decision, we addressed and rejected a number of arguments against TMF's appointment as lead plaintiff on the basis of its failure to satisfy the typicality as well as adequacy requirements of Rule 23(a)(3) and (4), and we find no novel reason on the record before us to believe that TMF's claims are atypical in any manner or that it is ***187** subject to unique defenses. *See In re Imax Sec. Litig.,* Master File No. 06 Civ. 6128, 2011 WL 1487090, at *3–7 (S.D.N.Y. April 14, 2011) (rejecting arguments that TMF's (i) successive reassignment of its claims and (ii) investment strategies did not give rise to unique defenses or undermine satisfaction of the typicality and adequacy requirements).

c. Adequacy

[5] "The adequacy requirement of Rule 23(a)(4) involves an inquiry as to whether: (1) the plaintiffs interests are antagonistic to the interests of the other members of the [c]lass; and (2) plaintiffs counsel are qualified, experienced, and capable of conducting the litigation." *In re Giant,* 279 F.R.D. at 159 (citing *Baffa v. Donaldson, Lufkin & Jenrette Sec. Corp.,* 222 F.3d 52, 60 (2d Cir.2000)). Here, there is no reason to believe that lead plaintiff's interests are in conflict with those of the other members of the settlement class whose claims share common questions of law and fact, and we find that lead plaintiff's counsel is qualified to litigate this case on behalf of the settlement class. We note that the achievement of the lead plaintiff and lead plaintiff's counsel in securing a well-received settlement that we approve below provides confirmation that they have met the adequacy requirement. *See id.* (finding satisfaction of adequacy requirement "confirmed by the lack of any opposition to this settlement (and the very small number of opt-outs), as well as the above-average recovery in this case, measured as a percentage of maximum potential recovery").

2. Federal Rule of Civil Procedure 23(b)(3)

In addition to meeting the four requirements of Rule 23(a), a class must also satisfy one out of the three sub-paragraphs to Rule 23(b). Here, lead plaintiff seeks certification of the settlement class pursuant to Rule 23(b)(3), which requires that a court find "that the questions of law or fact common to class members predominate over any questions affecting only individual members, and that a class action is superior to other available methods for fairly and efficiently adjudicating the controversy." FED. R. CIV. P. 23(b)(3).[FN8]

FN8. In undertaking these two inquiries, the following matters are among those that Rule 23(b)(3) identifies as "pertinent":

(A) the class members' interests in individually controlling the prosecution or defense of separate actions;

(B) the extent and nature of any litigation concerning the controversy already begun by or against class members;

(C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; and

(D) the likely difficulties in managing a class action.

FED. R. CIV. P. 23(b)(3).

a. Predominance of Common Questions

[6] "Class-wide issues predominate if resolution of some of the legal or factual questions that qualify each class member's case as a genuine controversy can be achieved through generalized proof, and if these particular issues are more substantial than the issues subject only to individualized proof." *Moore v. PaineWebber, Inc.,* 306 F.3d

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1247, 1252 (2d Cir.2002). As the Supreme Court has observed, the requirement of predominance is "readily met in certain cases alleging consumer or securities fraud or violations of the antitrust laws." *Amchem Prods., Inc. v. Windsor,* 521 U.S. 591, 625, 117 S.Ct. 2231, 138 L.Ed.2d 689 (1997). Here, lead plaintiff alleges that defendants' allegedly fraudulent public statements caused damages to the settlement class, and these allegations are sufficient to establish predominance. *See In re Global Crossing,* 225 F.R.D. at 454.

b. Superiority to Other Methods of Adjudication

[7] The class action here is superior to the other available methods for adjudicating the controversy between the settlement class and defendants. "The interest of the class as a whole in litigating the many common questions substantially outweighs any interest by individual members in bringing and prosecuting separate actions," which has been evidenced from the fact that only one member of the settlement class has objected to the amended settlement and only seven members ***188** of the settlement class have sought to exclude themselves from the amended settlement. *Cromer Fin. Ltd. v. Berger,* 205 F.R.D. 113, 133 (S.D.N.Y.2001) (continuing to note that "[t]o force each investor to litigate separately would risk disparate results among those seeking redress, ... would exponentially increase the costs of litigation for all, and would be a particularly inefficient use of judicial resources").

Given the existence of the Canadian Action, it has been periodically suggested in the course of this litigation that the parallel class action proceedings to the north offer a better forum for the resolution of this general controversy. *See In re IMAX,* 272 F.R.D. at 158. Indeed, the one objection to the amended settlement alleges the comparative attractiveness of the Canadian Action. *See* Objection 2–3. We again "decline to deny certification on th[is] ground [ ] because, amongst other reasons," PwC is not a defendant in the Canadian Action, the American Class Period is significantly longer than the Canadian Class Period, and the American Class includes only purchasers on the NASDAQ whereas the Canadian Class includes purchasers on both the NASDAQ and Toronto Stock Exchange. *In re IMAX,* 272 F.R.D. at 158–59. As we previously stated:

> At bottom, a class action in a foreign jurisdiction, applying that jurisdiction's securities laws, to which a named defendant in the United States action is not a party, in which the first complaint in the foreign jurisdiction was filed after the first complaint in this case, is not a "superior" way of adjudicating plaintiffs' claims against that party for alleged violations of U.S. securities laws—claims which we already have upheld against defendants' motions to dismiss.

Id. at 159. Moreover, there is now a further factor in play that we find resolves any lingering doubt as to whether this class action is superior: the American Class has secured a certain recovery of millions of dollars against defendants through the advocacy of lead plaintiff's counsel here whereas the Canadian Class continues to litigate in the hope of securing a settlement or judgment.[FN9] It is no less true in the context of securities class action litigation that a bird in hand is worth two in the bush. Finally, to the extent that members of the American Class who are also members of the Canadian Class—it is estimated that 83.9% of the shares of IMAX involved in the Canadian Action were purchased on the NASDAQ, *see* Preliminary Order Ex. A–1 4—share the opinion conveyed in the one objection that the Canadian Action promises a superior alternative for them to recover their investment losses they would "presumably have excluded themselves from the settlement class." *In re Global Crossing,* 225 F.R.D. at 454. As noted earlier, there were only seven exclusion requests despite the extensive notice.

FN9. The most recent development of which we are aware in the settlement negotiations in the Canadian Action is that on May 3, 2012 defendants' counsel in the Ca-

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> nadian Action made an offer to plaintiffs' counsel in the Canadian Action to settle on terms roughly analogous to those on which the parties have reached agreement here. *See* Abbey Decl. Ex. A Tab 2 ¶ 29.
>
> * * *

In light of the foregoing analysis, we find that the settlement class satisfies the requirements of Federal Rule of Civil Procedure 23(a) and (b)(3) and accordingly certify it for the purpose of settlement.

C. Final Approval of the Amended Settlement

At the outset, we emphasize that that there is a "strong judicial policy in favor of settlements, particularly in the class action context." *In re PaineWebber Ltd. P'ships Litig.*, 147 F.3d 132, 138 (2d Cir.1998). Pursuant to Federal Rule of Civil Procedure 23(e) any settlement of this class action requires our approval. *See* FED. R. CIV. P. 23(e). Because the amended stipulation will bind the settlement class to its terms, we can only approve it should we find that "it is fair, reasonable, and adequate." FED. R. CIV. P. 23(e)(2). "In undertaking this evaluation, [we] must consider 'both the [amended] settlement's terms and the negotiating process leading to settlement,' that is, [we] must review the settlement for both procedural and substantive fairness." *In re Giant,* 279 F.R.D. at 160 (quoting *Wal–Mart Stores, Inc.* ***189** *v. Visa U.S.A., Inc.*, 396 F.3d 96, 116 (2d Cir.2005)).

1. Procedural Fairness

[8] We owe a fiduciary duty to the settlement class "to ensure that the [amended] settlement is not the product of collusion." *In re PaineWebber Ltd. P'ships Litig.,* 171 F.R.D. 104, 125 (S.D.N.Y.1997), *aff'd,* 117 F.3d 721 (2d Cir.1997) (citing *In re Warner Commc'ns Sec. Litig.,* 798 F.2d 35, 37 (2d Cir.1986)). With that said, "a class action settlement enjoys a 'presumption of correctness' where it is the product of arm's-length negotiations conducted by experienced, capable counsel." *In re Telik, Inc. Sec. Litig.,* 576 F.Supp.2d 570, 575 (S.D.N.Y.2008) (quoting *In re Union Carbide Corp. Consumer Prods. Bus. Sec. Litig.,* 718 F.Supp. 1099, 1103 (S.D.N.Y.1989)). Further, "great weight is accorded to the recommendations of counsel, who are most closely acquainted with the facts of the underlying litigation." *In re PaineWebber,* 171 F.R.D. at 125 (internal quotation marks omitted). Here, the presumption of correctness attaches because "[a]ll parties were represented throughout the [s]ettlement negotiations by able counsel experienced in class action and securities litigation." *In re Telik,* 576 F.Supp.2d at 576. This finding is further buttressed in light of the substantial merits-related discovery conducted in this case as well as the prior mediation sessions that, though unfruitful, took place before retired judges. *See In re Giant,* 279 F.R.D. at 160 (noting extent of merits-related discovery); *In re Telik,* 576 F.Supp.2d at 576 (noting involvement of retired judges). In the absence of evidence to rebut the presumption, we find that the amended settlement is procedurally fair.

2. Substantive Fairness

[9] In the Second Circuit, district courts determine whether a proposed settlement in a class action is substantively fair through analysis of the nine factors articulated in *City of Detroit v. Grinnell Corp.,* 495 F.2d 448 (2d Cir.1974). These factors are:

> (1) the complexity, expense and likely duration of the litigation;
>
> (2) the reaction of the class to the settlement;
>
> (3)the stage of the proceedings and the amount of discovery completed;
>
> (4) the risks of establishing liability;
>
> (5) the risks of establishing damages;
>
> (6) the risks of maintaining the class action through the trial;
>
> (7) the ability of the defendants to withstand a

greater judgment;

(8) the range of reasonableness of the settlement fund in light of the best possible recovery;

(9) the range of reasonableness of the settlement fund to a possible recovery in light of all the attendant risks of litigation.

Wal–Mart Stores, 396 F.3d at 117 (quoting *Grinnell,* 495 F.2d at 463). "In finding that a settlement is fair, not every factor must weigh in favor of settlement, 'rather [a] court should consider the totality of these factors in light of the particular circumstances.' " *In re Global Crossing,* 225 F.R.D. at 456 (quoting *Thompson v. Metro. Life Ins. Co.,* 216 F.R.D. 55, 61 (S.D.N.Y.2003)). Upon consideration of these factors, we find that the amended settlement is substantively fair.

a. Complexity, Expense, and Likely Duration of Litigation

"[I]n evaluating the settlement of a securities class action, federal courts, including this [c]ourt, have long recognized that such litigation is notably difficult and notoriously uncertain." *In re Sumitomo Copper Litig.,* 189 F.R.D. 274, 281 (S.D.N.Y.1999) (internal quotation marks omitted). In this case, we have from the outset acknowledged the complexity of the underlying accounting principles involved. *See In re IMAX,* 587 F.Supp.2d at 475–77. While this complexity does not appear extraordinary in the context of issues that are regularly implicated in the course of securities class action litigation, we agree with lead plaintiffs counsel that it would materially increase the challenge as well as expense of litigating this case through trial. *See* Mem. of Law in Support of Lead Plaintiffs Mot. for Final Approval of the Settlement, etc. ("Br.") 9–10; Abbey Decl. ¶ 110. Furthermore, we agree with lead plaintiffs counsel that following a renewed class certification motion, a motion for summary judgment***190** from one or more of the defendants would possibly precede a trial. *See* Abbey Decl. ¶ 9. In short, we find that the amended settlement permits the settlement class to avoid complicated, expensive, and likely protracted litigation, probably lengthened in its cost and duration due to the parties' likely efforts to coordinate proceedings with those in the Canadian Action.

b. Class Members' Reaction to the Amended Settlement

"It is well-settled that the reaction of the class to the settlement is perhaps the most significant factor to be weighed in considering its adequacy." *Maley v. Del Global Techs. Corp.,* 186 F.Supp.2d 358, 362 (S.D.N.Y.2002). Here, only one investor objected to the amended settlement and only seven requested to opt out of the settlement class. In light of the fact that over 87,000 notices were mailed to investors and possible members of the settlement class, this demonstration of discontent is but a whisper amidst an otherwise thundering roar of silence.

c. Stage of Proceedings and Amount of Discovery Completed

In considering this factor, "the question is whether the parties had adequate information about their claims," *In re Global Crossing,* 225 F.R.D. at 458, such that their counsel can intelligently evaluate "the merits of [p]laintiffs claims, the strengths of the defenses asserted by [d]efendants, and the value of [p]laintiffs' causes of action for purposes of settlement." *Maley,* 186 F.Supp.2d at 364. The threshold necessary to render the decisions of counsel sufficiently well informed, however, is not an overly burdensome one to achieve—indeed, formal discovery need not have necessarily been undertaken yet by the parties. *See In re Sony SXRD Rear Projection Television Class Action Litig.,* No. 06 Civ. 5173(RPP), 2008 WL 1956267, at *7 (S.D.N.Y. May 1, 2008) (stating "[a]lthough the parties did not engage in extensive formal discovery, such efforts are not required for the [s]ettlement to be adequate, so long as the parties conducted sufficient discovery to understand their claims and negotiate settlement terms" and citing cases). This case has been pending for almost six years. During that time period, substantial merits-

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related discovery of both a formal and informal variety has occurred. In addition, the parties have conducted additional confirmatory discovery pending their entrance into the amended settlement. Against this history of activity, we find that lead plaintiff's counsel and defendants' counsel are both able to assess the strengths and weaknesses of their respective positions.

d. Risks of Establishing Liability

"This factor does not require [a] [c]ourt to adjudicate the disputed issues or decide unsettled questions; rather, the [c]ourt need only assess the risks of litigation against the certainty of recovery under the proposed settlement." *In re Global Crossing,* 225 F.R.D. at 459. *See In re Austrian & German Bank Holocaust Litig.,* 80 F.Supp.2d 164, 177 (S.D.N.Y.2000) (approving proposed settlement and emphasizing "[t]he [c]ourt is impressed by the factual difficulties and legal defenses that plaintiffs face in further litigation of their claim"). We agree with lead plaintiff's counsel that significant risks would lie ahead should the litigation of this case proceed. *See* Br. 17–18. In particular, for reasons that we have previously noted, albeit in denying defendants' motion to dismiss, whether lead plaintiff could establish scienter on the part of IMAX, the individual defendants, and PwC is far from certain in this case involving accounting irregularities that implicated the recognition not creation of income. *See In re IMAX,* 587 F.Supp.2d at 481, 485 (noting the question of whether scienter was adequately pleaded as to IMAX and the individual defendants was a "close one" and observing "[i]f ... discovery reveals that P[w]C's involvement in the development of IMAX's accounting policy was not so extensive as alleged" then the "inference of scienter will weaken substantially").

e. Risks of Establishing Damages

In the context of securities class actions, "[c]alculation of damages is a 'complicated and uncertain process, typically involving conflicting expert opinion' about the difference between the purchase price and the stock's 'true' value absent the alleged fraud." ***191** *In re Global Crossing,* 225 F.R.D. at 459 (quoting *Maley,* 186 F.Supp.2d at 365). In this case, loss causation presents a stark challenge to lead plaintiff. On August 9, 2006, IMAX disclosed (i) that the SEC was investigating its accounting practices and also (ii) that a potential acquisition or strategic partnership had not come to fruition. The timing of these twin disclosures significantly complicates the question of what, if any, amount of the resulting drop in the share price is attributable to prior allegedly misrepresentative statements regarding theater system installations and resulting revenue.[FN10]

> FN10. In addition, on July 20, 2007, when IMAX actually restated its financial results from multiple prior years, its share price closed up $0.45 in response to this correction. Abbey Spanier effectively now concedes that no loss to investors is attributable to the restatement, which conclusion guides its proposed plan of allocation, as discussed below. *See* Abbey Decl. ¶ 132.

f. Risks of Maintaining Class Action Through Trial

We have not yet certified a class in this case except for the purpose of settlement. Were this case to proceed in the absence of the amended settlement, even if lead plaintiff secured certification of the entire settlement class, at the next stage the possibility would remain that following additional factual development multiple sub-classes would emerge for different groups of investors. *See In re NASDAQ Market–Makers Antitrust Litig.,* 187 F.R.D. 465, 476 (S.D.N.Y.1998) (noting that "if insurmountable management problems were to develop at any point, class certification can be revisited at any time" pursuant to Federal Rule of Civil Procedure 23(c)(1)) (internal quotation marks omitted).

g. Defendants' Ability to Withstand Greater Judgment

Without question, IMAX, the individual defendants, and PwC could withstand a much greater judgment against them, and this factor weighs

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against the fairness of the amended settlement. "But a defendant is not required to 'empty its coffers' before a settlement can be found adequate." *In re Sony,* 2008 WL 1956267, at *8 (quoting *McBean v. City of New York,* 233 F.R.D. 377, 388 (S.D.N.Y.2006) (Lynch, J.)). Indeed, this factor, standing alone, is not sufficient to preclude a finding of substantive fairness where the other factors weigh heavily in favor of approving a settlement. *See D'Amato v. Deutsche Bank,* 236 F.3d 78, 86 (2d Cir.2001).

h. Amended Settlement's Range of Reasonableness in Light of Possible Recovery

"The adequacy of the amount achieved in settlement may not be judged in comparison with the possible recovery in the best of all possible worlds, but rather in light of the strengths and weaknesses of plaintiffs' case." *In re Giant,* 279 F.R.D. at 162 (internal quotation marks omitted). Instead, we must examine whether the settlement amount lies within a "range of reasonableness," which range reflects "the uncertainties of law and fact in any particular case and the concomitant risks and costs necessarily inherent in taking any litigation to completion." *Wal–Mart,* 396 F.3d at 119 (internal quotation marks omitted). We have already discussed the material weaknesses in lead plaintiff's case as well as the additional risks attendant to further litigating this class action. In light of these weaknesses and risks, we find that the settlement amount here—$12,000,000, which constitutes over 13% of the maximum damages that lead plaintiff's counsel argues are conceivably possible to prove—is within the range of reasonableness. Nor is it without precedent that settlement amounts reflecting similar (or lower) percentages of possible recoveries have been approved in other recent securities class action cases. *See, e.g., In re Giant,* 279 F.R.D. at 162 (finding $13,000,000 settlement amount that reflected percentage of recovery of 16.5% was within the range of reasonableness). *See also In re China Sunergy Sec. Litig.,* No. 07 Civ. 7895(DAB), 2011 WL 1899715, at *5 (S.D.N.Y. May 13, 2011) (noting "average settlement amounts in securities fraud class actions where investors sustained losses over the past decade ... have ranged from 3% to 7% of the class members' estimated losses") (internal quotation marks omitted); *In re Union Carbide,* 718 F.Supp. ***192** at 1103 (noting the Second Circuit "has held that a settlement can be approved even though the benefits amount to a small percentage of the recovery sought" and emphasizing "[t]he essence of settlement is compromise").

* * *

In light of the foregoing analysis, we find that the amended settlement is substantively fair under the factors of *Grinnell* and accordingly give it final approval.

D. Final Approval of the Plan of Allocation

" 'To warrant approval, the plan of allocation must also meet the standards by which the settlement was scrutinized—namely, it must be fair and adequate.' " *In re WorldCom, Inc. Sec. Litig.,* 388 F.Supp.2d 319, 344 (S.D.N.Y.2005) (quoting *Maley,* 186 F.Supp.2d at 367). " 'When formulated by competent and experienced counsel,' a plan for allocation of net settlement proceeds 'need have only a reasonable, rational basis.' " *In re Telik,* 576 F.Supp.2d at 580 (quoting *In re Global Crossing,* 225 F.R.D. at 462). Such "[a] reasonable plan may consider the relative strength and values of different categories of claims." *Id. See In re Lloyd's Am. Trust Fund Litig.,* No. 96 Civ. 1262(RWS), 2002 WL 31663577, at *18 (S.D.N.Y. Nov. 26, 2002) ("[c]lass action settlement benefits may be allocated by counsel in any reasonable or rational manner because allocation formulas reflect the comparative strengths and values of different categories of the claim") (internal ellipsis and quotation marks omitted).

[10] The proposed plan of allocation effectively divides the settlement class period into two parts. For common shares of IMAX purchased from February 27, 2003 through August 9, 2006, the plan of allocation assigns an inflation factor per share of $3.90, which reflects the entire drop in the share

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price that occurred immediately following IMAX's disclosure on August 9th of the SEC's investigation into its accounting practices. For shares of IMAX purchased from August 10, 2006 through July 20, 2007, the plan of allocation assigns no inflation factor. *See* Preliminary Order Ex. A–1 19–20. This latter assignment of value renders worthless the claims of those members of the settlement class who purchased the common stock of IMAX after the initial disclosure. The plan of allocation reflects the advice of lead plaintiff's counsel's damages expert, who in particular "recommended that there w[ere] no damages for IMAX shareholders between the period of August 10, 2006 and July 20, 2007 (the date of the [r]estatement) because on the date of the restatement, IMAX'[s] stock closed up $0.45 from the previous day's closing." Abbey Decl. ¶ 132.

We find that the proposed plan of allocation, which was devised by experienced counsel, is fair and supported by a reasonable, rational basis. The assignment of no value to the claims of investors who purchased after August 9th not unreasonably reflects what we agree would be the considerable difficulty of establishing damages during this time period. The mere fact that the lead plaintiff selects zero as the proper correction to the share price during this period of the settlement class does not alone undermine the fairness of the plan of allocation because the selection of zero seems rational here. *See Buxbaum v. Deutsche Bank AG,* 216 F.R.D. 72, 74–76, 78–79 (S.D.N.Y.2003) (rejecting post-approval challenge to plan of allocation in securities class action premised on allegedly false denials of impending merger that assigned "$8.00 per share for those shares traded from October 26, 1998 through November 18, 1998; $3.91 per share for those shares traded on November 19, 1998; and $0.00 for [those] shares traded on November 20, 1998" and noting "[t]he deflationary effect declined to $3.91 per share on November 19 [th] and to zero on November 20th, because by those dates there was new information in the marketplace indicating that there was to be an impending merger announcement and that information drove the price ... back to its predeflationary levels"). Furthermore, no member of the settlement class has objected to this aspect of the plan of allocation.

The one objection to the amended settlement instead criticizes the plan of allocation because it assigns a uniform inflation value to claims arising from transactions on or before ***193** August 9th. *See* Objection 1. In particular, the objection argues that the value of common shares prior to 2005 was less inflated, citing the opinion of an expert submitted in the Canadian Action. *See id.;* Abbey Decl. Ex. B Tab 2 ("Torchio Aff."). While we have no reason to doubt that the expert retained by plaintiffs' counsel in the Canadian Action is as qualified to opine on this topic as the expert retained by Abbey Spanier here and moreover that his rationale for further segmenting the share price inflation in the plan of allocation is not unreasonable, *see* Torchio Aff. ¶¶ 18–20, it is well established that damages calculations in securities class actions often descend into a battle of experts. *See In re Marsh,* 2009 WL 5178546, at *6 ("[o]n damages, this case would have ended up as a classic 'battle of the experts' "). In the context of settlement approval, however, the rationale here for setting inflation at a constant rate throughout the entire portion of the settlement class period that preceded the initial corrective disclosure and that was covered by subsequently restated financial results need not overwhelm in our estimation all competing theories of damages. Instead, the rationale need only be reasonable and rational, which it is.

E. The Requested Attorneys' Fees and Expenses

In connection with its motion for final approval of the amended settlement, Abbey Spanier also seeks an award of attorneys' fees of $3,000,000, representing 25% of the settlement amount, as well as reimbursement of expenses totaling $1,677,838.02. *See* Br. 33–42. Adding these attorney's fees and expenses, the total of $4,677,838.02 reflects almost 39% of the settlement amount. While this figure alone gives us pause, as we ex-

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plained at the hearing on June 14, 2012, we are concerned about the attorneys' hours expended and expert fees incurred by Abbey Spanier and in particular Robbins Geller given the evidentiary challenges that were obviously involved in bringing this case from the outset. In addition, we find particularly troubling the failure of Robbins Geller to address in its application the circumstances of its prior removal as lead plaintiff's counsel, which circumstances drew into question the candor and good faith of its representations to this Court. *See In re IMAX,* 272 F.R.D. at 155–57, 160; *In re IMAX,* 2011 WL 1487090, at *9. In light of these concerns, we agreed with Abbey Spanier at the hearing on the 14th that further briefing on the issue of the requested attorneys' and expenses is appropriate. Accordingly, we reserve decision on the award of fees and reimbursement of expenses.

IV. Conclusion

For the reasons stated above as well as those reasons that we articulated at the hearing, which are incorporated here by reference, we (1) find that notice provided to members of the was adequate; (2) certify the class for purpose of settlement; (3) approve the settlement; (4) approve the plan of allocation; and (5) reserve decision on the requested attorneys' fees and expenses pending further briefing on these issues from lead plaintiff's counsel.

S.D.N.Y.,2012.
In re IMAX Securities Litigation
283 F.R.D. 178

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United States District Court,
S.D. New York.
FEDERAL HOUSING FINANCE AGENCY,
Plaintiff,
v.
NOMURA HOLDING AMERICA INC., et al., Defendants.

No. 11cv6201 (DLC).
Signed Dec. 18, 2014.

Background: Federal Housing Finance Agency (FHFA), as conservator of the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac), brought action against various financial institutions involved in the packaging, marketing and sale of residential mortgage-backed securities (RMBS) that the government sponsored enterprises (GSEs) purchased in the period from 2005 to 2007, asserting claims under federal securities laws and the District of Columbia and Virginia Blue Sky Acts. FHFA moved for partial summary judgment.

Holdings: The District Court, Denise Cote, J., held that:
(1) issuer failed to conduct reasonable investigation or exercise reasonable care to confirm accuracy of representations in offering documents for RMBS, and
(2) underwriter failed to conduct reasonable investigation or exercise reasonable care to confirm accuracy of representations in offering documents for RMBS.

Motion granted.

West Headnotes

[1] Federal Civil Procedure 170A ⚷2545

170A Federal Civil Procedure
170AXVII Judgment
170AXVII(C) Summary Judgment
170AXVII(C)3 Proceedings
170Ak2542 Evidence
170Ak2545 k. Admissibility. Most Cited Cases

Submission in opposition to, or in support of, summary judgment need be considered only to the extent that it would be admissible at trial. Fed.Rules Civ.Proc.Rule 56, 28 U.S.C.A.

[2] Securities Regulation 349B ⚷25.21(4)

349B Securities Regulation
349BI Federal Regulation
349BI(B) Registration and Distribution
349BI(B)4 Registration Statements
349Bk25.17 False Statements or Omissions; Accuracy
349Bk25.21 Grounds of and Defenses to Liability
349Bk25.21(4) k. Good faith; due diligence or reasonable investigation. Most Cited Cases

Securities Regulation 349B ⚷25.62(2)

349B Securities Regulation
349BI Federal Regulation
349BI(B) Registration and Distribution
349BI(B)5 Prospectuses and Communications
349Bk25.55 False Statements or Omissions; Accuracy
349Bk25.62 Grounds of and Defenses to Liability
349Bk25.62(2) k. Scienter; fault or due diligence. Most Cited Cases

A defendant's assertion of the due diligence defense requires an exquisitely fact intensive inquiry into all of the circumstances surrounding the facts upon which a claim under Securities Act section attaching civil liability to material misstatements or omissions in a registration statement is premised,

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and the same is true for a defense of reasonable care under Securities Act section attaching civil liability to material misstatements or omissions in a prospectus. Securities Act of 1933, §§ 11(b)(3)(A), 12(a)(2), 15 U.S.C.A. §§ 77k(b)(3)(A), 77*l*(a)(2).

[3] Securities Regulation 349B ⚷25.35

349B Securities Regulation
349BI Federal Regulation
349BI(B) Registration and Distribution
349BI(B)4 Registration Statements
349Bk25.35 k. Questions of law or fact; jury questions. Most Cited Cases

Securities Regulation 349B ⚷25.75

349B Securities Regulation
349BI Federal Regulation
349BI(B) Registration and Distribution
349BI(B)5 Prospectuses and Communications
349Bk25.75 k. Questions of law or fact; jury questions. Most Cited Cases

Questions of reasonableness, as defense to claims under Securities Act provisions attaching civil liability to material misstatements or omissions in registration statement or prospectus, are mixed questions of law and fact that are often reserved for the trier of fact. Securities Act of 1933, §§ 11(b)(3)(A), 12(a)(2), 15 U.S.C.A. §§ 77k(b)(3)(A), 77*l*(a)(2).

[4] Federal Civil Procedure 170A ⚷2511

170A Federal Civil Procedure
170AXVII Judgment
170AXVII(C) Summary Judgment
170AXVII(C)2 Particular Cases
170Ak2511 k. Securities cases in general. Most Cited Cases

Even the issue of materiality of misrepresentations or omissions in registration statement or prospectus, which requires delicate assessments of the inferences a "reasonable shareholder" would draw from a given set of facts and the significance of those inferences to him, assessments that are peculiarly ones for the trier of fact, is appropriately resolved as a matter of law by summary judgment, where the misrepresentations or omissions are so obviously important to an investor that reasonable minds cannot differ on the question. Securities Act of 1933, §§ 11(b)(3)(A), 12(a)(2), 15 U.S.C.A. §§ 77k(b)(3)(A), 77*l*(a)(2); Fed.Rules Civ.Proc.Rule 56, 28 U.S.C.A.

[5] Securities Regulation 349B ⚷25.10

349B Securities Regulation
349BI Federal Regulation
349BI(B) Registration and Distribution
349BI(B)4 Registration Statements
349Bk25.10 k. In general. Most Cited Cases

Securities Regulation 349B ⚷25.50

349B Securities Regulation
349BI Federal Regulation
349BI(B) Registration and Distribution
349BI(B)5 Prospectuses and Communications
349Bk25.50 k. In general. Most Cited Cases

In order to provide investors with full disclosure of material information concerning public offerings of securities, the Securities Act requires the filing and distribution of certain documents in connection with such an offering, including a registration statement and a prospectus. Securities Act of 1933, §§ 11(b)(3)(A), 12(a)(2), 15 U.S.C.A. §§ 77k(b)(3)(A), 77*l*(a)(2).

[6] Securities Regulation 349B ⚷25.18

349B Securities Regulation
349BI Federal Regulation
349BI(B) Registration and Distribution
349BI(B)4 Registration Statements
349Bk25.17 False Statements or Omissions; Accuracy

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349Bk25.18 k. In general. Most Cited Cases

Securities Regulation 349B 25.56

349B Securities Regulation
349BI Federal Regulation
349BI(B) Registration and Distribution
349BI(B)5 Prospectuses and Communications
349Bk25.55 False Statements or Omissions; Accuracy
349Bk25.56 k. In general. Most Cited Cases

Securities Act provisions attaching civil liability to material misstatements or omissions in a registration statement or prospectus are notable both for the limitations on their scope as well as the in terrorem nature of the liability they create. Securities Act of 1933, §§ 11(b)(3)(A), 12(a)(2), 15 U.S.C.A. §§ 77k(b)(3)(A), 77*l*(a)(2).

[7] Securities Regulation 349B 25.20(1)

349B Securities Regulation
349BI Federal Regulation
349BI(B) Registration and Distribution
349BI(B)4 Registration Statements
349Bk25.17 False Statements or Omissions; Accuracy
349Bk25.20 Persons Liable
349Bk25.20(1) k. In general. Most Cited Cases

Securities Act provision attaching civil liability to material misstatements or omissions in a registration statement was designed to assure compliance with the disclosure provisions of the Act by imposing a stringent standard of liability on the parties who play a direct role in a registered offering. Securities Act of 1933, § 11, 15 U.S.C.A. § 77k.

[8] Securities Regulation 349B 25.19

349B Securities Regulation
349BI Federal Regulation
349BI(B) Registration and Distribution
349BI(B)4 Registration Statements
349Bk25.17 False Statements or Omissions; Accuracy
349Bk25.19 k. Persons entitled to sue or recover. Most Cited Cases

Securities Regulation 349B 25.20(1)

349B Securities Regulation
349BI Federal Regulation
349BI(B) Registration and Distribution
349BI(B)4 Registration Statements
349Bk25.17 False Statements or Omissions; Accuracy
349Bk25.20 Persons Liable
349Bk25.20(1) k. In general. Most Cited Cases

Securities Act provisions attaching civil liability to material misstatements or omissions in a registration statement grants the purchaser of a security a cause of action against the issuer and underwriter, among others, where any part of a registration statement, at the time it became effective, contained a material misstatement or omissions. Securities Act of 1933, § 11, 15 U.S.C.A. § 77k.

[9] Securities Regulation 349B 25.21(2)

349B Securities Regulation
349BI Federal Regulation
349BI(B) Registration and Distribution
349BI(B)4 Registration Statements
349Bk25.17 False Statements or Omissions; Accuracy
349Bk25.21 Grounds of and Defenses to Liability
349Bk25.21(2) k. Scienter, absolute or strict liability. Most Cited Cases

While issuers are subject to virtually absolute liability under Securities Act provision attaching civil liability to material misstatements or omissions in a registration statement, underwriters may

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be held liable for mere negligence. Securities Act of 1933, § 11(b)(3), 15 U.S.C.A. § 77k(b)(3).

[10] Securities Regulation 349B ⚷25.21(4)

349B Securities Regulation
349BI Federal Regulation
349BI(B) Registration and Distribution
349BI(B)4 Registration Statements
349Bk25.17 False Statements or Omissions; Accuracy
349Bk25.21 Grounds of and Defenses to Liability
349Bk25.21(4) k. Good faith; due diligence or reasonable investigation. Most Cited Cases

"Reasonable investigation" that would support due diligence defense to claim under Securities Act provision attaching civil liability to material misstatements or omissions in a registration statement must be thorough and searching, with systematic attention to detail and relationship. Securities Act of 1933, § 11(b)(3), 15 U.S.C.A. § 77k(b)(3); 17 C.F.R. § 230.176.

[11] Securities Regulation 349B ⚷25.21(4)

349B Securities Regulation
349BI Federal Regulation
349BI(B) Registration and Distribution
349BI(B)4 Registration Statements
349Bk25.17 False Statements or Omissions; Accuracy
349Bk25.21 Grounds of and Defenses to Liability
349Bk25.21(4) k. Good faith; due diligence or reasonable investigation. Most Cited Cases

Even if a reasonable investigation would have proven futile in uncovering the fraud or misstatements alleged, a defendant must establish that it undertook such investigation in order to claim the benefit of due diligence defense to claim under Securities Act provision attaching civil liability to material misstatements or omissions in a registration statement. Securities Act of 1933, § 11(c), 15 U.S.C.A. § 77k(c); 17 C.F.R. § 230.176.

[12] Securities Regulation 349B ⚷25.21(4)

349B Securities Regulation
349BI Federal Regulation
349BI(B) Registration and Distribution
349BI(B)4 Registration Statements
349Bk25.17 False Statements or Omissions; Accuracy
349Bk25.21 Grounds of and Defenses to Liability
349Bk25.21(4) k. Good faith; due diligence or reasonable investigation. Most Cited Cases

In context of due diligence defense to claim under Securities Act provision attaching civil liability to material misstatements or omissions in registration statement, there is a "sliding scale" in the diligence required of parties, with heavier demands of those with more central roles and greater access to the information and expertise needed to confirm the accuracy of the registration statement. Securities Act of 1933, § 11(b)(3), 15 U.S.C.A. § 77k(b)(3).

[13] Securities Regulation 349B ⚷25.20(1)

349B Securities Regulation
349BI Federal Regulation
349BI(B) Registration and Distribution
349BI(B)4 Registration Statements
349Bk25.17 False Statements or Omissions; Accuracy
349Bk25.20 Persons Liable
349Bk25.20(1) k. In general. Most Cited Cases

For those whose moral responsibility to the public is particularly heavy, such as underwriters, there is a correspondingly heavier legal liability under Securities Act provision attaching civil liability to material misstatements or omissions in registration statement. Securities Act of 1933, § 11, 15

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U.S.C.A. § 77k.

[14] Securities Regulation 349B ⚷25.21(2)

349B Securities Regulation
349BI Federal Regulation
349BI(B) Registration and Distribution
349BI(B)4 Registration Statements
349Bk25.17 False Statements or Omissions; Accuracy
349Bk25.21 Grounds of and Defenses to Liability
349Bk25.21(2) k. Scienter, absolute or strict liability. Most Cited Cases

Securities Regulation 349B ⚷25.21(4)

349B Securities Regulation
349BI Federal Regulation
349BI(B) Registration and Distribution
349BI(B)4 Registration Statements
349Bk25.17 False Statements or Omissions; Accuracy
349Bk25.21 Grounds of and Defenses to Liability
349Bk25.21(4) k. Good faith; due diligence or reasonable investigation. Most Cited Cases

Issuers are strictly liable for the material accuracy of registration statements, and the diligence required of inside directors is so great that liability will lie in practically all cases of misrepresentation. Securities Act of 1933, § 11, 15 U.S.C.A. § 77k.

[15] Securities Regulation 349B ⚷25.20(1)

349B Securities Regulation
349BI Federal Regulation
349BI(B) Registration and Distribution
349BI(B)4 Registration Statements
349Bk25.17 False Statements or Omissions; Accuracy
349Bk25.20 Persons Liable
349Bk25.20(1) k. In general. Most Cited Cases

In context of claim under Securities Act provision attaching civil liability to material misstatements or omissions in registration statement, no greater reliance in self-regulatory system is placed on any single participant in the issuance of securities than upon the underwriter. Securities Act of 1933, § 11, 15 U.S.C.A. § 77k.

[16] Securities Regulation 349B ⚷25.21(4)

349B Securities Regulation
349BI Federal Regulation
349BI(B) Registration and Distribution
349BI(B)4 Registration Statements
349Bk25.17 False Statements or Omissions; Accuracy
349Bk25.21 Grounds of and Defenses to Liability
349Bk25.21(4) k. Good faith; due diligence or reasonable investigation. Most Cited Cases

To avail itself of the due diligence defense to claim under Securities Act provision attaching civil liability to material misstatements or omissions in registration statement, an underwriter must conduct an investigation reasonably calculated to reveal all those facts that would be of interest to a reasonably prudent investor. Securities Act of 1933, § 11, 15 U.S.C.A. § 77k.

[17] Securities Regulation 349B ⚷25.21(4)

349B Securities Regulation
349BI Federal Regulation
349BI(B) Registration and Distribution
349BI(B)4 Registration Statements
349Bk25.17 False Statements or Omissions; Accuracy
349Bk25.21 Grounds of and Defenses to Liability
349Bk25.21(4) k. Good faith; due diligence or reasonable investigation. Most Cited Cases

In context of due diligence defense to claim un-

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der Securities Act provision attaching civil liability to material misstatements or omissions in registration statement, by associating himself with a proposed offering an underwriter impliedly represents that he has made a reasonable investigation in accordance with professional standards; investors properly rely on this added protection. Securities Act of 1933, § 11, 15 U.S.C.A. § 77k.

[18] Securities Regulation 349B ⚷25.21(4)

349B Securities Regulation
349BI Federal Regulation
349BI(B) Registration and Distribution
349BI(B)4 Registration Statements
349Bk25.17 False Statements or Omissions; Accuracy
349Bk25.21 Grounds of and Defenses to Liability
349Bk25.21(4) k. Good faith; due diligence or reasonable investigation. Most Cited Cases

For purposes of the due diligence defense to claim under Securities Act provision attaching civil liability to material misstatements or omissions in registration statement, a "red flag" is any information that would cause a prudent man in the management of his own property to question the accuracy of the registration statement. Securities Act of 1933, § 11, 15 U.S.C.A. § 77k.

[19] Securities Regulation 349B ⚷25.21(4)

349B Securities Regulation
349BI Federal Regulation
349BI(B) Registration and Distribution
349BI(B)4 Registration Statements
349Bk25.17 False Statements or Omissions; Accuracy
349Bk25.21 Grounds of and Defenses to Liability
349Bk25.21(4) k. Good faith; due diligence or reasonable investigation. Most Cited Cases

In context of claim under Securities Act provision attaching civil liability to material misstatements or omissions in registration statement, where a defendant encounters a red flag, a duty of investigation arises that requires the defendant to look deeper and question more in order to restore a reasonable belief in registration statement's accuracy. Securities Act of 1933, § 11, 15 U.S.C.A. § 77k.

[20] Securities Regulation 349B ⚷25.18

349B Securities Regulation
349BI Federal Regulation
349BI(B) Registration and Distribution
349BI(B)4 Registration Statements
349Bk25.17 False Statements or Omissions; Accuracy
349Bk25.18 k. In general. Most Cited Cases

What constitutes a red flag that would require a defendant to investigate accuracy of registration statement depends on the facts and context of a particular case under Securities Act provision attaching civil liability to material misstatements or omissions in registration statement and may require an exquisitely fact intensive inquiry. Securities Act of 1933, § 11, 15 U.S.C.A. § 77k.

[21] Securities Regulation 349B ⚷25.21(4)

349B Securities Regulation
349BI Federal Regulation
349BI(B) Registration and Distribution
349BI(B)4 Registration Statements
349Bk25.17 False Statements or Omissions; Accuracy
349Bk25.21 Grounds of and Defenses to Liability
349Bk25.21(4) k. Good faith; due diligence or reasonable investigation. Most Cited Cases

Industry standards are relevant to due diligence defense's reasonableness inquiry, in action under Securities Act provision attaching civil liability to

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material misstatements or omissions in registration statement, but ultimate question remains whether, given a defendant's role in offering and access to material information, defendant's investigation of and belief in accuracy of registration statement was that of prudent man in management of his own property. Securities Act of 1933, § 11, 15 U.S.C.A. § 77k.

[22] Securities Regulation 349B ⚷25.21(4)

349B Securities Regulation
349BI Federal Regulation
349BI(B) Registration and Distribution
349BI(B)4 Registration Statements
349Bk25.17 False Statements or Omissions; Accuracy
349Bk25.21 Grounds of and Defenses to Liability
349Bk25.21(4) k. Good faith; due diligence or reasonable investigation. Most Cited Cases

Industry standards will be less relevant to due diligence defense's reasonableness inquiry, in action under Securities Act provision attaching civil liability to material misstatements or omissions in registration statement, when industry is comprised of only few participants who controlled practice, as standard they developed could fall short of standard of reasonable care, and indeed these standard setters might engage in "race to the bottom." Securities Act of 1933, § 11, 15 U.S.C.A. § 77k.

[23] Securities Regulation 349B ⚷25.62(2)

349B Securities Regulation
349BI Federal Regulation
349BI(B) Registration and Distribution
349BI(B)5 Prospectuses and Communications
349Bk25.55 False Statements or Omissions; Accuracy
349Bk25.62 Grounds of and Defenses to Liability
349Bk25.62(2) k. Scienter; fault or due diligence. Most Cited Cases

Reasonable care defense to claim under Securities Act provision attaching civil liability to material misstatements or omissions in prospectus is less demanding in some respects than due diligence defense to claim under provision attaching civil liability to material misstatements or omissions in registration statement. Securities Act of 1933, §§ 11, 12, 15 U.S.C.A. §§ 77k, 77*l*.

[24] Securities Regulation 349B ⚷25.21(2)

349B Securities Regulation
349BI Federal Regulation
349BI(B) Registration and Distribution
349BI(B)4 Registration Statements
349Bk25.17 False Statements or Omissions; Accuracy
349Bk25.21 Grounds of and Defenses to Liability
349Bk25.21(2) k. Scienter, absolute or strict liability. Most Cited Cases

Securities Regulation 349B ⚷25.21(4)

349B Securities Regulation
349BI Federal Regulation
349BI(B) Registration and Distribution
349BI(B)4 Registration Statements
349Bk25.17 False Statements or Omissions; Accuracy
349Bk25.21 Grounds of and Defenses to Liability
349Bk25.21(4) k. Good faith; due diligence or reasonable investigation. Most Cited Cases

Securities Regulation 349B ⚷25.62(2)

349B Securities Regulation
349BI Federal Regulation
349BI(B) Registration and Distribution
349BI(B)5 Prospectuses and Communications
349Bk25.55 False Statements or Omissions; Accuracy

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349Bk25.62 Grounds of and Defenses to Liability
349Bk25.62(2) k. Scienter; fault or due diligence. Most Cited Cases

While Securities Act provision attaching civil liability to material misstatements or omissions in registration statement imposes a duty to conduct a reasonable investigation as to any portion of a registration statement not made on the authority of an expert, Securities Act provision attaching civil liability to material misstatements or omissions in a prospectus does not make any distinction based upon "expertised" statements and only requires the defendant to show that it used reasonable care; yet, under either section, defendants may be held liable for mere negligence. Securities Act of 1933, §§ 11(b)(3)(A), 12(a)(2), 15 U.S.C.A. §§ 77k(b)(3)(A), 77*l*(a)(2).

[25] Securities Regulation 349B ⚷25.21(4)

349B Securities Regulation
349BI Federal Regulation
349BI(B) Registration and Distribution
349BI(B)4 Registration Statements
349Bk25.17 False Statements or Omissions; Accuracy
349Bk25.21 Grounds of and Defenses to Liability
349Bk25.21(4) k. Good faith; due diligence or reasonable investigation. Most Cited Cases

Securities Regulation 349B ⚷25.62(2)

349B Securities Regulation
349BI Federal Regulation
349BI(B) Registration and Distribution
349BI(B)5 Prospectuses and Communications
349Bk25.55 False Statements or Omissions; Accuracy
349Bk25.62 Grounds of and Defenses to Liability
349Bk25.62(2) k. Scienter; fault or due diligence. Most Cited Cases

Financial institution involved in packaging, marketing, and sale of residential mortgage-backed securities (RMBS) purchased by government sponsored enterprises (GSEs) failed to conduct reasonable investigation or exercise reasonable care to confirm accuracy of representations in offering documents for RMBS, thus precluding its due diligence and reasonable care defenses under Securities Act provisions attaching civil liability to material misstatements or omissions in registration statement or prospectus, in action brought by Federal Housing Finance Agency (FHFA), as conservator for GSEs; institution made no attempt to reliably verify accuracy of its representations concerning certificates backed by supporting loan groups, and institution failed to reasonably respond to red flags raised by high kick-out-rates in sampled bulk pools. Securities Act of 1933, §§ 11, 12, 15 U.S.C.A. §§ 77k, 77*l*.

[26] Securities Regulation 349B ⚷25.21(4)

349B Securities Regulation
349BI Federal Regulation
349BI(B) Registration and Distribution
349BI(B)4 Registration Statements
349Bk25.17 False Statements or Omissions; Accuracy
349Bk25.21 Grounds of and Defenses to Liability
349Bk25.21(4) k. Good faith; due diligence or reasonable investigation. Most Cited Cases

Securities Regulation 349B ⚷25.62(2)

349B Securities Regulation
349BI Federal Regulation
349BI(B) Registration and Distribution
349BI(B)5 Prospectuses and Communications
349Bk25.55 False Statements or Omissions; Accuracy
349Bk25.62 Grounds of and De-

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fenses to Liability
349Bk25.62(2) k. Scienter; fault or due diligence. Most Cited Cases

Underwriter of residential mortgage-backed securities (RMBS) purchased by government sponsored enterprises (GSEs) failed to conduct reasonable investigation or exercise reasonable care to confirm accuracy of representations in offering documents, thus precluding its due diligence and reasonable care defenses under Securities Act provisions attaching civil liability to material misstatements or omissions in registration statement or prospectus, in action brought by Federal Housing Finance Agency (FHFA), as conservator for GSEs; underwriter signed off on representations concerning loans in one securitization, having seen only one-page summary of issuer's pre-acquisition review of all trade pools that contributed loans to that securitization and list of those originators who contributed more than five percent of loans to securitization, and performed no review of underlying loans in another securitization, and there was no evidence that underwriter ever asked in connection with either securitization how loans in trade pools were mapped to supporting loan groups (SGLs). Securities Act of 1933, §§ 11(b)(3)(A), 12(a)(2), 15 U.S.C.A. §§ 77k(b)(3)(A), 77*l*(a)(2).

Philippe Z. Selendy, Andrew R. Dunlap, David B. Schwartz, Quinn Emanuel Urquhart & Sullivan, LLP, New York, NY, for Plaintiff Federal Housing Finance Agency.

David B. Tulchin, Steven L. Holley, Bruce E. Clark, Bradley A. Harsch, Katherine J. Stoller, Sullivan & Cromwell LLP, Amanda F. Davidoff, Elizabeth A. Cassady, Sullivan & Cromwell LLP, Washington, DC, for Nomura Holding America Inc., Nomura Asset Acceptance Corp., Nomura Home Equity Loan, Inc., Nomura Credit & Capital, Inc., Nomura Securities Int'l, Inc., David Findlay, John McCarthy, John P. Graham, Nathan Gorin, and N. Dante LaRocca.

Thomas C. Rice, David J. Woll, Andrew T. Frankel, Alan Turner, Craig S. Waldman, Simpson Thacher & Bartlett LLP, New York, NY, for RBS Securities Inc.

OPINION & ORDER

DENISE COTE, District Judge:

***1** Plaintiff Federal Housing Finance Agency ("FHFA"), as conservator for the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac") (together, the Government–Sponsored Enterprises or "GSEs"), brings this action against financial institutions involved in the packaging, marketing, and sale of residential mortgage-backed securities ("RMBS") purchased by the GSEs between 2005 and 2007, alleging among other things that defendants [FN1] made materially false statements in offering documents for the RMBS (the "Offering Documents"). This is one of sixteen related actions brought by FHFA that have been litigated before this Court. All but this action have settled. This remaining action concerns seven RMBS created by Nomura (the "Securitizations").

In each of these Securitizations, one of the GSEs purchased a certificate backed by a pool of loans known as a supporting loan group ("SLG"). Those certificates (the "Certificates") were sold by underwriters, including—for four of the Securitizations—RBS. [FN2] The GSEs purchased the seven Certificates for more than $2 billion. [FN3] Nomura and RBS are strictly liable for any material misrepresentations in the Offering Documents for those Certificates, unless they can avail themselves of one of a limited number of statutory defenses.

On November 10, 2014, FHFA moved for partial summary judgment on the Defendants' due diligence and reasonable care defenses under Section 11 [FN4] and Section 12(a)(2) of the Securities Act of 1933 (the "Securities Act"), 15 U.S.C. §§ 77k(b)(3)(A), 77*l*(a)(2), and similar provisions of the D.C. and Virginia Blue Sky Acts, D.C.Code § 31–5606.05(a)(1)(B); Va.Code § 13.1–522(A)(ii) (the "Blue Sky Laws"). This motion was fully sub-

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mitted on December 12.

The reasonableness of a defendant's due diligence investigation will, in most cases, be a question for the jury. It is a mixed question of law and fact that will often hinge on disputed factual issues. Even when it does not, reasonable minds could often disagree about whether a given investigation would have satisfied a prudent man in the management of his own property. In exceptional cases, where no reasonable, properly instructed jury could find for a defendant, summary judgment is appropriate. For the reasons explained at length below, this is such a case.

Here, the loans within each of the groups that supported the seven Certificates were loans that Nomura itself had previously purchased. There were over 15,000 such loans within the seven SLGs. Nomura never conducted a due diligence program to confirm the accuracy of the representations in the Offering Documents about the 15,000 loans in the SLGs at or near the time of the securitization. Nor did it undertake such a review of the loans at or about the time Nomura selected the loans for and placed them within the SLGs. Instead, to support its reliance on the affirmative defenses of due diligence and reasonable care, Nomura points to its program for reviewing loans before purchasing them. The 15,000 loans in the SLGs at issue here were drawn from close to 200 pools of loans that Nomura had purchased (the "Trade Pools") from loan originators.

*2 While it is conceivable that a review of loans at purchase—which may occur months before Nomura selects the loans to be placed in a particular SLG—might have been sufficient for a jury to find in Nomura's favor on these affirmative defenses, the pre-purchase review that Nomura conducted here was not adequate for that purpose as a matter of law. Nomura's post hoc attempts in its briefing to piece together the façade of a due diligence program from reviews Nomura undertook before purchasing more than fifty thousand loans in hundreds of trade pools, portions of which would later contribute to the seven relevant SLGs in the Securitizations, simply underscore the lack of evidence that Nomura undertook any reasonable investigation of the accuracy of its representations about the SLGs before issuing the Certificates.

Nomura's pre-acquisition review was not designed to ensure the accuracy of the descriptions in the Offering Documents of the SLGs that backed the Certificates. Nomura tested samples of loans as it purchased them, but then weeks or months later pulled certain kinds of loans (reviewed and unreviewed) to form the SLGs without taking any care to ensure that the findings from its pre-purchase review program could be reliably applied to the SLGs. This broke the link between the results of Nomura's pre-acquisition sampling and the characteristics of particular SLGs as they were described in the Offering Documents. Nomura has offered no evidence that it considered how its selection of particular loans for the SLGs impacted its reliance on the sampling of the trade pools. Indeed, there is no evidence Nomura took any care to structure its processes—its pre-acquisition sampling, its construction of SLGs, or its pre-securitization review of the sampling results—to ensure the accuracy of its representations about the SLGs in the Offering Documents.

Even putting aside this fundamental error, Nomura's pre-acquisition review was poorly designed and not implemented in a way that could give reasonable assurance that the kinds of representations that Nomura included in its Offering Documents were accurate. But, even if one assumed that that review were adequate, Nomura's pre-acquisition review raised red flags Nomura ignored. Despite high "kick-out" rates in the Trade Pools that populated the seven Securitizations, never once did Nomura upsize its sample to test whether it had sufficiently culled loans. Indeed, in at least some cases, Nomura's bid to buy loans from their originators included a stipulation that Nomura would limit its pre-purchase sampling.

Most importantly, there is simply no evidence

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Nomura ever considered the implications of these kick-out rates for the quality of the loans it would later place in the SLGs and describe in the Offering Documents. No reasonable jury could find that Nomura conducted reasonable investigations or exercised reasonable care with respect to these seven Securitizations.

And RBS, although it agreed to act as sole lead underwriter for three of the Securitizations and co-lead for a fourth, made little real effort to test the accuracy of the representations about the SLGs. Unlike Nomura, to the extent RBS conducted a review of loans, it did so after the composition of the SLGs had been determined. But, for two of the Securitizations, RBS undertook no independent review of the loan files. For one of these two, RBS knew nothing of the results of Nomura's pre-acquisition review of the loan pools from which Nomura selected loans to populate the Securitization beyond a one-page summary that warned the summary might be neither "complete" nor "accurate." For the other, RBS was the sole lead underwriter, yet it relied entirely on Nomura's pre-acquisition reviews of the Trade Pools.

***3** RBS did review loans in the other two Securitizations for which it served as sole lead underwriter, but these reviews were manifestly inadequate as a matter of law. For one of these two, RBS's Credit Group called the loans "crap" and asked to review one-quarter of them, but was told that RBS did not "own" these loans—RBS ultimately decided to sample less than one-fourth that number. But, even then, when RBS failed to collect all of the files for those small samples, RBS simply proceeded with a review of incomplete sets. To make matters worse, RBS appeared to ignore entirely the results of its valuation reviews in both of these Securitizations, taking no action when a substantial portion of its sampled loans in both groups appeared to have faulty appraisals. Those loans were securitized, and the Offering Documents calculated loan-to-value ("LTV") [FN5] ratios based on the potentially faulty appraisals. For these and other reasons, no reasonable jury could find that RBS undertook a reasonable investigation or exercised reasonable care as underwriter for any of these four Securitizations.

BACKGROUND

The adequacy of any due diligence program is a fact-intensive inquiry, and therefore, ordinarily a matter addressed at trial. But, based on the record here, summary judgment is appropriate.

Below are the principal facts cited in Defendants' major arguments, as well as needed context for those facts. All factual disputes are resolved in Defendants' favor, and all reasonable inferences are drawn in Defendants' favor, as non-movants. Where Defendants offered a litany of similar examples, the Court has attempted to select the strongest or most illustrative. [FN6]

I. RMBS, in Brief

RMBS are securities entitling the holder to income payments from pools of residential mortgage loans held by a trust; these pools are called Supporting Loan Groups or SLGs. Each of the mortgage loans underlying the Securities at issue (the "Mortgage Loans") began as a loan application approved by a financial institution, known as the loan's originator (the "Originator"). [FN7] Nomura acted as an "aggregator" here, purchasing Alt–A and subprime mortgage loans [FN8] and then pooling them together, on the basis of credit or other characteristics. The loans selected for a given Securitization were transferred to a trust created specifically for that private-label securitization, or "PLS" (a special purpose vehicle or "SPV").

Within a given Securitization, the loans were placed into one or more Supporting Loan Groups. For example, Nomura's NHELI 2006–FM1 Securitization, offered through a Prospectus Supplement of October 31, 2006, was composed of fourteen classes of certificates, or "tranches," and two supporting loan groups with an aggregated stated principal balance of over $1.1 billion. Nomura represented that the original principal balances of the

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loans in Group I "conform[ed] to Freddie Mac loan limits," and made no such guarantee about the loans in Group II.

***4** The trust then issued certificates, and underwriters sold the certificates to investors like Freddie Mac. These certificates entitled the holder to a stream of income from borrowers' payments on the loans in a particular SLG. Thus, a certificate's value largely depended on the ability of mortgagors to repay the loan principal and interest and the adequacy of the collateral in the event of default. The process that generated the Certificates is described in greater detail below.

II. Origination: A Loan Is Approved

First, a homeowner or prospective homeowner applied for a mortgage loan to a bank or other financial institution (the "originator" of the loan). If the loan was needed to purchase the home, it was called a "Purchase Money Loan." Alternatively, the applicant might be seeking to refinance an existing loan (a "Refinance Loan"), or to liquidate a portion of the applicant's equity in an already-mortgaged home (a "Second Mortgage").

The relevant documents for each loan application were collected into "loan files." These documents would include those submitted by the applicant, as well as certain documents created by the originator in the course of reviewing the loan application. Each loan file was reviewed in a process called "underwriting" at one or more times before the loan was placed in a securitization. Underwriting was done in connection with a set of guidelines limiting the sorts of loans an originator would make, called "underwriting guidelines."

In the first instance, the originator was expected to underwrite each loan it approved, confirming that it met applicable underwriting guidelines, was valued reasonably and accurately, and was not fraudulent. Originators could make case-by-case exceptions to their underwriting guidelines when a loan application failed to meet a certain guideline but appeared to nonetheless qualify for a mortgage program based on compensating factors indicating that the applicant was a sufficiently good credit risk. As will be seen below, originators did not always faithfully underwrite their loans.

III. Enter Nomura: Purchase of the Loans

Nomura Credit & Capital Inc. ("NCCI"), acting as an "aggregator" of the mortgage loans, acquired loans from originators in order to pool them into supporting loan groups that would be tied to securities sold to investors. The originator might be selling a group of loans in bulk—a "bulk trade pool" or a "mini-bulk trade pool," depending on whether the aggregate principal balance of the loans was greater or less than $25 million—or, if the loans had been underwritten to Nomura's "conduit" guidelines, it might be selling them loan-by-loan.[FN9] The Supporting Loan Groups for the Certificates here were composed of 15,806 loans, drawn from 194 Trade Pools [FN10] and 122 individual loans purchased through Nomura's conduit channel. Of those 194 Trade Pools, 140 were mini-bulk pools (the "Mini–Bulk Pools")—contributing 1,561 loans to the SLGs (approximately 10% of the SLGs)—and the remaining 54 were bulk pools (the "Bulk Pools"), which contributed 14,123 loans to the SLGs (approximately 89%).

***5** A trader at Nomura's Trading Desk, learning of a sale of loans by an originator Nomura had approved following a counterparty review, would bid to purchase them. Before bidding on a pool of loans, a Nomura collateral analyst would receive and review a "loan tape"—a spreadsheet listing selected characteristics of each loan in the pool—and recalculate certain values, like the LTV and debt-to-income ("DTI") ratios, based on data on the loan tape (in the case of the LTV ratio, the loan amount and the appraisal or sale price of the property) to test the internal consistency of the data. If the Nomura trader won the bid, Nomura was permitted to review some or all of the loan files before final settlement of the trade.

The review of loans was undertaken by Nomura's Diligence Group (also called the "Credit

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Group" or "Residential Credit Group") [FN11] and by vendors chosen by Nomura. During the relevant period, the Diligence Group consisted of between three and five employees, including the head of the group: from 2005 through mid–2006, Joseph Kohout ("Kohout"), and afterward Neil Spagna ("Spagna"). According to a fellow employee, "[o]ne of [Kohout's] favorite lines was[, 'W]e are not staffed for this, we are not staffed for this....['] They could be ordering lunch, I think he was understaffed for that...." Kohout and Spagna have both testified that their staffing was "adequate" to conduct pre-acquisition loan reviews.

The Diligence Group was responsible for three different reviews for each trade pool: (1) credit review, in which the loan files for some or all of the loans were examined to determine if the loan was originated in accordance with the originator's credit guidelines; (2) compliance review, in which the loan files for some or all of the loans were examined to determine if the loan complied with federal, state, and municipal regulations; and (3) valuation review (or "collateral review"), in which the Diligence Group determined if some or all of the appraisals of the loans' underlying properties were reasonable and accurate.

The number of loans reviewed depended upon the deal and the type of review. Valuation review was conducted on all loans. Credit and compliance reviews were usually conducted on all loans in a mini-bulk trade pool,[FN12] as well as any individual loans submitted through Nomura's conduit channel, but only for a sample of loans in a bulk pool. Nomura's sampling methods are described below, following a description of Nomura's valuation review.

A. Nomura's Valuation Review

Nomura submitted the loan tapes reflecting all loans in a trade pool to a vendor, either Hansen or CoreLogic, for valuation review. Hansen applied its valuation product, "PREVIEW," which contained the "ValueSure" automated valuation model ("AVM")—a computer program that computed an appraisal value for a property based on a database of real estate transactions, taking into account factors like recent transactions nearby, area history, and regional economic risk.

***6** The loan tape information sent to CoreLogic was first reviewed by "HistoryPro," a "proprietary risk assessment engine" that measured the risk of fraud or default for each loan and assigned it a corresponding "F–Score" between 0 and 25, with higher scores more likely to default. HistoryPro considered a number of factors, including "pricing and appraisal attributes" compared against property characteristics, sales history, comparable sales, and local market data. If a loan received an F–Score of 0, no further valuation testing was done. Approximately 52% of loans in the SLGs received F–Scores of 0. A loan with an F–Score between 1 and 9 was then reviewed by an AVM. If an AVM valuation by Hansen or CoreLogic was within 10% of the originator's appraisal of a subprime loan, or within 15% of the appraisal of an Alt–A loan (the relevant "variance thresholds"), no further valuation review was conducted.

If not, a broker price opinion ("BPO")—typically offered by a realtor, who visited the property, took photographs, and considered recently sold or listed comparable properties (a "drive-by")—was usually ordered from a BPO vendor. Among the 46,032 loans in the Trade Pools that underwent Nomura's valuation review (via HistoryPro or AVM), BPOs were ordered for 8,003 loans (17.4%), including 2,129 loans selected for the SLGs. For loans with an F–Score above 9, the AVM was bypassed and a BPO was ordered directly, or the loan was added to the credit and compliance sample discussed below.

Following the broker's drive-by, the BPO vendor would attempt to reconcile the BPO with the originator's appraisal. If the reconciled BPO differed from the originator's appraisal by more than the variance threshold (10% for a subprime loan, 15% for Alt–A), the loan was identified as defective. Nomura would ordinarily refuse to pur-

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chase the loan ("kick-out" the loan from the trade pool), unless the originator presented evidence rebutting the BPO, which was "rare." In such cases, Nomura sent the originator's rebuttal evidence to the BPO vendor, who would consider it and issue a "final [BPO] value."

162 loans—approximately 1% of the loans in the SLGs—had final BPOs that differed from the originator's appraisal by more than the relevant variance threshold, yet were included in the SLGs anyway. Of these 162 loans, more than 75% came from just four Trade Pools: Fremont's SP02 and SP03 (55 loans), and People's Choice's SP01 and SP02 (67 loans). Nomura has provided no documentation that reflects that it made an individualized assessment of the valuation discrepancies for these 162 loans or explains why they were not kicked out despite exceeding the variance threshold. Nomura has speculated that the Originators might have provided "additional information" here, but neither explains why this was not factored into the BPOs' "final values" nor presents any documentary evidence that this rare event occurred for any of these 162 loans, let alone 55 times for the two Fremont Pools and 67 times for the two People's Choice Pools.

B. Nomura's Sampling Methods for Credit and Compliance Reviews

1. Sample Size

*7 Nomura required a sample size of at least 20% of loans in each bulk trade pool for credit and compliance reviews; John Graham ("Graham"), who headed Nomura's Contract Finance and Transaction Management Groups, testified that samples were often approximately 30% of the pool. For 24 of the Bulk Pools, Nomura conducted credit and compliance review on all or nearly all of the loans. For the remaining 30 Bulk Pools—constituting approximately 80% of the loans in the 54 Bulk Pools, and 12,971 (82.1%) of the loans in the SLGs—sample sizes ranged from just over 20% to 50% (the "Sampled Bulk Pools"). Kohout explained that sample sizes might be higher in Nomura's first trades with an originator. The Trading Desk, not the Diligence Group, ultimately determined the appropriate sample size for each pool.

In some cases, the Trading Desk entered into agreements with originators that prohibited Nomura from sampling more than a fixed percentage of loans in the pool. For instance, Nomura agreed to review no more than between 24% and 30% of the following six trade pools: OwnIt SP02, Gateway 17A, People's Choice SP01 and SP02, and Silver State 62 and 66. Nomura's actual sample sizes were within 2% of those caps, with a single exception. FN13 In other cases, Nomura agreed to limit its sampling, but reserved the right to request a larger sample (to "upsize" the sample) in certain circumstances. Together, the Trading Desk agreed to limit its sampling for 15 of the 30 Sampled Bulk Pools and one of the Mini–Bulk Pools. As discussed below, there is no evidence Nomura upsized its sample in any of the Sampled Bulk Pools here.

2. Selection of Credit and Compliance Sample

Once the Trading Desk determined the sample size for credit and compliance review, it would relay that number to the Diligence Group, which would then select the sample. The Diligence Group selected an "adverse sample," which was meant to include the "most risky" loans. Kohout has estimated that 90% of Nomura's adverse sample was selected by a proprietary computer program created by rating agency Standard & Poor's ("S & P") called "LEVELS" that purported to measure the credit risk level of each loan.

Kohout objected to the use of LEVELS, stating in an email of April 21, 2005 to the Managing Director of Whole Loan Trading, Steven Katz ("Katz"), that "[t]his is a non industry standard approach," that "our process does not conform to what is generally deemed to be effective by industry standards," and that "when presenting our process to both internal and external parties, it will have to be made clear that Credit's role in both the sample selection and management of risk on bulk transactions has been diminished to the point of that

of a non effective entity pursuant to our limited role in the process." FN14

RBS traders recognized that credit risk did not necessarily correlate perfectly with the risk of fraud. In an email exchange in November 2006 concerning RBS's adverse sampling, one RBS employee asked another, "Given how fast loans are going bad in deals and how much fraud there appears to be, do you think we need to think about further refining our diligence efforts on the front." When the second employee replied that RBS "reunderwrite[s] about 25 to 30% of the [trade] pool selected in an adverse sample," the first responded, "we target lots of low [FICO] FN15 type loans but the low [FICO] type loans are not where we find all the fraud."

***8** The 10% of the sample not selected by LEVELS was chosen in an ad hoc fashion by the Diligence Group, considering risk factors including high DTI ratio, high LTV ratio, geographic "soft" markets, high loan amounts, documentation type, and concerns about the accuracy of the property appraisal. The Diligence Group's selections were relayed to the originator, who sent the loan files for the sample loans. FN16

3. Vendor Review of Credit and Compliance Sample

Nomura outsourced all of its credit and compliance review, in the first instance, to third-party vendors. For the Bulk Trade Pools here, Nomura employed the Clayton Group ("Clayton") and American Mortgage Consultants ("AMC"). Clayton is a leading RMBS review vendor; AMC, too, was used by a number of other RMBS issuers during the relevant period.

Clayton and AMC reviewed the loan files for the sample loans against the originator's underwriter guidelines ("reunderwriting"), in addition to certain "overlays" imposed by Nomura, FN17 and gave each loan a grade for both credit and compliance. "Event Level 1" ("EV1") indicated that the loan met the originator's guidelines (and Nomura's overlays); a grade of "EV2" indicated that a loan deviated from the guidelines (or overlays), but the deviation was immaterial or offset by compensating factors; and a grade of "EV3" indicated that the loan did not meet the guidelines (or overlays), or could not be evaluated because of documents missing from the loan file. The vendor could request further information or documentation from the originator.

Nomura exercised a great deal of control over the personnel assigned to its reviews: it required Nomura-specific teams composed of employees whose qualifications Nomura had reviewed, and it selected its own project leads. Vendors provided daily reports to the Diligence Group. At least once, in September 2005, an employee of the Diligence Group visited Clayton "to help review [a] trade." Employees of Nomura's vendors testified that Nomura took its reviews "seriously"; one called Nomura's Diligence Group "knowledgeable" and "professional."

As evidence of Nomura's "active engagement with its due diligence vendors," Nomura cites discussions between James Burt ("Burt"), Clayton's project lead for trade pool Fremont SP 02, and Kohout on October 5 and 6, 2005. Burt informed Kohout of an issue concerning certain forms in the sample; Kohout ordered Clayton to "[p]ull 20 files at random" (within the sample) to investigate the issue. Burt and Kohout also discussed a Massachusetts regulatory issue concerning the borrower's benefit from a loan. Clayton explained that "[i]t usually is left up to the client [aggregator] to decide if they feel like the [borrower's] benefit is adequate" to satisfy Massachusetts law; in response, Kohout instructed Clayton to "[c]lear [all of] the MA loans," instead of requesting individualized inquiry into borrower benefit.

4. Nomura's Review of Vendor Reports on Credit and Compliance Samples

***9** The Diligence Group reviewed the vendors' exception reports or "Individual Asset Summaries" concerning all sampled loans graded EV2 or EV3,

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which identified the ways in which a loan deviated from the guidelines or overlays. Some of these reports also identified compensating factors relied upon in assigning a loan a grade of EV2. The Diligence Group did not review the loan files. It also reviewed, at random, vendor reports concerning some portion of loans graded EV1. Kohout estimated this sample could be "anywhere from 25 to 50 percent of the 1s"; another Diligence Group employee testified he reviewed EV1s "[i]f time allowed."

Following its review of EV3 grades and a vendor's report, the Diligence Group frequently directed its vendor to regrade a loan as EV2; this was called a "client override" or "waiver." By FHFA's count, in the 54 Bulk Pools which contributed loans to the SLGs, Nomura's vendors graded 501 loans as EV3. The Diligence Group issued client overrides for 203 of these loans (approximately 40%), instructing the vendor to regrade them as EV2—*i.e.*, acceptable for purchase and securitization.[FN18] There is no evidence that the Diligence Group ever directed a vendor to regrade as EV3 a loan a vendor had graded as EV1 or EV2.

Nomura has produced a single post-closing quality control audit of Nomura's vendors' pre-acquisition reviews, performed by IngletBlair, LLC ("IngletBlair"). In July and August 2006, IngletBlair reviewed 189 loans securitized by Nomura from the fifteen originators Nomura had purchased the most loans from; 39 of these loans are in the SLGs for the Certificates. Of these 189, IngletBlair reviewed 109 loans that had been previously reviewed by a Nomura vendor, each receiving a final grade of EV1 or EV2. Upon its own review of those loans, IngletBlair graded 7 loans EV3 and another 29 loans EV4, indicating that "[t]he loan is missing critical documentation to determine loan eligibility." Accordingly, more than 30% of the securitized loans that had been graded EV1 or EV2 were determined either to warrant an EV3 or to lack critical information in the loan file that would permit an EV1 or EV2 grade. IngletBlair delivered these results to Nomura on August 24, 2006. Nomura has identified no evidence that it took any steps in response to this audit, including any change in its use or supervision of its vendors. Sales of four of the Certificates settled after this date.

5. Credit and Compliance Kick–Outs

Generally, any loan graded EV3 that was not regraded to EV2 following Nomura's review of the vendor reports was "kicked-out" of the trade pool: the Diligence Group would inform the originator that Nomura would not purchase those loans, and the originator would remove those loans from the trade pool before the trade settled. As Kohout testified, "there really isn't a recommended kickout," since "anything that remains in event level 3 is, in fact, kicked out."

In practice, in the Bulk Pools, Nomura purchased and then included in the SLGs 418 loans (2.6% of the SLGs' loans) that received a "final grade of [EV]3"—235 of those received a final EV3 for credit and 197 received a final EV3 for compliance (14 received an EV3 for both) (the "Securitized EV3 Loans").[FN19] For the NHELI 2007–1 Securitization, 8% of the SLGs' loans had received a final grade of EV3. Nomura has identified no evidence explaining the Diligence Group's or Trading Group's decision to purchase the Securitized EV3 Loans, although one of Nomura's experts has reunderwritten 17 of these loans and offered post hoc justifications that he contends would have supported regrading some of them as EV2s.

***10** The typical kick-out rate in Nomura's subprime or Alt–A trade pools is disputed. In an email of November 20, 2006, Spagna wrote, concerning review of certain Fremont trades, that "our kickout rate on some of these deals are much higher than our typical 7–8% for most subprime deals." The kick-out rates for those three pools were 6.48%, 11.22%, and 12.12%. The parties' expert reunderwriting witnesses have testified that the meaning of a kick-out rate depends upon the reason the loans were kicked out of the trade pool.

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6. Upsizing a Credit and Compliance Sample

When the Diligence Group sent the results of its review to the Trading Desk, it could recommend expanding the sample to include additional loan files. Graham recognized the "industry standard that you could increase the sample size ... if you found a trend that could reveal some particular issue in the origination," and testified that Nomura would upsize where it saw a negative "trend" in order to "determine if indeed that was something that was systematic and [Nomura would] further increas[e] the ... size of the sample until [it] w [as] satisfied." When asked if Nomura ever upsized a sample, Kohout "[could] not point to a specific trade," but confirmed "it did, in fact, happen." There is no evidence Nomura upsized a sample in any of Sampled Bulk Pools at issue here.[FN20]

Although the Diligence Group could recommend to the Trading Desk that a sample be upsized, the decision to request an upsize from an originator was ultimately the Trading Desk's. As Kohout explained, "[w]e would present the results and make recommendations, but whether sample sizes were ultimately increased or not was a function of the relationship between the trading desk and the counterparty." Upsizing required "buy in from the seller" because "[t]he seller ha[d] the loan files."

As noted above, in some cases the Trading Desk entered into agreements with originators that prohibited Nomura from sampling more than a fixed percentage of loans in the pool (in the examples cited above, between 25% and 30%); in other cases, Nomura agreed to limit its sampling, but reserved the right to request an upsize in the sample in certain circumstances. In all cases, Nomura could refuse to purchase the trade pool if an originator refused to permit upsizing. Again, there is no evidence Nomura upsized its sample of the Trade Pools at issue here.

An email exchange between Kohout and Katz on April 6, 2006 illustrates some of the concerns at play when considering an upsize. Katz emailed Kohout and others in the Diligence Group to "discuss the fallout on [a] trade" with originator People's Choice. In response, Kohout noted that 90 loans had been kicked out due to faulty appraisals and that 80 of those were accepted by the originator's in-house appraiser. Kohout stated, "[w]here a seller's in-house appraiser agrees with ±90% of the loans with value issues pursuant to [our] BPO's, there is obviously an inherent flaw in their origination process." Later that day, Kohout wrote that he "took a closer look" and "property valuation declines are off the charts" and reiterated that "the simple fact that only ±10% of the declines in this category were even disputed is further evidence of a systemic issue in this area on the origination side." Katz asked, "should we test more values? ? even if they passed muster on the initial screen? ?" Kohout replied:

> ***11** Would not be a bad idea. Especially, the higher LTV/CLTV [FN21] loans. However, playing devils advocate, doing so, would likely place Nomura in a position where we will not be given consideration on future trades. Do we care?

Katz responded: "we care.... We can always run them if you think we are at risk ... if there are large differences, we can hold onto them and present [them to the originator for repurchase] when they go down.... or if they go down."[FN22]

IV. Securitization: Nomura Bundles the Loans to Create Securities

1. Holding the Loans

When the Trading Desk's purchase of a trade pool settled, NCCI took title to the loans and received the loan files for the loans that had not been part of the pre-acquisition sample. There is no evidence Nomura reviewed any of these files, or conducted any further review of those loans, prior to the commencement of this litigation.

These loans were then held on NCCI's books until they were securitized. If a loan suffered an early payment default while Nomura was holding the loan, Nomura would not securitize it. More than two-thirds of the loans in the SLGs for the Certific-

ates were held on Nomura's books for at least two months; approximately 12% were held for five months or longer.

2. Selecting Loans for a Securitization from Trade Pools

As noted above, all but 122 of the 15,806 loans that comprise the SLGs were drawn from 194 Trade Pools.[FN23] The Trading Desk would instruct collateral analysts, who then selected loans from the Trade Pools to populate the SLGs in a given securitization. As one trader explained the "art of selecting the loans," he would "tell [his] Collateral Analyst what I want, how I want [the securitization pool to] look, what I think will suit the market, what's in demand." He considered factors including geographic concentrations, weighted average FICO scores, owner-occupancy status, and weighted average LTV ratios.

3. Representations in the Offering Documents

After the securitization was structured, Nomura's Transaction Management Group, with the assistance of outside accounting firms and outside counsel, would draft the offering documents to be sent to potential investors. In the Offering Documents for each Securitization, Defendants made representations to purchasers, like the GSEs, concerning the Mortgage Loans' adherence to applicable guidelines and the loans' characteristics. The Offering Documents included a Shelf Registration Statement filed with the Securities and Exchange Commission ("SEC"), as well as the relevant Prospectus and Prospectus Supplements.[FN24]

For instance, with respect to Supporting Loan Group I in Nomura's Securitization 2006–FM2 ("2006–FM2"),[FN25] an SLG that backed a senior Certificate purchased by Freddie Mac, Nomura represented that:

(1) "[a]ll of the mortgage loans were originated or acquired by [originator] Fremont, generally in accordance with the underwriting guidelines described in this section";[FN26]

***12** (2) 57.5% of the loans (or 68.4% of the pool by principal balance) had an LTV ratio[FN27] of 80% or lower, and 26.5% of the loans (or 31.1% of the pool by principal balance) had a CLTV ratio[FN28] of 80% or lower;

(3) 93.2% of the underlying properties were owner occupied; and

(4) the most senior class, I–A–1 would be given the highest credit rating by Standard & Poor's, Moody's, Fitch, and DBRS.

With respect to the second and third representations, Nomura stated that "[t]he Group I Mortgage Loans are expected to have [those] characteristics as of the Cut-off date," thirty days before the Securitization's closing date. Nomura also stated:

> Prior to the Closing Date, we may remove Mortgage Loans from the mortgage pool and we may substitute other mortgage loans for the mortgage loans we remove. The depositor believes that the information set forth in this prospectus supplement will be representative of the characteristics of the mortgage pool as it will be constituted at the time the certificates are issued, although the range of mortgage rates and maturities and other characteristics of the mortgage loans may vary. The characteristics of the mortgage loans as described in this prospectus supplement may differ from the final pool as of the closing date due, among other things, to the possibility that certain mortgage loans may become delinquent or default or may be removed or substituted and that similar or different mortgage loans may be added to the pool prior to the closing date. The actual mortgage loans included in the trust fund as of the Closing Date may vary from the mortgage loans as described in this prospectus supplement by up to plus or minus 5% as to any of the material characteristics described in this prospectus supplement.

The Prospectus Supplement for 2006–FM2 also disclosed the following regarding compensating

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factors:

> On a case by case basis, Fremont may determine that, based upon compensating factors, a prospective mortgagor not strictly qualifying under the underwriting risk category guidelines described below is nonetheless qualified to receive a loan, i.e., an underwriting exception. Compensating factors may include, but are not limited to, low loan-to-value ratio, low debt to income ratio, substantial liquid assets, good credit history, stable employment and time in residence at the applicant's current address. It is expected that a substantial portion of the mortgage loans may represent such underwriting exceptions.

And the Prospectus Supplements for five of the Securitizations defined the LTV ratio for loans other than Refinance Loans as "generally the lesser of (a) the appraised value determined in an appraisal obtained by the originator at origination of that loan and (b) the sales price for that property." FN29

These numbers were taken from the loan tapes created by the Originator that listed these characteristics, and others, for each loan. Nomura has offered no evidence to suggest that these representations were altered in any way to reflect the results of its pre-acquisition reviews. FN30 For example, for the 162 loans in the SLGs with BPOs that differed from the Originator's appraisal by more than the relevant variance threshold, Nomura does not dispute that its LTV and CLTV representations in the Offering Documents were based on the possibly faulty origination appraisals, not the out-of-threshold BPOs.

***13** Nomura has offered the following evidence of steps taken, after the pre-acquisition review, to confirm the accuracy of these representations. The Transaction Management Group sometimes received results from the Diligence Group's pre-acquisition review—they received results for 89 of the 194 Trade Pools—and, at times, participated in telephone calls with underwriters of the securities. For four of the seven Securitizations, a single-page chart titled "Due Diligence Summary" was circulated to the Transaction Management Group that listed the percentage of loans to be securitized that had been reviewed and the kick-out rates for credit, compliance, and valuation reasons for the contributing Trade Pools; three of these summaries broke out these rates for the top two Originators. All four include the following disclaimer: "The material contained herein is preliminary and based on sources which we believe to be reliable, but it is not complete, and we do not represent that it is accurate." Nomura has identified no evidence concerning its use or discussion of these summaries.

Graham, who headed Nomura's Transaction Management Group, has testified that he or someone else "would have at some point vetted th[e] language [concerning compliance with the originator's underwriting guidelines] with someone in the Due Diligence Group to verify that it generally reflected the underwriting guidelines that were used to originate the loans." There is no record that the Diligence Group took any steps, after the loans were acquired, to verify the accuracy of this Offering Document representation. Graham explained he relied on "indirect verification," as he "had confidence in the processes and systems that were involved in the acquisition of mortgage loans," which "would include due diligence" at that stage.

Nomura did hire an outside accountant, Deloitte & Touche LLP ("Deloitte"), to confirm that the Offering Documents accurately calculated the number of loans with certain characteristics based on the data listed on the loan tape (e.g., an LTV between 75% and 80%), but Deloitte undertook no examination of the accuracy of the data on the loan tapes concerning the loans' characteristics, and it made "no representations as to ... the accuracy of the information" in the Offering Documents. Nomura also hired Wells Fargo as a "collateral custodian" to ensure that certain required documents concerning the mortgages (e.g., any assignments or title policies) were in its possession. Wells Fargo did nothing to verify the accuracy of the informa-

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tion on the loan tapes concerning LTV ratios or owner-occupancy.

4. Underwriting

As noted above, an SPV that held the loans in the supporting loan groups would issue certificates tied to different classes or tranches of the security. Those certificates were sold to underwriters, who in turn sold them to investors, including the GSEs.

In each of the Securitizations, Nomura kept some of the most junior certificates (the "Residual Certificates"). These Residual Certificates were the first to take losses should borrowers default. Nomura's Residual Certificates had recorded market values, at the time of the Securitizations' respective closings, of between approximately $11 million and $40 million; together, they totaled approximately $190 million. Nomura sold some of these interests within one month of the Residual Certificates' issuance—including nearly two-thirds of its residual interests in NHELI 2006–FM2 and three-quarters of its residual interests in NHELI 2007–2—and it sold all of its remaining interests within approximately one year of each Securitization. According to a Nomura presentation entitled "RMBS Residual Analysis," "[l]osses [on residuals] are realized in years 2–4 and much of the cash flow has already been received in year 1."

V. Enter RBS: Underwriter

***14** Nomura Securities acted as sole lead underwriter for two of the Securitizations (NAAC 2005–AR6 and NHELI 2006–FM1); RBS was the sole lead underwriter for three (NHELI 2006–FM2, NHELI 20071, and NHELI 2007–2), and was identified as a co-lead underwriter for a fourth (NHELI 2006–HE3). Non-party Lehman Brothers, Inc. acted as the sole lead underwriter for the final Securitization (NHELI 2007–3). Although RBS's Underwriting Committee was charged with approving sponsors before RBS could underwrite their RMBS, "approval was mistakenly not obtained from the RBS[ ] Underwriting Committee" until after RBS had underwritten Nomura's NHELI 2006–HE3 and NHELI 2006–FM2.

A. NHELI 2006–HE3

RBS is identified as a co-lead underwriter in the Offering Documents for NHELI 2006–HE3 ("2006–HE3"). RBS's expert, Charles Grice, has explained that during the relevant period, "typically only one underwriter serves as the true lead underwriter," and RBS's "role can be best described as that of a non-lead underwriter" in connection with 2006–HE3. RBS had previously underwritten a Nomura securitization that closed on July 28, 2006, but RBS has identified no specific knowledge of Nomura's processes that RBS gained from that experience.

On August 4, 2006, Timothy Crowley, a Vice President at Nomura Securities and member of the Transaction Management Group, emailed a group including RBS employee Adam Smith ("Smith") to circulate "the initial draft of the term sheet" for 2006–HE3 and request "comments ... by 2:00 Monday [August 7]." In response, Smith emailed Crowley to ask, "Can you send me a summary of the due diligence done on the he3 collateral?" On August 7, another Nomura employee, Michael Orfe ("Orfe"), emailed Smith the single-page "Due Diligence Summary" created for 2006–HE3. This summary included the following disclaimer: "The material contained herein is preliminary and based on sources which we believe to be reliable, but it is not complete, and we do not represent that it is accurate."

Smith responded that the listed balance for the trade, $4 billion, "looks incorrect"; Orfe explained that it

> represents the total balance of any trade that a loan in this pool was part of. So it is the case that there may be one loan in this pool that came from a trade of $100mm [million], and that $100mm is included in the $4 billion. The idea is to give an overall picture of our DD [due diligence] process.

This summary for 2006–HE3 listed the percentage of loans (by unpaid principal balance) that had been kicked out of the contributing Trade Pools for

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reasons of "Credit," "Compliance," and "Property" (together, 7.5%), and the same statistics for the two Originators with loans comprising 10% or more of the Securitization's loans, People's Choice and First NLC. The summary did not identify the percentage of loans that had been sampled for credit and compliance review in the underlying Trade Pools, or identify the percentage of loans to be securitized that had been reviewed; it only identified the percentage of People's Choice's and First NLC's loans that had been reviewed (accounting for 60% of the loans, by unpaid principal balance). Smith emailed this summary to Brian Farrell ("Farrell") and James Whittemore ("Whittemore") in RBS's Credit Group, asking them to "review Nomura due diligence on the HE3 transaction that we are a co-manager. Seems to be in-line with subprime loans, please confirm that you are ok with the results." Farrell asked to see "LTV, FICO, DTI, PPP [prepayment penalty], Property Types" for the collateral; he was sent a summary of the collateral and ten minutes later replied, "Overall snapshot of this looks ok."

***15** Nomura also provided RBS with a list of the six Originators who contributed loans comprising more than 5% of the Securitizations' loans. One RBS employee asked another for the "complete list," writing, "[n]ot to be a pain in the ass but that still leaves [unaccounted for the originators of] over 20% of the pool." He was told, "Nomura will only disclose those originators that comprise over 5% of the pool."

On August 10, Smith requested confirmation from Katz of Nomura's "General Due Diligence Procedures," outlining his understanding in eleven sentences; Katz provided a few additional details and attached a June 2006 presentation made to S & P entitled "Nomura Securities International Residential Whole Loan Securitization Platform." The presentation includes three slides under the heading "Due Diligence Process" that represent, among other things, that Nomura's sampling of bulk trade pools was one-third "[r]andom" and two-thirds "[a]dverse."

RBS also tested the "data integrity" of the loan tape to identify any data input errors; received a "negative assurance letter" from Nomura's counsel, Thacher Proffitt & Wood LLP ("Thacher"), stating that Thacher was not aware of any facts that would render the Offering Documents for 2006–HE3 misleading; and received confirmation from Deloitte that the Offering Documents accurately calculated the number of loans with certain characteristics, based on the loan tapes. RBS participated in a "post-securitization due diligence conference call," although RBS has identified no details concerning that call.

On the basis of this work, RBS underwrote 2006–HE3. At no point did RBS review any of the loan files for the loans underlying the Securitization.

B. NHELI 2006–FM2

RBS served as the sole lead underwriter for NHELI 2006–FM2 ("2006–FM2"), which securitized loans from two Bulk Pools, both purchased from Fremont: Fremont SP03 ("SP03") and Fremont SP04 ("SP04"). In September 2006, RBS received three spreadsheets including information from loan-level reviews conducted for Nomura by the vendor AMC. The first, entitled "Seller Trade Breakout," listed the number of loans in SP03 and SP04 that underwent credit and compliance review, an AVM review, and a BPO review, as well as the number of loans kicked out of each of these pools "for Credit," "for Compliance," "for Valuation," and "for Collateral." The Seller Trade Breakout showed that Nomura's credit and compliance samples were 24.6% and 24.8% of the loans in SP03 and SP04, respectively; that 30.0% and 34.8% of those samples, respectively, had been kicked out for compliance issues; another 5.3% and 8.3%, respectively, of these samples had been kicked out due to credit issues. The other two spreadsheets included the results of AMC's and Nomura's credit, compliance, and valuation reviews, for loans reviewed in SP03 and SP04. RBS received all of AMC's results.

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Before these three spreadsheets were sent to RBS, Spagna, the head of Nomura's Diligence Group, instructed AMC to retroactively regrade 19 EV3 loans that had been purchased by Nomura. In an email with the subject line "Huge Favor—Fremont ASAP," Spagna noted that "the last set of exception reports" from AMC "shows that there are 12 loans in Fremont 3 and 7 loans in Fremont 4 that AMC had marked as [EV]3s but, for what[ ]ever reason, we decided to buy from Fremont." Spagna then instructed AMC to "[p]lease mark these loans as client overrides Credit Event 2s for all 19 loans in question. Then please forward to me the updated set of reports for these two deals." Nomura has provided no other evidence to explain the change in the classification of these 19 loans.

***16** These revised reports were sent to RBS later that day, and Smith then sent these reports to others at RBS, asking them to "review the results and sampling methods so that we can discuss the extent of our required due diligence as an underwriter." Farrell emailed Spagna and another member of Nomura's Diligence Group, Mendy Sabo ("Sabo"), asking them to "elaborate more on high risk characteristics" used to select the adverse sample. Sabo said Nomura would be unable to send a "formal" response in time—Farrell asked for a response the same day—and so instead provided "a quick ad hoc" description. There is no evidence RBS was provided with a fuller description before the Securitization closed.

Farrell wrote to Smith that "[t]he only concern is the high number of payment stream [FN31] exceptions," and that "[i]f the payment stream issues are isolated, the rest of [the] pool looks good." Farrell noted RBS had "r[u]n into similar issues in April/ May of this year" and that "Fremont stated that they intended to fix their process, which we believe is now true as a result of our [$]1.1 [billion] Fremont review this month." Earlier in that email chain, a member of Nomura's Diligence Group wrote that "# 's are skewed (because of the Compliance drops) because we found an issue with the payment stream on [certain] loans ... which we performed 100% [due diligence] on." [FN32] Whittemore wrote that "[i]t appears the due diligence sample was sufficient for the size of the pool," "[t]heir sample methodology and AVM/BPO process appear to be sound," and "[t]he exception ratios excluding the payment stream issue appears to be what we see when we do our due diligence at Fremont for whole loan trades." Later, Farrell wrote to Smith that "Credit was ok with results and sampling methodol[og]y."

Months later, in February 2007—after 2006–FM2 had closed—Farrell was asked by another RBS employee, Grace–Ann Didato ("Didato"), about RBS's diligence on this deal. Farrell wrote, "We did not perform actual diligence on this. Diligence was performed by another company for Nomura. We signed off on their results." When Didato asked, "How frequently is this done?," Farrell replied, "Since being employed, this is the only review type I was involved in w[h]ere [due diligence] results were reviewed and a new diligence was not ordered."

Before 2006–FM2 was issued, RBS participated in a "due diligence teleconference" with RBS's counsel, Nomura, Nomura's counsel, and non-lead underwriters. General corporate issues were discussed; according to Spagna, only two questions were addressed to Nomura's Diligence Group. Spagna wrote to Sabo: "We had 2 questions. I took the liberty to bullshit them. I think it worked." In addition to this call, RBS received a negative assurance letter from Nomura's counsel, Thacher, and Deloitte verified the accuracy of the information on the loan tape and the calculations based on that data in the Offering Documents.

C. NHELI 2007–1 and NHELI 2007–2

***17** RBS was also the sole lead underwriter for NHELI 2007–1 ("2007–1") and NHELI 2007–2 ("2007–2"). RBS conducted its own loan reviews, through its vendor Clayton, in connection with these securitizations. While RBS did receive the results of Nomura's pre-acquisition review for the

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trade pools that fed into 2007–2, there is no evidence RBS ever received the results of Nomura's review of the pools that populated the relevant SLG of 2007–1.

For both Securitizations, RBS's sampling was partly "semi-random" and partly adverse. The semi-random sample was created by stratifying the pool to be sampled by unpaid principal balance into bands of $50,000 or $100,000, and then using a random number generator to select loans within each band. The larger the aggregate balance was in a band, the more loans that band would contribute to the sample.

The adverse sample was selected according to characteristics like loan balance, FICO score, LTV ratio, and region. Where only some loans with particular adverse characteristics were to be reviewed, a random number generator was used to select them. The adverse sample would be selected before the semi-random sample. In addition, RBS ordered a drive-by BPO for a sample of loans.

RBS determined the appropriate sample size according to a number of factors, including the Originator, the type of product, and other risk characteristics. According to the RBS Greenwich Capital Credit Procedures Manual, "[t]he number of files selected for review and the manner of selection may vary due to a number of factors, the most important of which, is [RBS] Greenwich's exposure to the transaction." When asked at depositions, RBS employees stated they were not aware that RBS policy varied sample size according to RBS's "exposure."

1. Sample Selection

a) 2007–1 Sample Selection

For 2007–1, RBS selected two samples—each partly semi-random and partly adverse—one from a group of fixed-rate loans ("Group I") and a second from a group of adjustable-rate loans ("Group II"). FN33 Group II, composed of 1,751 loans, was later divided into two different supporting loan groups, one of which supported the Certificate purchased by Freddie Mac. Farrell selected samples of 250 loans from Group II; that sample was reduced from 250 loans (14.3% of the group) to 102 loans (5.8%) because Nomura reported it "did not have imaged files for all the loans in [Farrell's] original samples." 32 of these loans were selected semi-randomly; 70 were adversely selected. There is no evidence RBS followed up with Nomura, and RBS simply reviewed the requested loan files that Nomura did send.

b) 2007–2 Sample Selection

RBS did receive the results of Nomura's review of the loans securitized in 2007–2. Yet, Farrell wrote to Whittemore, "[t]his one is crap. I'm looking for a suggestion." Farrell warned Smith, "[t]his [sample] will be larger than 250." When asked why, Farrell explained: "Because it's crap." Smith replied, "OK. Do what you feel comfortable with." Farrell then told Smith, "I would like to review 25% of the total loan population," or 1,284 of the 5,136 loans in 2007–2. Within one minute, Smith replied: "We don't own the pool. Call me. [Extension] 2271." When asked at his deposition "why Mr. Smith would want to take this conversation off line," Farrell said he did not know.

***18** Ultimately, RBS selected a sample of 368 loans for 2007–2 (7.2% of the 5,136 loans). 138 were selected semi-randomly, 168 adversely. As was the case for 2007–1, Nomura reported that it did not "have imaged files" for 60 of those loans, so Farrell's sample was reduced to the 308 loans (6.0% of 2007–2) for which Nomura transmitted imaged loan files.

2. RBS Loan Reviews

There is some additional evidence that RBS used different standards when it reunderwrote loans in what its employees called "securities"— *i.e.,* RMBS to be issued by third-parties—than when it performed pre-acquisition review of "whole loan purchases" RBS might securitize itself. In connection with another third-party securitization of Fremont loans RBS was underwriting, on January 31, 2006, RBS employee Donald Lawson ("Lawson")

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gave feedback to another employee, Anne Shera ("Shera"), who had just submitted a draft report of findings concerning those loans, writing: "As this is a security, we will not be as tough on appraisal and underwriting issues...." A few days before, Shera had asked Lawson for advice, as Clayton flagged a loan as "high cost" but Fremont disputed that. Shera asked Lawson if RBS should "kick" the loan. Lawson replied: "OK for one loan and we're securitizing off their shelf. We would not buy this loan. Let them know that because we just agreed to buy a $1 Billion pool from them which closes in March."

a) 2007–1 Loan Reviews

Of RBS's sample of 102 loans from Group II, in its initial report to RBS, Clayton graded 28 loans (or 27.5%) "3" due to credit issues; of these 28, 16 loans were graded "3C"—which indicated "only curable material exceptions"—and three were graded "3D," which meant "missing material documentation." Nine loans (or 8.8%) received a grade of "3" due to a compliance issue; one of these was graded "3C," and four "3D." All told, 33 loans were graded "3" for either credit or compliance reasons (and four for both) according to Clayton's report prepared January 18, 2007 at 5:35 p.m. Clayton issued a revised report approximately one hour later, at 6:41 p.m., showing that all but three of those 33 loans had been regraded "2W," indicating a client override, for credit or compliance. RBS's Whittemore testified that, when "review[ing] a loan file to see if there were compensating factors for exceptions," he might "flip through the pages and review" in "20 minutes," or spend as many as "three hours ... [i]f [he] thought it was important." No documentation of any compensating factors identified by RBS for these 30 loans has been produced. For six of the loans, however, Farrell has recently reviewed them and reports that they appear to have "sufficient compensating factors" that he would have deemed them acceptable at the time. Farrell indicates in conclusory terms that the other loans appear also to be loans he would have "deemed acceptable in 2007 for similar reasons." FN34 Ultimately, RBS overrode all of the "3" grades for the sampled loans.

b) 2007–2 Loan Reviews

***19** In RBS's 308–loan sample for 2007–2, Clayton initially graded 50 loans (16.2%) a "3" for credit, including 8 loans graded "3C" and 7 loans graded "3D." RBS overrode all 50 of these initial grades. Again, there is no documentary evidence of compensating factors identified by RBS for these loans.

3. Valuation Diligence

RBS ordered drive-by appraisals for 50 loans within the 2007–1 Group II credit and compliance sample. It is not clear how these 50 loans were selected. Nine of those appraisals were canceled. FN35 For 6 of the 41 loans for which a drive-by appraisal was completed (14.6%), that appraisal was more than 20% below the Originator's appraisal (based upon which the Offering Document's LTV ratio was calculated). Similarly, RBS ordered drive-by appraisals for 100 loans within its 2007–2 sample. Six were canceled. Again, for approximately 15% of the loans (14 loans among those 94), the drive-by appraisal was more than 20% below the Originator's appraisal.

According to a November 2006 investor presentation concerning RBS's whole-loan acquisitions, where a BPO is more than 20% below the originator's appraisal, RBS would conduct a reconciliation. In connection with a different loan review, when Frank Camacho of RBS's Credit Group was asked "what happens" when the BPO varies greatly from the originator's appraisal, he explained:

> I want to see the drivebys with over a 20% variance. I'll pull the original appraisal, look at them both, and figure out who's on crack. If the appraiser's right, fine, if the driveby's right I'll kick the loan out of the trade and the lender will have to sell the loan to someone else. If this happens on a widespread enough basis I'll recommend increased due diligence, repricing the trade, or not doing the deal at all.

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There is no evidence that RBS took any further steps concerning valuation diligence for either the 2007–1 or 2007–2 samples. Those 20 loans with BPOs more than 20% below the Originator's appraisal were securitized in 2007–1 and 2007–2, and the Offering Documents' representations concerning LTV ratios were calculated based on the Originators' appraisals for those loans.

4. Other Diligence

As it did with the other Nomura securitizations, RBS received negative assurance letters from Thacher, and verification from Deloitte, based on loan tape data, of the calculations that appeared in the Offering Documents.

VI. Facts Concerning the Parties

A. Relationships Among the Nomura Entities

Nomura Holding America Inc. is a holding company and is the parent, directly or indirectly, of Nomura Securities, NCCI, Nomura Asset Acceptance Corp. ("NAAC"), and Nomura Home Equity Loan, Inc. ("NHELI"). The depositors for the seven Securities were NAAC and NHELI.

David Findlay ("Findlay") served on the boards of NAAC, NHELI, and Nomura Securities. NAAC's and NHELI's boards were identical. Nomura Securities employed Dante LaRocca, the chief executive officer of NHELI, as well as Graham, who served as chief executive officer of NAAC. Nomura Securities also employed Nathan Gorin, the chief financial officer of NAAC, NHELI, NCCI, and Nomura Securities, as well as Sam Herbstman, the tax officer of both NAAC and NHELI.

***20** Neither NAAC nor NHELI had employees. Nomura asserts that NAAC's and NHELI's boards of directors had the authority to prevent the issuance of the Securitizations, but its designee could not state that these directors ever held a meeting, let alone took meaningful action as directors. Findlay could not recall serving as a director of either NAAC or NHELI.

NCCI is identified as the "seller" or "sponsor" in each Prospectus Supplement. All of NCCI's officers were employed by Nomura Securities, and before October 2006 NCCI had no employees. Before that date, members of Nomura's Trading Desk, Diligence Group, and Transaction Management Group were employed by Nomura Securities. After that date, NCCI, rather than Nomura Securities, appeared on their paychecks. Nomura's corporate representative was not aware of any substantive change in any person's function as a result of that change. Three of the Securitizations closed before October 2006, one closed on or about October 31, 2006, and three closed in early 2007.

B. The GSEs

1. The GSEs' Participation in the RMBS Market

Fannie Mae and Freddie Mac are government-sponsored enterprises created to ensure liquidity in the mortgage market. Fannie Mae was established in 1938, Freddie Mac in 1970. Their primary business is to purchase mortgage loans from originators that conform to the GSEs' standards ("conforming loans") and then either hold those loans on their own books or securitize them for offer to the public. This side of their business is known as the "Single Family" side. In their Single Family businesses, the GSEs review loans before purchasing them in bulk; the GSEs also monitor loans after purchasing them.

In 2000, the GSEs began to purchase quantities of Alt–A and subprime loans and to securitize some of those purchases. Office of Policy Development and Research, U.S. Department of Housing and Urban Development, *Fannie Mae and Freddie Mac: Past, Present and Future* (2009), *in* 11 Cityscape: J. Pol'y Dev. & Res. 231, 236–37 (2009). During this period, some portion of the Alt–A and subprime loans the GSEs purchased were non-conforming loans—that is, they were underwritten to the seller's guidelines (with certain modifications), not the GSEs'.

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Each GSE also conducts a second business, purchasing and holding PLS. This is a substantially smaller portion of their activities. It is the PLS that the GSEs purchased from the Defendants that prompt the claims in this lawsuit. The GSEs held approximately $100 billion in PLS in 2002, with roughly $35 billion in subprime and $3 billion in Alt–A PLS; at their peak, in 2005, the GSEs' PLS holdings had grown to approximately $350 billion, with roughly $145 billion in subprime and $40 billion in Alt–A PLS. Cong. Budget Office, *Fannie Mae, Freddie Mac, and the Federal Role in the Secondary Mortgage Market* 10 (Dec.2010); [FN36] Nat'l Comm'n on the Causes of the Fin. & Econ. Crisis in the U.S., *The Financial Crisis Inquiry Report* 124 fig. 7.3 (2011) ("*Financial Crisis Report* ").[FN37] In the two years prior to September 7, 2007, the GSEs purchased more than $251 billion in PLS, approximately 8% of the $3 trillion in PLS issued in those years.

2. The GSEs' Aggregator Reviews

***21** The GSEs' Single Family businesses investigated and approved originators before purchasing mortgage loans from them. The PLS operations at the GSEs relied on those reviews, or the results of those reviews, from the Single Family operations in making their trading decisions.

Fannie Mae's Single Family Counterparty Risk Management Group ("SFCPRM") was tasked with approving counterparties, including aggregators. SFCPRM reviews, some of which included on-site visits, primarily assessed "[c]ounterparty risk" for Fannie Mae's Single Family business, which was "the risk of financial loss to Fannie Mae resulting from [the counterparty]'s failure to meet its contractual obligation[s]," including inability to meet repurchase obligations. Freddie Mac's Alternative Market Operations Group ("AMO"), a part of Freddie Mac's Single Family business, similarly conducted reviews of aggregators.

a) Nomura

Freddie Mac's AMO issued an aggregator operational review of Nomura on March 14, 2006. "Based upon the combination of good due diligence methodologies, reasonable valuation processes and sound controls, AMO rate[d] Nomura subprime as Satisfactory overall." AMO found that "Nomura's due diligence program is well managed," and "found no issues with Nomura['s] appraisal process, which is solid." AMO noted that "Nomura takes the property evaluation process seriously and places a high priority on collateral valuation." A Freddie Mac report on Nomura's diligence practices in March 2006 found that Nomura conducted property and compliance due diligence on 100% of loans, and credit due diligence on 100% of loans in pools with amounts less than $25 million, and on 20% of loans in pools with greater amounts. AMO cited no concern about the many deficiencies FHFA now alleges.

b) RBS

Fannie Mae issued an aggregator review of RBS Greenwich Capital in November 2006. The review notes that RBS employed Clayton, the Capital Group, and Watterson–Prime to "conduct loan level due diligence on its acquisitions." RBS reviewed loans "pursuant to seller's guidelines," and "stated that its program to monitor seller lending matrices [in connection with their guidelines] [wa]s robust," although Fannie Mae was not provided "in-depth detail regarding this program." RBS was found to "perform[ ] credit reviews through a process designed to determine that the loans generally comply with the lender's underwriting guidelines through a check of borrower income and asset documentation, review of credit reports and credit scores, and recalculation of debt to income ratios."

Fannie Mae reported in a 2006 review that RBS's "typical sample size" for non-prime loans was 25%, "predominantly adversely selected." For prime and Alt–A loans, "sampling size [wa]s determined by a statistical calculation intended to obtain a 95 percent confidence interval, a less than 10 percent error rate, and precision of five percent or greater." RBS "require[d] additional adverse selection for compliance [red flags], high loan balance,

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low FICO [credit] score, seasoning, or other abnormal loan characteristics." Fannie Mae cited no concern about the many deficiencies FHFA now alleges.

DISCUSSION

I. Summary Judgment Standard

***22** [1] Summary judgment may not be granted unless all of the submissions taken together "show[ ] that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law." Fed.R.Civ.P. 56(a). The moving party bears the burden of demonstrating the absence of a material factual question, and in making this determination, the court must view all facts in the light most favorable to the non-moving party. *Eastman Kodak Co. v. Image Technical Servs.,Inc.*, 504 U.S. 451, 456, 112 S.Ct. 2072, 119 L.Ed.2d 265 (1992); *Holcomb v. Iona Coll.*, 521 F.3d 130, 132 (2d Cir.2008). Once the moving party has asserted facts showing that the non-movant's claims or affirmative defenses cannot be sustained, the opposing party must "set out specific facts showing a genuine issue for trial," and cannot "rely merely on allegations or denials" contained in the pleadings. Fed.R.Civ.P. 56(e); *see also Wright v. Goord*, 554 F.3d 255, 266 (2d Cir.2009). Nor may a party "rely on mere speculation or conjecture as to the true nature of the facts to overcome a motion for summary judgment," as "[m]ere conclusory allegations or denials cannot by themselves create a genuine issue of material fact where none would otherwise exist." *Hicks v. Baines*, 593 F.3d 159, 166 (2d Cir.2010) (citation omitted). "A submission in opposition to (or in support of) summary judgment need be considered only to the extent that it would ... be[ ] admissible at trial." *Doe ex rel. Doe v. Whelan*, 732 F.3d 151, 157 (2d Cir.2013) (citation omitted). Only disputes over material facts—"facts that might affect the outcome of the suit under the governing law"—will properly preclude the entry of summary judgment. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986).

[2][3][4] "A defendant's assertion of the due diligence defense requires an exquisitely fact intensive inquiry into all of the circumstances surrounding the facts upon which the Section 11 claim is premised," and the same is true for a defense of reasonable care under Section 12(a)(2). *In re WorldCom, Inc. Sec. Litig.*, 02cv3288 (DLC), 2005 WL 638268, at *11 (S.D.N.Y. Mar. 21, 2005). Such questions of reasonableness are mixed questions of law and fact that are often reserved for the trier of fact. Yet, even the issue of materiality of a misrepresentation or omissions—which "requires delicate assessments of the inferences a 'reasonable shareholder' would draw from a given set of facts and the significance of those inferences to him, ... assessments [that] are peculiarly ones for the trier of fact"—is "appropriately resolved as a matter of law by summary judgment" where the misrepresentations or omissions "are so obviously important to an investor, that reasonable minds cannot differ on the question." *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 450, 96 S.Ct. 2126, 48 L.Ed.2d 757 (1976); *accord Mendell v. Greenberg*, 927 F.2d 667, 673 (2d Cir.), *amended*, 938 F.2d 1528 (2d Cir.1990) (holding summary judgment on materiality appropriate "when reasonable minds could not differ on the issue"). Indeed, as the Second Circuit recognized in another securities case, whether a given set of facts triggers a duty to investigate is an "objective determination [that] can be resolved as a matter of law—it need not be made by a trier of fact." *Staehr v. Hartford Fin. Servs. Grp., Inc.*, 547 F.3d 406, 427 (2d Cir.2008) (addressing investor's duty of inquiry). When no reasonable jury could find for the non-movant, the movant is entitled to summary judgment as a matter of law. *Accord In re Livent, Inc. Noteholders Sec. Litig.*, 355 F.Supp.2d 722, 735–38 (S.D.N.Y.2005) (granting partial summary judgment for plaintiffs on Section 11 due diligence defense).

II. Law Governing Sections 11's Due Diligence Defense and Section 12(a)(2)'s Reasonable Care Defense

***23** [5][6] In order to "provide investors with

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full disclosure of material information concerning public offerings of securities," the Securities Act requires the filing and distribution of certain documents in connection with such an offering, including a registration statement and a prospectus. *Ernst & Ernst v. Hochfelder,* 425 U.S. 185, 195, 96 S.Ct. 1375, 47 L.Ed.2d 668 (1976). Section 11 of the Securities Act ("Section 11") attaches civil liability to material misstatements or omissions in a registration statement, 15 U.S.C. § 77k; Section 12(a)(2) of the Securities Act ("Section 12(a)(2)") does the same for a prospectus, *id.* at § 77*l*. As described below, Sections 11 and 12(a)(2) are "notable both for the limitations on their scope as well as the *in[ ] terrorem* nature of the liability they create." *NECA–IBEW Health & Welfare Fund v. Goldman Sachs & Co.,* 693 F.3d 145, 156 (2d Cir.2012) (citation omitted), *cert. denied,* ––– U.S. ––––, 133 S.Ct. 1624, 185 L.Ed.2d 576 (2013).

A. Section 11's Due Diligence Defense

[7][8] Section 11 of the Securities Act "was designed to assure compliance with the disclosure provisions of the Act by imposing a stringent standard of liability on the parties who play a direct role in a registered offering." *Herman & MacLean v. Huddleston,* 459 U.S. 375, 381–82, 103 S.Ct. 683, 74 L.Ed.2d 548 (1983). Thus, Section 11 grants the purchaser of a security a cause of action against the issuer and underwriter, among others, where any part of a registration statement, at the time it became effective, contained a material misstatement or omissions.[FN38] *NECA,* 693 F.3d at 156. Thus, the registration statement must be materially accurate as of the date it becomes effective. *See* 15 U.S.C. § 77k (establishing liability as of the date "such part [of the registration statement] became effective"); *cf. Dalberth v. Xerox Corp.,* 766 F.3d 172, 183 (2d Cir.2014) (noting materiality is determined according to the "total mix of information made available" at that time) (citation omitted). Certain affirmative defenses are available to defendants. The defense at issue here is the "due diligence" defense, described below.

[9][10][11] Section 11 shields from liability any defendant "other than the issuer"[FN39] should the defendant prove that,

> after reasonable investigation, [it had] reasonable ground to believe and did believe, at the time such part of the registration statement became effective, that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading.

Id. at § 77k(b)(3).[FN40] Thus, while "[i]ssuers are subject to virtually absolute liability under [S]ection 11," underwriters "may be held liable for mere negligence." *In re Morgan Stanley Info. Fund Sec. Litig.,* 592 F.3d 347, 359 (2d Cir.2010) (citation omitted). Section 11 defines the "standard of reasonableness" as "that required of a prudent man in the management of his own property," 15 U.S.C. § 77k(c), which is a negligence standard, *NECA,* 693 F.3d at 156. Such an investigation must be thorough and searching, "with systematic attention to detail and relationship." *WorldCom,* 346 F.Supp.2d at 678 (citation omitted). Even if a reasonable investigation "would have proven futile in uncovering the fraud" or misstatements alleged, a defendant must establish that it undertook such investigation in order to claim the benefit of this defense. *Id.* at 661 n. 40.

***24** Reasonableness, both of any investigation and any belief in the accuracy of the representations, is determined according to all relevant circumstances. 17 C.F.R. § 230.176. These circumstances include

> (a) The type of issuer;
>
> (b) The type of security;
>
> (c) The type of [defendant];
>
> [...]
>
> (e) The presence or absence of another relationship to the issuer when the person is a director ...;

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(f) Reasonable reliance on officers, employees, and others whose duties should have given them knowledge of the particular facts (in the light of the functions and responsibilities of the particular person with respect to the issuer and the filing);

(g) When the [defendant] is an underwriter, the type of underwriting arrangement, the role of the particular [defendant] as an underwriter and the availability of information with respect to the registrant.

Id. The SEC has "expressly rejected the consideration of competitive timing and pressures when evaluating the reasonableness of an underwriter's investigation." The Regulation of Security Offerings, SEC Release No. 7606A, 63 Fed.Reg. 67174, *available at* 1998 WL 792508, at *92 (Nov. 17, 1998) ("SEC Rel. 7606A"); *see WorldCom,* 346 F.Supp.2d at 669–71.

1. A "Sliding Scale"

[12][13] As these factors suggest, there is a "sliding scale" in the diligence required of parties, with heavier demands of those with more central roles and greater access to the information and expertise needed to confirm the accuracy of the registration statement. *WorldCom,* 2005 WL 638268, at *9 (quoting 1 Hazen, *Law of Sec. Reg.* § 7.4[2][A][1] (4th ed.2002)); *see also Feit v. Leasco Data Processing Equip. Corp.,* 332 F.Supp. 544, 577–78 (E.D.N.Y.1971) ("[W]hat constitutes 'reasonable investigation' and a 'reasonable ground to believe' will vary with the degree of involvement of the individual, his expertise, and his access to the pertinent information and data."). In the House Report discussing the bill that would become the Securities Act, Congress affirmed that "[t]he duty of care to discover varies in its demands upon participants in security distribution with the importance of their place in the scheme of distribution and with the degree of protection that the public has a right to expect." H.R.Rep. No. 73–85, at 9 (1933); *accord* Circumstances Affecting the Determination of What Constitutes Reasonable Investigation and Reasonable Grounds for Belief Under Section 11 of the Securities Act, SEC Release No. 6335, *available at* 1981 WL 31062, at *14 (Aug. 6, 1981) ("SEC Rel. 6335") ("Congress intended that there would be variation in the thoroughness of the investigation performed by the different persons subject to Section 11 liability based on the importance of their place in the scheme of distribution and with the degree of protection that the public has a right to expect.") (citation omitted). "For those whose moral responsibility to the public is particularly heavy"—such as underwriters—"there is a correspondingly heavier legal liability." *Gustafson v. Alloyd Co., Inc.,* 513 U.S. 561, 581, 115 S.Ct. 1061, 131 L.Ed.2d 1 (1995) (citation omitted).

***25** [14] In a traditional equity security offering, the security was backed by the issuer's financial well-being and thus the issuer, and its inside directors, were most intimately familiar with the information material to investors. Accordingly, issuers are strictly liable for the material accuracy of registration statements, and the diligence required of inside directors is so great that "liability will lie in practically all cases of misrepresentation." *WorldCom,* 2005 WL 638268, at *9 (quoting *Feit,* 332 F.Supp. at 578).[FN41]

Yet the issuer itself "may be so hard pressed for cash ... that they will accept or undervalue the risk of civil liability," and its directors "are not free to assume an adverse role, and in any event they are not entirely free from the pressures on and optimism of management." *Feit,* 332 F.Supp. at 581 (citation omitted). "Only the underwriter and the accountant are free to assume an adverse role, have little incentive to accept the risk of liability, and possess the facilities and competence to undertake an independent investigation." *Id.* (citation omitted). Accordingly, "underwriters must play devil's advocate" and are expected to exercise "a high degree of care in investigation and independent verification of the company's representations." *Id.* at 582 (citation omitted).

Asset-backed securities, including the RMBS here, turn the traditional paradigm on its head. Un-

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like equity securities, which depend upon the financial health and future profitability of the issuer, the asset-backed securities here were issued by SPVs designed only to hold the loans underlying a securitization in order to issue related securities. These SPVs were "solely passive entities" with no employees of their own.

Likewise, the other statutory "issuers" here—the depositors, NAAC and NHELI—were corporate shells. They had no employees, and there is no evidence their directors—the same four employees, three of whom were employed by Nomura Securities and the fourth by its parent, Nomura Holding America Inc.—ever held a meeting; at least one director does not recall serving as a director for either entity. Before October 2006, it was employees of Nomura Securities who negotiated the purchase of the underlying loans from originators, employees of Nomura Securities who conducted pre-acquisition diligence to refine the pool of loans to be purchased, and Nomura Securities' Transaction Management Group that created the Supporting Loan Groups from the purchased pools and then transferred the loans through one of the depositors to an SPV for securitization. As a practical matter, the four Securitizations that closed in or before October 2006 were each the creature of Nomura Securities. The same is true of NCCI for the three post-October 2006 Securitizations. And while "Nomura Credit & Capital, Inc." appeared on the Trading Desk's, Diligence Group's, and Transaction Management Group's paychecks after October 2006, there is no evidence to suggest that Nomura Securities ever lacked full access to all potentially relevant information held by NCCI and control over every decision and decision-maker responsible for the Securitizations.

***26** It is instructive to note that, as it crafted the Securities Act, Congress expressly considered who should bear the issuer's absolute liability with respect to "security issues of an unusual character," including certificates issued by a trustee backed by collateral held by the trust. Congress determined that the depositor, as the entity "responsible for the flotation of the issue" and the one in possession of the best information about the underlying assets, should carry that liability:

> Under such an arrangement, although the actual issuer [of the certificates] is the trustee, the depositor is the person responsible for the flotation of the issue. Consequently, information relative to the depositor and the [assets backing the certificates] is what chiefly concerns the investor—information respecting the assets and liabilities of the trust rather than of the trustee. For these reasons the duty of furnishing this information is placed upon the actual manager of the trust and not the passive trustee, and this purpose is accomplished by defining "issuer" as in such instances referring to the depositor or manager.

H.R.Rep. No. 73–85, at 12 (1933).[FN42] This reaffirms that courts reviewing a due diligence defense in the asset-backed securities context should apply a sliding scale responsive to a defendant's role in the offering and ability to check the accuracy of the registration statement.

2. The Underwriter's Role

[15][16] The underwriter—in a traditional equity security, often an unrelated investment bank—undertakes to investigate the issuer in order to make certain representations to the public purchasing its issue. "No greater reliance in our self-regulatory system is placed on any single participant in the issuance of securities than upon the underwriter." *Chris–Craft Indus., Inc. v. Piper Aircraft Corp.,* 480 F.2d 341, 370 (2d Cir.1973). "Congress recognized that underwriters occupied a unique position that enabled them to discover and compel disclosure of essential facts about the offering" and accordingly placed them under the *in terrorem* threat of Section 11 liability, believing this "would provide the necessary incentive to ensure their careful investigation of the offering." SEC Rel. 7606A, 1998 WL 792508, at *75. Accordingly, the underwriter's diligence burden is heavy. To avail itself of the due diligence defense,

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an underwriter "must conduct an investigation reasonably calculated to reveal all those facts that would be of interest to a reasonably prudent investor." *Id.* at *92 (citation omitted).

a) Affiliated & Unaffiliated Underwriters

In two of the seven Securitizations, Nomura Securities served as sole underwriter; in a third, Nomura Securities was a co-lead underwriter. As described above, Nomura Securities also employed the directors and officers of the depositors, NAAC and NHELI (the securities' "issuers" for purposes of Section 11) and the sponsor, NCCI, and before October 2006 employed those who designed the Securitizations. In these circumstances, where the issue is the creature of the underwriter, the underwriter's Section 11 liability "approaches that of the issuer as guarantor of the accuracy of the prospectus" and a due diligence defense will fail "in practically all cases of misrepresentation." *Feit,* 332 F.Supp. at 578.FN43

*27 Unaffiliated underwriters, like RBS here, also bear a heavy burden. The adversity and thoroughness of the unaffiliated underwriter may be even more vital in the case of RMBS than it is in the context of equity securities. The accuracy of core representations in the offering of equity securities may be able to be checked by outside accountants, outside directors, market analysts, and sophisticated investors. With RMBS, the value of the certificates depends upon the reliability of the data listed on the loan tapes, and the sole source against which to check the tapes—the loan files—are not available to the public. Indeed, here, the only post-acquisition review of that accuracy was undertaken by the unaffiliated underwriter.

The record reflects that RMBS sponsors, including Defendants here, entered into contracts with residential mortgage loan originators, frequently agreeing to limit their pre-purchase diligence on the originators' loans.FN44 The originator stands to gain from inflating the quality of the loans it sells to a sponsor. And the evidence before the Court on this motion paints the private-label RMBS securitization market in 2005–2007 as one in which sponsors were fiercely competing to securitize an ever greater share of residential mortgage loans. In such an environment, sponsors have reason to accede to originators' demands and look the other way, conducting half-hearted review and rejecting only an acceptably small percentage of offered loans.FN45 In these circumstances, if an unaffiliated underwriter did not thoroughly review the quality of the Supporting Loan Groups and confirm that the Offering Documents' descriptions were accurate, there was a substantial risk that no one would.

[17] "By associating himself with a proposed offering [an underwriter] impliedly represents that he has made [a reasonable] investigation in accordance with professional standards. Investors properly rely on this added protection...." 41 SEC 398 [1961–1964 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,904, 1963 WL 63647 (Feb. 27, 1963). In the circumstances set out above, should an unaffiliated underwriter lend its name to an RMBS offering, it must conduct a searching review of the underlying loans if it seeks the protection of Section 11's due diligence defense. This is not to suggest, however, that such review must individually examine each loan file, or that a reasonably diligent review cannot be accomplished through the application of appropriate sampling methods.

b) Nomura's Argument

Nomura argues that the rationales animating the requirement that an underwriter play an adversarial role are absent in an offering of asset-backed securities. The financial health of the SPV and depositor issuing the asset-backed securities have almost no impact on the value of the securities, and thus, Nomura argues, there is no need for the underwriter to play devil's advocate.

Nomura's focus on the need for underwriter independence from the issuer misses the point. Nomura fails to recognize that, where the underwriter controls the issuer of asset-backed securities, the affiliated underwriter itself is the entity effect-

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ively creating the securities, with all of the "intimate knowledge" expected of the issuer (and its inside directors) of a traditional corporate security. Section 11 is designed such that the entity with the greatest information about the security has the greatest burden of diligence. With traditional corporate offerings, that is the issuer; here, it is the affiliated underwriter. Even when the underwriter is not affiliated with the sponsor, for the reasons stated above, the underwriter remains the actor best positioned to check the accuracy of the registration statement and its prospectus supplement and bears a heavy diligence burden should it agree to bless an RMBS offering.

c) Lead Underwriters and Participating Underwriters

***28** The lead, or managing, underwriter may be assisted by participating underwriters. "The participating underwriter's reasonable investigation may not be as heavy a burden as that of the managing underwriter's, and, in making a reasonable investigation, the participating underwriter need not duplicate the investigation made by the manager." New High Risk Ventures: Obligations of Underwriters, Brokers and Dealers, SEC Release No. 9671, *available at* 1972 WL 125474, at *6 (July 27, 1972) ("SEC Rel. 9671"). Indeed, "[t]he participant may delegate the performance of the investigation to the manager" and thereby "appoint the manager as his agent to do the investigation." *Id.* Yet, "the delegation to the manager and the subsequent reliance on his investigation must be 'reasonable in light of all the circumstances' " and the participant "must satisfy himself that the managing underwriter makes the kind of investigation the participant would have performed if he were the manager." *Id.; accord* Circumstances Affecting the Determination of What Constitutes Reasonable Investigation and Reasonable Grounds for Belief Under Section 11 of the Securities Act, SEC Release No. 6335, *available at* 1981 WL 31062, at *15 n. 66 (quoting SEC Rel. 9671). The participant "should assure himself that the manager's program of investigation and actual investigative performance are adequate." SEC Rel. 9671, 1972 WL 125474, at *6.

3. "Red Flags"

[18][19][20] For purposes of the due diligence defense, a "red flag" is any information that would cause a "prudent man in the management of his own property" to question the accuracy of the registration statement. *WorldCom,* 346 F.Supp.2d at 679 (citation omitted). Where a defendant encounters a red flag, a "duty of investigation" arises that requires the defendant to "look deeper and question more" in order to restore a reasonable belief in the registration statement's accuracy. *Id.* at 677 (citation omitted). "[W]hat constitutes a red flag depends on the facts and context of a particular case" and may require an "exquisitely fact intensive inquir[y]." *Id.* at 673, 679.

4. Industry Standards

[21][22] Industry standards are relevant to the reasonableness inquiry, but the ultimate question remains whether, given a defendant's role in the offering and access to material information, the defendant's investigation of and belief in the accuracy of the registration statement was that of a prudent man in the management of his own property. Industry standards will be less relevant when "the industry [i]s comprised of only a few participants who controlled the practice," as "the standard they developed could fall short of a standard of reasonable care," and indeed "the[se] standard setters [might] engage in a 'race to the bottom.' " *SEC v. Dain Rauscher, Inc.,* 254 F.3d 852, 857 (9th Cir.2001) (addressing "reasonable prudence" of defendant under the Securities and Exchange Act of 1934).

***29** Given the concentration in the private-label RMBS market, such caution is warranted here. And as noted above, the record reflects that RMBS sponsors often contracted with originators to limit their review of the originators' loans. Indeed, after studying RMBS securitizations during the period in question, the Financial Crisis Inquiry Commission concluded that "firms securitizing mortgages failed to perform adequate due diligence on the mortgages

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they purchased and at times knowingly waived compliance with underwriting standards.... These problems appear to have been significant." *Financial Crisis Report* at 187. In these circumstances, compliance with the industry standards of the time (assuming that such standards are shown to have existed) may do little to suggest a defendant's due diligence was adequate.

5. Review Later Mandated by the Dodd–Frank Act

Several years after the period at issue here, Congress passed the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd–Frank Act"). Section 945 of the Dodd–Frank Act requires the SEC to adopt regulations that, among other things, require the issuer of an asset-backed security to (1) "perform a review of the [underlying] assets"; (2) "disclose the nature of the review"; and (3) "disclose asset-level or loan-level data, if such data are necessary for investors to independently perform due diligence." 15 U.S.C. § 77g(c), (d). This review "should not be confused with, and [wa]s not intended to change, the due diligence defense against liability under ... Section 11." Issuer Review of Assets in Offerings of Asset–Backed Securities, SEC Release No. 9176, *available at* 2011 WL 194494, at *2 n. 9 (Jan. 20, 2011) ("SEC Rel. 9176"). The contours of the resulting rule are instructive nonetheless.

In response, the SEC adopted Rule 193. Rule 193 provides that an issuer "shall perform a review of the pool assets underlying the asset-backed security" that, "[a]t a minimum, ... must be designed and effected to provide reasonable assurance that the [prospectus] disclosure regarding the pool assets ... is accurate in all material respects." 17 C.F.R. § 230.193. In promulgating Rule 193, the SEC noted that some commentators suggested that sampling should be permitted in this review. The SEC determined as follows:

> While we agree that sampling may be appropriate depending on the facts and circumstances, we believe that whether sampling is sufficient to satisfy the "reasonable assurance" standard in Rule 193 will depend on a variety of factors, such as the type of [asset-backed security] being offered. For example, in offerings of residential mortgage-backed securities ("RMBS"), where the asset pool consists of a large group of loans, it may be appropriate, depending on all the facts, to review a sample of loans large enough to be representative of the pool, and then conduct further review if the initial review indicates that further review is warranted in order to provide reasonable assurance that disclosure is accurate in all material respects.

***30** SEC Rel. 9176, *available at* 2011 WL 194494, at *6. The SEC declined to "adopt[ ] a minimum sample size," as "any appropriate sample size must be based on the facts and circumstances." *Id.* Under these new regulations, where an issuer only reviews a sample of assets, it must disclose "the size of the sample and the criteria used to select the assets sampled." 17 C.F.R. § 229.1111(a)(7). The "findings and conclusions" of this review must also be disclosed. *Id.* at § 229.1111(a)(7)(ii).

B. Section 12(a)(2)'s Reasonable Care Defense

"Claims under sections 11 and 12(a)(2) are Securities Act siblings with roughly parallel elements." [FN46] *New Jersey Carpenters Health Fund v. Royal Bank of Scotland Group, PLC,* 709 F.3d 109, 120 (2d Cir.2013) (citation omitted). Where Section 11 concerns misstatements or omissions in a registration statement, Section 12(a)(2) "imposes liability under similar circumstances against certain 'statutory sellers' for misstatements or omissions in a prospectus." *NECA,* 693 F.3d at 156.

Like Section 11, Section 12(a)(2) provides defendants with several affirmative defenses. At issue here is the "reasonable care" defense, which is similar to Section 11's due diligence defense. Any Section 12(a)(2) defendant, including an issuer, can avoid liability under that section if he can prove "that he did not know, and in the exercise of reasonable care could not have known, of [the alleged]

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untruth or omission" in the prospectus. 15 U.S.C. § 77*l*.[FN47]

[23][24] Section 12(a) (2)'s reasonable care defense is "less demanding" in some respects than Section 11's due diligence defense. *WorldCom,* 346 F.Supp.2d at 663. "[W]hile Section 11 imposes a duty to conduct a reasonable investigation as to any portion of a registration statement not made on the authority of an expert, Section 12(a)(2) does not make any distinction based upon 'expertised' statements and only requires the defendant to show that it used reasonable care." *Id.*[FN48] Yet, under either section, "defendants ... may be held liable for mere negligence." *In re Morgan Stanley Info. Fund Sec. Litig.,* 592 F.3d at 359.

III. Nomura Failed to Conduct Reasonable Investigations or Exercise Reasonable Care.

[25] No reasonable jury could find that Nomura conducted a "reasonable investigation" and reasonably believed that the representations in the Offering Documents were accurate, or that Nomura exercised reasonable care in that regard. Nomura never created a due diligence program to confirm the accuracy of the representations in the Offering Documents. Instead, in opposing this motion Nomura relies entirely on the results of its preacquisition review of the 194 Trade Pools from which it would later take loans to populate the seven SLGs. But, Nomura took no care to design this pre-acquisition review, or the process it later used to select loans from those Trade Pools for the SLGs, to render that review, in conjunction with its selection process, a reliable basis to believe that the Offering Documents' descriptions of the SLGs were accurate.

***31** Nomura tested a single non-random sample of the 30 Sampled Bulk Pools, and its traders then pulled both reviewed and unreviewed loans from those Trade Pools to populate the SLGs not randomly, but based on credit characteristics that could well have caused it to put a string of defective loans in a given SLG. The 30 Sampled Bulk Pools were the source of more than 80% of the loans in the seven SLGs. As explained below, this process broke any link between the results of Nomura's pre-acquisition review process and the SLGs. Indeed, there is no evidence Nomura even considered during the securitization process the impact its processes would have on the accuracy of its representations in the Offering Documents. Nomura did not so much as ask this question, let alone study the applicability of its pre-acquisition review to the SLGs. Thus, there is no evidence Nomura took any steps to structure its processes to reasonably assure itself that its pre-acquisition review of the 194 Trade Pools would suffice to verify the accuracy of its later representations concerning the seven SLGs.

Even if Nomura had not broken the link between the Trade Pools and SLGs—and so could reasonably have relied on results of its review of those Pools—Nomura's review of the Trade Pools raised red flags Nomura ignored. The credit and compliance kick-out rate for the Trade Pools was 15.2%—approximately double the 7–8% the head of Nomura's Diligence Group called "typical" in late 2006, and 25% higher than the 12.12% kick-out rate he called "much higher" than that typical rate. Under a best-case scenario, in which Nomura's deliberate selections from the Trade Pools would not cause the concentration of an unrepresentatively large number of defective loans in the SLGs, Nomura would have had reason to expect—had it stopped to consider this, which there is no evidence it did—that at least as many of the unreviewed loans in the SLGs might be defective. As described below, Nomura's counsel has now calculated that it could have expected 17.6% of the unreveiwed loans to be defective. Also, as explained below, given the high kick-out rate, the testing of a single set of loans based on adverse sampling provided no reliable basis to believe that all or most of the defective loans had been located and culled. Combined with the hundreds of loans in the SLGs Nomura knew to have a final grade of EV3 (418) or to have a faulty appraisal (162), Nomura should have expected roughly 1 in 7 loans might be defective. There is, however, no evidence that Nomura *did* stop to consider this, or even looked closely enough

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at the results of its pre-acquisition review in connection with the representations about the SLGs to see these red flags.

And there is no evidence Nomura took any steps to address these red flags, even at the pre-acquisition stage. Nomura never once upsized its pre-acquisition sample for any of the 30 Sampled Bulk Pools. The head of the Diligence Group once asked to do so and was told that the Trading Desk had to be concerned about losing the opportunity to purchase loans from that Originator in the future; in any case, the Trading Desk had already agreed with the Originator to limit its sampling of that Trade Pool to 25%, sight unseen.

***32** Then, after it reviewed the results of its audit of its pre-acquisition review vendors, in August of 2006—an audit which placed it on notice that it could no longer have confidence that loans were being properly classified as EV1 and EV2—Nomura took no steps to upgrade or further investigate its review practices. Four of the Securitizations closed after that date.

In sum, there is no evidence from which a reasonable jury could find that Nomura Securities, NCCI, or the individual Nomura Defendants [FN49] met their obligations under Section 11. This is true whether judged against the standard imposed on an arms-length underwriter or the heightened standard which is appropriate here given their access to information concerning—if not control of—the statutory issuers NAAC and NHELI, such that "liability will lie in practically all cases of misrepresentation." *WorldCom,* 2005 WL 638268, at *9 (quoting *Feit,* 332 F.Supp. at 578). Similarly, no reasonable jury could find that any of the Nomura Defendants exercised reasonable care within the meaning of Section 12(a)(2).

A. Nomura Made No Attempt to Reliably Verify the Accuracy of its Representations Concerning the SLGs.

Nomura took no steps at or near the time of its securitization of the Mortgage Loans to verify the accuracy of the representations about the characteristics of the SLGs in the Offering Documents. It had no due diligence program dedicated to that task. Virtually its only nod to that obligation was its employment of an auditor to confirm that the numbers taken from the loan tapes matched the aggregate numbers represented in the Offering Documents.

To present a due diligence defense to the claims presented in this lawsuit, it has relied almost exclusively on its pre-acquisition review of the 194 Trade Pools that contributed to the seven Supporting Loan Groups at issue. Most fundamentally, the result of its non-random sampling of the Sampled Bulk Pools offered little reliable information concerning the unsampled loans taken from the Sampled Bulk Pools and placed into the SLGs. Those loans were selected ad hoc by traders for inclusion in the SLGs, based on characteristics like FICO score, LTV ratio, and region, which might correlate with underwriting defects; the traders' "artistry" (in Nomura's words) in composing these SLGs might easily cause a concentrated group of defective loans to be pulled into a SLG. Nomura did not consider these issues; its focus was on review of its Trade Pools, not on verifying representations made to investors—often months later—about different sets of its loans. Rather than undertaking the investigation required during the securitization process to check its representations in the Offering Documents—or taking care to structure its pre-acquisition reviews and the population of its SLGs to ensure that the results of those reviews remained applicable to the SLGs—Nomura simply argues now that it had checked enough of the loans earlier.

***33** Nomura's position is not without a certain intuitive appeal: Nomura argues that it checked the loans before it bought them, looking at a large sample of them (nearly 40%) to confirm they were not defective; couldn't it then have reasonable confidence that the loans were good? The problem is that, without exercising any care, Nomura then

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grabbed bundles of those loans for securitization, and grabbed particular kinds of loans—looking at factors that might cause it to bundle together a large number of defective loans. As a result, Nomura might have concentrated most of the remaining defective loans in a few SLGs.[FN50] A prudent man managing Certificates of his own worth some $2 billion would not simply close his eyes and hope certain representations about a newly composed group of loans were accurate.

Nomura has argued that its interests were aligned with investors', because of its position on the Residual Certificates. The Residual Certificates granted Nomura a first-loss position in a securitization of subprime and Alt–A—i.e., relatively high risk—loans. As the lower credit ratings of junior tranches (tranches senior to the Residual Certificates) in these securitizations confirm, loss was likely even with no defective loans.[FN51] But, Nomura's retention of these high-risk certificates signifies little about its confidence in the representations in the Offering Documents. The cash-flows in these certificates were front-loaded and Nomura did not hold them long. Nomura sold some of these interests within one month of the Residual Certificates' issuance and all of its remaining residual interests within approximately one year of each Securitization. This temporary position in a highly risky investment is not a substitute for a reasonable due diligence program and does not create a triable issue of fact for the jury on the affirmative defenses of due diligence and reasonable care.[FN52]

B. Nomura Failed to Reasonably Respond to Red Flags Raised by High Kick–Out Rates.

Not once, in the 30 Sampled Bulk Pools at issue here, did Nomura upsize a sample. Yet, among those Sampled Bulk Pools, Nomura came across some startlingly high kick-out rates. In SSM 58, Nomura kicked out nearly two-thirds of its 30% sample of the pool. Nomura explains there was an "anomalous issue" concerning documentation that motivated many of these kick-outs; but this does not explain why Nomura purchased for securitization the remaining 70% of the pool without further testing. In WMC SP01, Nomura tested a large sample in its credit and compliance review—50% of the pool—but kicked out nearly one-quarter of that sample. Nomura did not request a further sample to determine whether, after that initial culling of adverse loans, the defect rate had fallen to an acceptable level.

It is true, as Nomura emphasizes, that these were kick-out rates for "adverse" samples—90% of which were identified by S & P's LEVELS program as the highest risk loans. Putting aside Kohout's complaint that the use of LEVELS was inappropriate and assuming, *arguendo,* that LEVELS effectively identified the loans most at risk of deviating from applicable underwriting guidelines, [FN53] Nomura's reliance on a single round of adverse sampling for these 30 Sampled Bulk Pools left it without any way to determine how effective it had been in culling defective loans. Nomura had no way of knowing whether, after looking at the 100 most adverse loans in a pool (as identified by LEVELS), the next 100 would or would not be virtually as flawed. Thus, at best, Nomura could hope its adverse sample did not under-represent defective loans, and thus conclude that the defect rate for the pool as a whole was no greater than the kick-out rate for its adverse sample. It had no reasonable basis to infer anything more.

***34** In opposition to the instant motion, Nomura proffered certain calculations by non-expert David Mishol ("Mishol") that purported to determine the "maximum implied kick-out rate" for the SLGs based on the assumptions that (1) the adverse sample of each Trade Pool did not understate the average defect rate, and (2) Nomura's non-random selection of loans from the Trade Pools did not skew the defect rate for the subset of loans taken from a given Trade Pool to populate a given SLG. In an Order of December 8, the Court held this analysis, as well as portions of Nomura's brief based on it, inadmissible when offered by a fact witness, noting that FHFA would be unable to

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cross-examine Mishol—or Nomura's counsel—about the reasonableness of the two assumptions above. The Court considers it here to show that even *if* these assumptions were sound and even *if* Nomura had, in fact, considered this calculation in connection with the Securitizations—Nomura does not claim it did—it merely shows that Nomura's pre-acquisition review raised red flags to which Nomura failed to respond.

Under Mishol's "maximum implied kick-out rate" analysis, which adopts the two assumptions above, Nomura might have believed that the overall kick-out rate for the 194 Trade Pools—15.2%—might apply to the unreviewed loans in the SLGs.[FN54] Applying the kick-out rate for each Trade Pool to the unreviewed loans selected from that Pool to populate a SLG, Mishol calculates that Nomura could have expected that 1,698 unreviewed loans in the SLGs (17.6% of the 9,628 unreviewed loans) might be defective.[FN55] These 1,698 "potential kick-outs" constitute 10.7% of the SLGs. This figure is much higher in certain SLGs, reaching as high as 15.8% for the relevant SLG of NHELI 2006–FM2. Added to that are the defective, or quite possibly defective, reviewed loans that Nomura included in the SLGs despite finding they warranted an EV3 grade (418 loans) or that their appraisal was likely faulty (162 loans). For the NHELI 2007–1 Securitization, for example, 8% of the SLGs' loans had received a final grade of EV3 but were nonetheless purchased and securitized. All told, in Nomura's best-case scenario, 2,278 of the 15,806 loans in the SLGs—14.4% or 1 in 7 loans—were potentially defective.[FN56] Such a defect rate is not in accordance with Nomura's representation in the Offering Documents that "[a]ll of the mortgage loans were originated ... generally in accordance with [applicable] underwriting guidelines."

Any reasonable jury would find that high kick-out rates would shake a reasonably prudent person's confidence in the above representation, and thus constitute red flags. The parties dispute the point at which a kick-out rate is "high." The only persuasive evidence on this point is a November 2006 email from Nomura's Spagna, noting a "typical 7–8% [kick-out rate] for most subprime deals" and describing rates of 11.22% and 12.12% as "much higher" than that typical rate. A kick-out rate substantially above 7–8% would cause a prudent man in the management of his own property to question the accuracy of the Offering Documents. Here, the issue is not simply isolated Trade Pools with high kick-out rates; the *overall* kick-out rate[FN57] for credit and compliance issues among all of the Trade Pools that contributed to the seven SLGs was above 15% (and, if weighted to account for the number of unreviewed loans selected from each Pool, above 17%)—approximately double Spagna's "typical" 7–8%, despite the fact that it includes Alt–A pools as well as subprime pools.[FN58] Even if, as Nomura urges, Spagna understated a typical subprime kick-out rate as of late 2006, Nomura has offered no evidence from which a reasonable jury could find that the typical kick-out rate was not substantially below 15.2%.

***35** Nomura urges, on the basis of expert testimony, that kick-out rates are not uniform, and that a high kick-out rate will be of greater or lesser concern depending on the reason for the kick-outs. That is undoubtedly true. But, a high kick-out rate—again, a kick-out rate substantially above average—is nonetheless a red flag that triggers a duty of investigation.[FN59] That duty may be satisfied where, after a closer look or upon further investigation, the aggregator reasonably determines that, in context, the high kick-out rate does not undermine the aggregator's confidence in the representation that all loans in a Supporting Loan Group were originated generally in accordance with underwriting guidelines. Nomura has identified no evidence of any such discussions, investigations, or reasonable determinations concerning the import and irrelevance of this high kick-out rate.[FN60]

To the contrary, and as described above, Nomura never once upsized its sample for any of

the 30 Sampled Bulk Pools at issue. Even where Spagna registered concern about the results of the pre-acquisition review and recommended an upsize in sampling, there is no evidence it ever occurred. On November 15, 2006, Spagna, concerned about the characteristics of Second Mortgages in OwnIt's SP02 pool, wrote, "We need to upsize the due diligence on the 2nd." Yet, in its Pool Summary and Trade Confirmation with OwnIt, Nomura had agreed to conduct only "25% due diligence." With no evidence of further sampling, 1,438 loans from OwnIt SP02—more than 9% of all the loans in the SLGs—were used to populate the relevant SLG of NHELI 2007–2. As that SLG was composed of only 3,001 loans, the OwnIt SP02 loans comprised nearly 50% of Freddie Mac's SLG. Defendants suggest that the Court should excuse a "single instance of a relaxation of standard[s]," but, for the reasons explained above, this incident is illustrative, not exceptional.

Nomura contends that its average sample size was high (nearly 40%); why, then, should it be required to upsize? This argument misses the point. The problem is not that Nomura's samples were too small; the problem is that the *results* of Nomura's adverse-only samples—high kick-out rates—raised red flags that were never addressed. If Nomura truly believed that its adverse sampling culled from the Trade Pools all but an immaterially small number of defective loans—and if Nomura was committed to verifying the representations in its Offering Documents—it could have taken steps to confirm that belief. Without taking such steps, that belief was not reasonably held. In sum, Nomura has failed to offer evidence from which a jury could find that it exercised due diligence or reasonable care in connection with the representations in the Offering Documents that are at issue here. No reasonable jury could find that a reasonably prudent person would take so little care with her own money, much less a person with the resources and expertise of a global investment bank.

***36** This is not to single out Nomura's practices. Indeed, Nomura has offered evidence that, in some respects, it met and even exceeded any industry-wide norms that existed during this period. And Nomura has pressed, at every opportunity, evidence that Fannie Mae and Freddie Mac were aware, and never objected to, the broad contours of Nomura's pre-acquisition "diligence" regime. But, this does not render Nomura's approach to diligence reasonable. Section 11 offers a complete defense to liability for anyone (issuer aside) who exercises reasonable diligence; Section 12(a)(2) offers a similar defense to those who act with reasonable care. No reasonable jury could find that Nomura merits such protection under either standard.[FN61]

IV. RBS Failed to Conduct Reasonable Investigations or Exercise Reasonable Care.

[26] RBS's position, with respect to the instant motion, is quite different from Nomura's. Nomura did no due diligence at the time of the securitizations, instead relying here on its pre-acquisition reviews of the 194 Trade Pools that contributed loans to the seven SLGs. This reliance was unreasonable as a matter of law for the reasons given above.

For two of the Securitizations, RBS's position is not so different, as it undertook no independent review of the loan files. For one of these, RBS knew nothing of the results of Nomura's pre-acquisition review beyond a one-page summary listing kick-out rates for all Trade Pools that contributed loans to the Securitization. For the other, RBS was the sole lead underwriter, yet it relied entirely on Nomura's pre-acquisition review of the Trade Pools, never asking how loans were selected from the Trade Pools to populate the SLGs or undertaking any independent investigation of the representations in the Offering Documents.

For the other two Securitizations, however, RBS's position is quite different from Nomura's. Unlike Nomura, RBS did test the pools of loans to be securitized. The question presented here is whether that testing was so riddled with obvious deficiencies that no reasonable jury could find RBS conducted a reasonable investigation or exercised

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reasonable care. For the reasons given below, that is the case here. Accordingly, no reasonable jury could find that RBS undertook a reasonable investigation or exercised reasonable care as underwriter for these four Securitizations.[FN62]

A. 2006–HE3 & 2006–FM2

RBS signed off on the representations concerning the loans in 2006–HE3, having seen only a one-page summary of Nomura's pre-acquisition review of all the Trade Pools that contributed loans to that Securitization and a list of those Originators who contributed more than 5% of the loans to the Securitization. The one-page summary included a disclaimer advising that "[t]he material contained herein is preliminary and based on sources which we believe to be reliable, but it is not complete, and we do not represent that it is accurate." RBS has identified no evidence that it followed up on this disclaimer and demanded a representation from Nomura that this summary of Nomura's review was complete and accurate.

*37 RBS was the sole lead underwriter for 2006–FM2, yet it performed no review of the underlying loans. Instead, it relied entirely on Nomura's (which acted as issuer) pre-acquisition review of the Trade Pools. It received three spreadsheets reflecting kick-out rates for various kinds of reviews of the loans in the two Bulk Pools that contributed to the Securitization, as well the results of AMC's review.

There is no evidence that RBS ever asked in connection with either Securitization how loans in the Trade Pools were mapped to SLGs. The loans in the relevant SLG of 2006–HE3 were selected from 71 Trade Pools. Although the loans in the relevant SLG of 2006–FM2 were selected from only two Trade Pools, Nomura's credit and compliance sample was under 25% for each of these Trade Pools, and Nomura then selected—on a nonrandom basis—approximately half of those Trade Pools for the relevant SLG. Approximately 75% of the loans Nomura selected for that SLG had not been reviewed in its credit and compliance samples. Nomura's practice of non-randomly selecting loans from Trade Pools to populate the SLGs threatened to place a disproportionate number of defective loans in this SLG, as well as the relevant SLG of 2006–HE3.

In addition, BPOs Nomura ordered for 21 of the loans included in the relevant SLG for 2006–FM2 had final values so far below Fremont's appraisals that, under Nomura's policy, Nomura should have refused to purchase and securitize those loans. RBS has identified no evidence that it took any action to remedy this, despite the fact that the Offering Documents' representations concerning LTV ratios were to be based on Fremont's appraisals for those loans. The results of Nomura's pre-acquisition reviews of those Trade Pools gave RBS no reasonable basis to believe the representations in the Offering Documents were accurate.

Moreover, in both cases, RBS failed utterly to "play devil's advocate." *Feit,* 332 F.Supp. at 582 (citation omitted). It performed no "independent verification of the [sponsor]'s representations." *Id.* (citation omitted). Instead of testing those representations, it accepted them.

RBS argues that underwriters of RMBS should not be required to duplicate a review already conducted by the sponsor. Where an underwriter does not undertake its own review of the underlying loans, it must assure itself that the other entity's review upon which it purports to rely was thorough, unbiased, and reliable, and that it continues to provide a sufficient basis to believe the Offering Documents will be accurate as of the effective date of the SEC filing. An underwriter abandons the posture of a skeptic at its own peril.

Here, for reasons explained at length above, Nomura's review was unreliable. RBS has identified no reasonable basis for it to believe otherwise.

RBS claims that, although it held itself out to the public in the Offering Documents for 2006–HE3 as a co-lead underwriter, it actually

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served only as a participating underwriter, delegating its responsibilities to its co-lead underwriter, Nomura Securities. Assuming, *arguendo,* that RBS should only be required to bear the lighter burden of a participating underwriter for that Securitization, its purported agent's diligence was inadequate for the reasons above, and RBS has identified insufficient evidence for a jury to conclude that RBS had a reasonable basis to believe that Nomura Securities's "program of investigation and actual investigative performance [we]re adequate." SEC Rel. 9671, 1972 WL 125474, at *6.[FN63] As of the time of this Securitization in August 2006, RBS had received very little information about Nomura's review processes. Whether RBS is considered a co-lead underwriter or a participating underwriter, no reasonable jury could find that a prudent man in the management of his own property would do so little to assure himself that the loans were accurately described in the Offering Documents.

B. 2007–1 and 2007–2

***38** RBS did review loans in the other two Securitizations for which it served as sole lead underwriter (2007–1 and 2007–2), but these reviews were riddled with troubling features that, together, render RBS's diligence inadequate to support a defense of due diligence or reasonable care in this action as a matter of law. RBS's Credit Group called 2007–2's loans "crap" (twice) and requested a 25% sample—more than four times the size of the 6% sample RBS ultimately requested—prompting a reminder that RBS did not "own" these loans. RBS's own manual directed the Credit Group to select sample sizes based, in large part, on RBS's "exposure" on the deal.

When RBS requested small samples for these Securitizations (6%), Nomura reported that it "did not have imaged files" for a substantial number of the loans RBS sought. RBS accepted this and agreed to review only the loans Nomura turned over rather than request the paper loan files for the rest, even where that gave RBS access to only 102 of the requested 250–loan sample for 2007–1's Group II. RBS does not seem to have considered whether the files for the most troubled loans might now be missing from its sample. *Cf.* Reference Guide on Survey Research, *in* Fed. Judicial Ctr., Reference Manual on Scientific Evidence 245 (2nd ed. 2000) (Samples with response rates below 50% "should be regarded with *significant caution* as a basis for precise quantitative statements about the population from which the sample was drawn.").

When Clayton graded a high percentage of the sampled loans as "3" (or "3C" or "3D") for credit issues—27.5% of the Group II 2007–1 sample, and 16.2% of the 2007–2 sample—RBS overrode all of these grades. For 2007–1, RBS overrode 30 "3" grades in one hour.[FN64] An email from RBS's Credit Group in the same time frame explained that RBS "will not be as tough on appraisal and underwriting issues" in third-party's securitizations as it would be on RBS's own.

Finally, RBS appeared to ignore entirely the results of its valuation reviews in both Securitizations, taking no action when 15% of its sampled loans in both groups appeared to have faulty appraisals. Those loans were securitized, and the Offering Documents calculated LTV ratios based on the potentially faulty appraisals.

Resolving all factual disputes in RBS's favor, and granting RBS the benefit of all reasonable inferences, no reasonable jury, considering these facts together, could find that RBS undertook the reasonable investigation of a prudent man managing his own property, or exercised reasonable care, with respect to either of these Securitizations. It cannot rely on either affirmative defense at trial.

V. Defendants' Remaining Arguments

***39** In opposition to the instant motion, Defendants raise a number of arguments that miss the mark. They are treated, in turn, below. First, Defendants argue that their reunderwriting expert has found only a small number of defective loans among the SLGs.[FN65] Similarly, RBS argues that the reasonableness of its diligence cannot be de-

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cided before determining whether the SLGs actually contained a substantial number of defective loans and the Offering Documents were materially false. Yet, whether the challenged representations were or were not accurate has no bearing on whether Defendants undertook a reasonable investigation or exercised reasonable care to assure themselves they were. It could be the case, for instance, that the representations in the Offering Documents were perfectly true. If so, FHFA will not be able to prove the elements of its claims, and Defendants will not be liable. But, this would do nothing to improve Defendants' due diligence, and Defendants would still not be entitled to the protection of a due diligence or reasonable care defense.

Next, Defendants repeatedly urge that they met or exceeded industry standards at the time. This argument is in tension with Defendants' expert's claim that no industry standards existed during this period.[FN66] Regardless, even if a reasonable jury found that Defendants were more diligent than other underwriters of RMBS, for reasons stated above they have failed to present sufficient evidence from which a jury could find that their performance in connection with these seven Securitizations satisfied the Securities Act's standards for reasonable investigations and reasonable care. Similarly, the experience and credentials of Defendants' diligence personnel, while relevant, is far from dispositive.

Third, Defendants urge that the representations in the Offering Documents were limited in certain ways that permitted them confidence in their accuracy even if a material percentage of the loans in the SLGs were defective. For instance, Defendants emphasize that representations concerning the loans' compliance with underwriting guidelines employed the word "generally." Defendants ignore the fact that the Offering Documents represented that "*[a]ll* of the mortgage loans were originated ... generally in accordance with [applicable] underwriting guidelines." (Emphasis added.) That *all* of the loans "generally" met guidelines indicated that certain immaterial exceptions might exist, not that a material number of the loans might substantially deviate from the guidelines, without compensating factors. The statement that "a substantial portion of the mortgage loans may represent ... underwriting exceptions" based on "[c]ompensating factors" is similar. Defendants have not shown that they had a reasonable basis to believe that compensating factors existed for all (or all but an immaterial number) of the loans they could have expected not to otherwise meet an Originator's underwriting guidelines.

***40** Defendants also argue that the Offering Documents define the LTV ratio, for certain loans, as the ratio of the loan amount to the "the appraised value determined in an appraisal obtained by the originator at origination" (if less than the sales price). Yet, if it were the case that a substantial number of those appraisals were fraudulent, this definition does nothing to render those LTV ratios less misleading. In order to avail themselves of the affirmative defenses of due diligence and reasonable care, Defendants had to investigate whether the statements in the Offering Documents were reliable, and when they had reason to doubt the accuracy of those statements, whether from a post-origination BPO or other information received during their investigation, then they had a duty to take corrective action to insure the Offering Documents were not misleading.

Next, Defendants argue that the GSEs themselves were aware of many of the review and diligence practices FHFA now challenges, and that the GSEs engaged in some of these practices in their own review of whole-loan purchases.[FN67] Although this may inform, to some extent, industry standards, Defendants cannot explain how these facts (if established) would alter the application of the objective standards of reasonableness here.

Finally, RBS argues that its lesser diligence was appropriate because it was merely "additive," when considered beside Nomura's pre-acquisition reviews. For reasons explained at length above, RBS could not reasonably rely on Nomura's re-

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views and when acting as a lead or co-lead underwriter had an independent obligation under the law to conduct a reasonable investigation if it wished to rely on the affirmative defenses at issue here.

CONCLUSION

FHFA's November 10, 2014 motion for partial summary judgment is granted. Defendants may not rely on the affirmative defenses of due diligence and reasonable care under Section 11 and Section 12(a)(2) of the Securities Act and similar provisions of the Blue Sky Laws.

SO ORDERED.

FN1. The defendants are Nomura Holding America Inc.; Nomura Asset Acceptance Corp.; Nomura Home Equity Loan, Inc.; Nomura Credit & Capital, Inc.; Nomura Securities International, Inc.; David Findlay; John McCarthy; John P. Graham; Nathan Gorin; and N. Dante LaRocca ("Nomura") and RBS Securities Inc. ("RBS") (collectively, "Defendants").

FN2. RBS was then conducting business under the name "Greenwich Capital Markets, Inc."

FN3. Fannie Mae purchased one Certificate in a senior tranche of Nomura Securitization NAA 2005–AR6. Freddie Mac purchased Certificates in senior tranches of the six other Nomura Securitizations: NHELI 2006–FM1, NHELI 2006–FM2, NHELI 2006–HE3, NHELI 2007–1, NHELI 2007–2, and NHELI 2007–3. The Certificates were each guaranteed to be awarded the highest credit rating from each of four prominent credit rating agencies.

FN4. Statutory issuers, like the depositors Nomura Asset Acceptance Corp. and Nomura Home Equity Loan, Inc., have no due diligence defense under Section 11 of the Securities Act of 1933.

FN5. The loan-to-value ratio is the ratio of the loan amount to the appraised value of the property securing the loan.

FN6. Some passages below are borrowed from a prior Opinion concerning Defendants' statute of limitations defenses. *FHFA v. Nomura Holding Am. Inc.*, 11cv6201 (DLC), —— F.Supp.3d ——, 2014 WL 6462239 (S.D.N.Y. Nov. 18, 2014) (" *Nomura* ").

FN7. The Originators in these Securitizations, none of which are parties to the action, include Aegis, Alliance, EquiFirst, First NLC, Fremont, Funding America, Mandalay, Novastar, OwnIt, People's Choice, ResMAE, and Silver State.

FN8. Mortgage loans are often divided, by credit risk, into three classes. In order of ascending risk, they are "prime" loans, "Alt–A" loans, and "subprime" loans. *Nomura,* —— F.Supp.3d at —— n. 5, 2014 WL 6462239, at *2 n. 5.

FN9. Whereas the loans in a bulk or mini-bulk pool were typically underwritten to that originator's guidelines, the loans sold via the "conduit" program were underwritten to Nomura's own guidelines.

FN10. The relevant SLG of each Securitization was composed of loans drawn from the following number of Trade Pools: 31 Trade Pools (NAA 2005–AR6), 1 Trade Pool (NHELI 2006–FM1), 2 Trade Pools (NHELI 2006–FM2), 71 Trade Pools (NHELI 2006–HE3), 30 Trade Pools (NHELI 2007–1), 56 Trade Pools (NHELI 2007–2), and 27 Trade Pools (NHELI 2007–3).

FN11. As discussed below, the parties dispute whether this group was part of Nomura Securities or NCCI.

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FN12. Of the 132 Mini–Bulk Pools for which credit or compliance review documentation was produced, Nomura performed credit and compliance review on all loans in 124 pools, more than 90% of all loans in 6 pools, and more than half of all loans in 2 pools.

FN13. Nomura actually sampled 40% of Silver State 66, although it had agreed to sample no more than 30%.

FN14. Nomura cites to the testimony of Brett Marvin ("Marvin"), a supervisor, who said this email reflected "a spat," that he "yelled at [Kohout and Katz] for writing stupid stuff like this," and that the final diligence process did not rely entirely on LEVELS.

FN15. FICO refers to a consumer credit score issued by the Fair Isaac Corporation.

FN16. Although Nomura contends that, at times, the Diligence Group employed random sampling, it offers no evidence that random sampling was used in any of the Sampled Bulk Pools.

FN17. These overlays included maximum debt-to-income and loan-to-value ratios, a minimum FICO credit score, and Fannie Mae's anti-predatory lending guidelines.

FN18. Nomura has not offered numbers of its own on this point.

FN19. The numbers offered by FHFA are somewhat different, for these counts and others. Throughout this Opinion, Defendants' counts are used where available.

FN20. Nomura has not identified a single instance in which it upsized a sample in any of the Sampled Bulk Pools. Nor has Nomura's reunderwriting expert. At his deposition, the expert was asked if it was correct that he had "not been able to identify any instance in which Nomura upsized any sample in the RMBS transactions at issue." He replied: "That's correct, I did not find evidence in these pools, but I did find consistent testimony across the record that the right [to upsize] existed and nobody would have prevented it." The Court notes, however, that it appears possible that Nomura reviewed additional loans to test for a specific, widespread compliance violation in connection with two Fremont Bulk Pools (SP03 and SP04), although Nomura has not asserted that it did. There is no evidence that the Mini–Bulk Pools here were upsized either, although only a minority of those pools were not reviewed for credit and compliance issues in their entirety.

FN21. The combined loan-to-value ("CLTV") ratio applies to properties securing more than one loan. It is the ratio of the sum of all loans secured by the property to the appraised value of the property.

FN22. In its default "Pool Summary and Trade Confirmation," Nomura retained the right to force an originator to repurchase a loan in the event that the borrower defaulted on his or her first scheduled monthly payment after the trade's cut-off date (often shortly before the trade's closing date).

FN23. Those 122 loans were purchased individually through Nomura's conduit channel.

FN24. The representations at issue in these actions appear in the Securities' Prospectus Supplements. Nomura issued the seven Securitizations pursuant to three Shelf Registration Statements and seven Prospectus Supplements.

FN25. Supporting Loan Group I had the

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greatest principal amount issued (over $525 million) of any of the relevant Nomura SLGs.

FN26. Similarly, Nomura represented that "[a]ll of the Mortgage Loans have been purchased by the sponsor from the Originator and were originated generally in accordance with the underwriting criteria described in this section."

FN27. As noted above, the loan-to-value ratio is the ratio of the loan amount to the appraised value of the property securing the loan. 80% was a common benchmark used to divide lower- and higher-risk loans.

FN28. As noted above, the combined loan-to-value ratio is the ratio of the sum of all loans secured by the property to the appraised value of the property.

FN29. Offering Documents for five of the Certificates at issue included a repurchase provision requiring Originators or Nomura as sponsor to buy back or substitute a "defective" loan in certain circumstances. The Originator or sponsor was obligated to repurchase or substitute a loan if it was originated as a result of fraud, negligence, or a misrepresentation or omission. For example, with respect to 2006–FM2, NCCI, as sponsor, was required to "repurchase [a defective] Mortgage Loan or provide the trustee with a substitute Mortgage Loan," should the trustee learn that any loan "is defective on its face due to a breach of the representations and warranties with respect to that Mortgage Loan made in the transaction agreements."

FN30. The correction of data entry errors is excepted.

FN31. Payment stream exceptions may refer to regulations concerning disclosure to the borrower of the amount of future payments due.

FN32. As noted above, this is the only evidence the parties have identified suggesting Nomura may have reviewed an upsized sample, here to test for compliance violations.

FN33. For both 2007–1 and 2007–2, RBS did not select samples from the relevant SLGs, but rather from larger pools including those SLGs. In the case of 2007–1, RBS selected its sample from Group II, which was subdivided into two supporting loan groups, Group II–1 and Group II–2. Group II–1 was the SLG supporting the Certificate Freddie Mac purchased. Similarly, with respect to 2007–2, RBS selected a sample from all loans in a pool later subdivided into two supporting loan groups: Freddie Mac's SLG, Group I, and Group II.

FN34. Farrell's declaration states: "I do not recall specifically what conversations, if any, I had with individuals at Clayton regarding this pool prior to reviewing the [relevant Clayton] Report, what loans I had previously reviewed or what diligence work I had previously done on this pool." He notes that he had previously received reports on this pool and speculates that it is "likely I had already been in discussions with Clayton regarding my opinion on various types of exceptions they identified." He notes "substantial recurrence of the types of issues causing Clayton to flag the loan," and ultimately opines, "I believe I would have been able to thoughtfully review the nine loans flagged for material credit exceptions [but not "3C" or "3D"] within the course of an hour."

FN35. The parties have not identified evidence indicating why these cancellations oc-

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curred.

FN36. Available at http://www.cbo.gov/publication/21992 (last visited December 18, 2014).

FN37. Available at htp://www.gpo.gov/fdsys/pkg/GPO–FCIC/pdf/GPO–FCIC.pdf (last visited December 18, 2014).

FN38. To establish a claim under Section 11, a plaintiff must prove that it:

> (1) ... purchased a registered security, either directly from the issuer or in the aftermarket following the offering;
>
> (2) the defendant participated in the offering in a manner sufficient to give rise to liability under section 11; and
>
> (3) the registration statement "contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading."
>
> *In re Morgan Stanley Information Fund Sec. Litig.,* 592 F.3d 347, 358–59 (2d Cir.2010) (quoting 15 U.S.C. § 77k(a)).

FN39. For asset-backed securities including RMBS, the "issuer" is the "depositor," which means "the depositor who receives or purchases and transfers or sells the pool assets to the issuing entity." 17 C.F.R. §§ 229.1101, 230.193.

FN40. This defense is sometimes lumped together with the less demanding "reliance" defense under Section 11, which provides an affirmative defense for defendants other than the issuer as to "expertised" portions of a registration statement. *See* 15 U.S.C. § 77k(c). A portion of the registration statement may only qualify as "expertised" if (1) that part "purport[s] to be made on the authority of an expert"; (2) the expert is an "accountant, engineer, or appraiser, or any person whose profession gives authority to a statement made by him"; and (3) the expert's written consent is filed as an exhibit to the registration statement. *Id.* at § 77k(a)(4); 17 C.F.R. § 230.436(a), (b); *In re WorldCom, Inc. Sec. Litig.,* 346 F.Supp.2d 628, 663–64 (S.D.N.Y.2004).

> A defendant establishes a reliance defense as to "expertised" portions of the registration statement if he can prove "he had no reasonable ground to believe and did not believe, at the time such part of the registration statement became effective, that the statements therein were untrue or that there was an omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, or that such part of the registration statement did not fairly represent the statement of the expert or was not a fair copy of or extract from the report or valuation of the expert." 15 U.S.C. § 77k(b)(3)(C).
>
> The due diligence and reliance defenses are, in some contexts, collectively referred to as the "due diligence defense." In this Opinion, "due diligence defense" refers only to the defense set out in the text above concerning non-expertised portions of a registration statement, and does not include the reliance defense.

FN41. *See Securities Act: Hearings Before the Comm. on Banking and Currency,* 73rd Cong. 210 (1933) (statement of Sen. Fletcher, Chairman, S. Comm. on Banking and Currency) ("I do not see why the company [issuing securities] should not be responsible, because the people it employs to check up inventories, and all that sort of

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thing, they must know about.... [T]hey ought to be responsible....").

FN42. *See* 15 U.S.C. § 77b(a)(4) (defining "issuer" for collateral-trust certificates to "mean[ ] the person or persons performing the acts and assuming the duties of depositor or manager pursuant to the provisions of the trust or other agreement or instrument under which such securities are issued").

FN43. FHFA's Section 15 control person claims against Nomura Securities for the other four Securitizations are not at issue in this motion.

FN44. *See also Financial Crisis Report* at 165 ("The originator and the securitizer negotiated the extent of the due diligence investigation. While the percentage of the pool examined could be as high as 30%, it was often much lower; according to some observers, as the market grew and originators became more concentrated, they had more bargaining power over the mortgage purchasers, and samples were sometimes as low as 2% to 3%.").

FN45. *See Financial Crisis Report* at 166 ("[Keith] Johnson [president of Clayton from May 2006 to May 2009] concluded that his clients often waived in loans to preserve their business relationship with the loan originator—a high number of rejections might lead the originator to sell the loans to a competitor. Simply put, it was a sellers' market.")

FN46. To establish a claim under Section 12(a)(2), a plaintiff must prove:

(1) the defendant is a "statutory seller";

(2) the sale was effectuated "by means of a prospectus or oral communication"; and

(3) the prospectus or oral communication "include[d] an untrue statement of a material fact or omit[ted] to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading."

In re Morgan Stanley, 592 F.3d at 359 (quoting 15 U.S.C. § 77*l*(a)(2)).

FN47. The Blue Sky Laws contain substantially identical reasonable care defenses. D.C.Code § 31–5606.05(a)(1)(B) (providing affirmative defense for offerors or sellers if they "did not know, and in the exercise of reasonable care could not have known, of the untruth or omission"); Va.Code § 13.1–522(A)(ii) (providing affirmative defense for seller who "did not know, and in the exercise of reasonable care could not have known, of such untruth or omission"). The parties agree that these defenses should be interpreted in accord with the Section 12(a)(2) defense. *See also FHFA v. Bank of Am. Corp.,* 11cv6195 (DLC), 2012 WL 6592251, at *7 n. 8 ("[T]he D.C. and Virginia securities laws are generally interpreted in accordance with Section 12(a)(2).") (collecting cases).

FN48. While a Section 11 defendant cannot avail himself of the due diligence defense if he failed to conduct a reasonable investigation, even where that investigation would not have uncovered the alleged misstatement, the same may not be true of Section 12(a)(2)'s reasonable care defense. *See* 15 U.S.C. § 77*l* (defendant must prove "he did not know, and in the exercise of reasonable care *could not have known,* of [the] untruth or omission") (emphasis added); *see also WorldCom,* 346 F.Supp.2d at 661 n. 40 (noting open question). Because defendants do not contend that they would have been unable to discover the in-

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accuracy of any alleged misstatements had they exercised greater care, the Court need not reach this question.

FN49. The individual Defendants do not claim to have undertaken any additional diligence in connection with these Securitizations. Graham, for instance, asserts that he "relied on the due diligence performed at the time of whole loan acquisition to ensure that the information presented to investors about those loans in the offering materials was correct." Such reliance was unreasonable for the reasons stated above.

FN50. Nomura has urged the Court to consider its diligence program as a whole, and has not argued that its review of any particular Securitization was more reliable than its review of any other. Nonetheless, the Court notes that Nomura's argument that it could reasonably rely on its pre-acquisition review applies with the most force to NHELI 2006–FM1 and NHELI 2006–FM2, where the loans in the relevant SLGs of those Securitizations were drawn from only one and two Trade Pools, respectively (Fremont SP02 for NHELI 2006–FM1, and Fremont SP03 and SP04 for NHELI 2006–FM2). But, Nomura's credit and compliance sample was under 25% for each of these Trade Pools, and it then selected—on a nonrandom basis—approximately half of those Trade Pools for the SLGs at issue. Nomura's practice of non-randomly selecting loans from Trade Pools to populate the SLGs threatened to place a disproportionate number of defective loans even in these SLGs.

FN51. The junior tranches had ratings as low as BBB or BBB-.

FN52. Nomura also entered certain short positions that hedged the risk it bore from the Residual Certificates.

FN53. Because LEVELS identified loans with the greatest risk of early payment defaults, it may have conflated credit risk (among loans accurately represented on the loan tapes) with the risk of fraud or originator error. Although there may well be some correlation between the loans most likely to deviate from the contours of a given underwriter's guidelines and the loans most likely to default, Nomura has offered no evidence to indicate that these groups are coextensive. There is evidence that at least RBS recognized that selecting loans with certain "adverse" characteristics may not capture all the fraudulent loans.

FN54. FHFA's figures are much higher than Mishol's. But, again, for purposes of this motion Nomura's figures are accepted.

FN55. This figure, 17.6%, differs from the overall kick-out rate for the Trade Pools, 15.2%, because different proportions of unreviewed loans were taken from each Trade Pool. Where more unreviewed loans were taken from a given Trade Pool, its kick-out rate applies to a larger number of unreviewed loans in the SLGs, producing a higher number of expected defective loans. The fact that the potential defect rate among the unreviewed loans in the SLGs, 17.6%, is greater than the kick-out rate for the Trade Pools as a whole, 15.2%, indicates that a disproportionate number of unreviewed loans in the SLGs were taken from Trade Pools with above-average kick-out rates.

FN56. This calculation sums the 1,698 unreviewed loans Nomura could expect to be defective with the 418 Securitized EV3 Loans and the 162 loans with out-of-tolerance BPOs to find that 2,278 of the 15,806 loans in the SLGs (14.4%, more

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than 1 in 7) could be expected to be defective. Note that this figure excludes the 96 unreviewed loans selected from the eight Trade Pools for which the results of credit and compliance reviews (including kick-out rate) are not available.

FN57. This rate is equal to the weighted average kick-out rate among the Trade Pools, where each Trade Pool's kick-out rate is weighted by the number of loans initially in the pool.

FN58. As Alt–A loans should have a lower incidence of fraud and overly aggressive underwriting than subprime loans, Alt–A pools should have a lower average kick-out rate than subprime pools.

FN59. "[W]hat constitutes a red flag depends on the facts and context of a particular case" and may require an "exquisitely fact intensive inquir [y]." *WorldCom,* 346 F.Supp.2d at 673, 679. Where no reasonable jury could disagree as to the existence of a red flag, this determination can be made as a matter of law.

FN60. Although Nomura's excluded "implied maximum kick-out rate analysis" indicates that this rate was lower for some of the Securitizations, Nomura has failed to offer evidence that it actually considered this at or before the time of those Securitizations. In any case, as Nomura urges, its purported "due diligence" program must be evaluated as a whole.

FN61. In light of Nomura's lack of any reasonable credit and compliance due diligence program, the Court need not separately address Nomura's valuation diligence. Here, where due diligence was required to confirm the accuracy of representations concerning fundamental characteristics of a group of assets, Nomura has not argued that it would be proper to consider its due diligence defense separately with respect to each alleged misrepresentation. As Nomura recognizes, "the proper question is the reasonableness of [Nomura's due diligence processes] as a whole." Indeed, the plain language of Section 11 speaks of a singular "reasonable investigation" after which defendant reasonably believed that all of "the statements [in the offering documents] were true." Similarly Section 12 speaks of the singular "exercise of reasonable care."

FN62. As neither Nomura nor RBS is entitled to a due diligence or reasonable care defense as a matter of law for the reasons stated here, the Court need not reach the parties' dispute over when, or whether, statistically reliable random sampling is required when reviewing asset pools.

FN63. The Court need not decide whether a participating underwriter may be entitled to a due diligence defense if it reasonably assures itself that a lead underwriter's diligence was adequate, when in fact it was not.

FN64. In opposition to this motion, Farrell declares that he has no recollection of this review, but speculates that he may have been in prior discussions with Clayton about some of these issues. The Court need not determine whether a reasonable jury could find these overrides were ordered after finding appropriate cures or compensating factors—a close question—because this would not change the conclusion that, considered as a whole, these other facts concerning RBS's sampling and response to out-of-tolerance BPOs would require summary judgment for FHFA on RBS's due diligence and reasonable care defenses.

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FN65. Not surprisingly, FHFA will seek to offer evidence to the contrary at trial.

FN66. Defendants' expert opines that "[t]here were no specific rules or industry standards creating requirements or processes for due diligence in RMBS transactions during the relevant period."

FN67. In other Opinions issued in this coordinated litigation, as well as in briefing on pending motions in *limine* in this action, the extent to which Fannie Mae and Freddie Mac securitized residential mortgages that they purchased has been described. Fannie Mae did not securitize either subprime or Alt–A mortgages. Freddie Mac securitized some Alt–A and subprime mortgages, but its participation in that securitization market was small. In any event, the GSEs retained the risk of nonpayment for their securitizations. *See FHFA v. UBS Americas Inc.*, 2013 WL 3284118 at *6, *8 n. 7, *23 (S.D.N.Y. June 28, 2013).

S.D.N.Y.,2014.
Federal Housing Finance Agency v. Nomura Holding America Inc.
--- F.Supp.3d ----, 2014 WL 7232443 (S.D.N.Y.), Fed. Sec. L. Rep. P 98,328

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Only the Westlaw citation is currently available.

United States District Court,
C.D. California.
Jeff FEYKO, individually and on behalf of all others similarly situated, Plaintiff,
v.
YUHE INTERNATIONAL, INC., Gao Zhentao and Hu Gang, Defendants.

No. CV 11–05511 DDP (PJWX).
Docket Nos. 79–83.
March 5, 2013.

Casey Edwards Sadler, Lionel Zevi Glancy, Michael M. Goldberg, Peter A. Binkow, Glancy Binkow & Goldberg LLP, Los Angeles, CA, Thomas C. Bright, Gold Bennett Cera and Sidener, San Francisco, CA, for Plaintiff.

Sara Beth Brody, Sidley Austin LLP, San Francisco, CA, Julia B. Strickland, John R. Loftus, Stroock and Stroock and Lavan LLP, Joseph A. Escarez, Los Angeles, CA, for Defendant.

ORDER GRANTING IN PART AND DENYING IN PART MOTIONS TO DISMISS AND STRIKE
DEAN D. PREGERSON, District Judge.

I. *Background*

*1 Lead Plaintiff aAd Partners LP alleges that it purchased shares of common stock of Yuhe International, Inc. ("Yuhe"), during the class period, including in the October 20, 2010 secondary offering of Yuhe shares. (Supplemental Consolidated Class Action Complaint ("CAC") ¶ 17, Docket No. 70.) There are three groups of Defendants in this case (collectively "Defendants"). The "Yuhe Defendants" are comprised of Yuhe ("Yuhe"), and the "Individual Defendants": Zhentao Gao ("Gao"), Yuhe's CEO, Chairman of the Board, and largest shareholder, Hu Gang ("Gang"), Yuhe's CFO; and Jiang Yingjun ("Yingjun"), Yuhe's Chief Accounting Officer. (*Id.* ¶¶ 19–21.) The second group is comprised only of Child, Van Wagoner & Bradshaw ("the Auditor Defendant"), which was Yuhe's independent auditor from March 12, 2008 to December 7, 2009, and from March 9, 2010 to June 17, 2011. (*Id.* ¶ 27.) The third group is called the "Underwriter Defendants." They are Roth Capital Partners, LLC ("Roth"); Brean Murray, Carret & Co., LLC; and Global Hunter Securities, LLC, and they were the underwriters for Yuhe's October 20, 2010 public offering, with Roth serving as the "book-running manager of the Offering". (*Id.* ¶¶ 23, 25–26.) [FN1]

FN1. Rodman & Renshaw, LLC ("Rodman") was also an underwriter, and was also named as a defendant in this action. (*Id.* at ¶ 24.) However, Rodman has filed for bankruptcy. (Docket No. 126.) Pursuant to section 326 of the Bankruptcy Code, the instant action is stayed as to Rodman only. The Court notes that Lead Plaintiff has not objected to staying the action against Rodman.

The CAC alleges four claims, with the first and second falling under the Securities Exchange Act of 1934 and the third and fourth under the Securities Act of 1933. Lead Plaintiff's first claim alleges the Yuhe Defendants violated Section 10(b) of the Exchange Act. The second claim alleges the Individual Defendants were control persons, who violated Section 20(a) of the Exchange Act. The third claim alleges that all Defendants violated Sections 11 and 15 of the Securities Act. Lead Plaintiff's fourth claim alleges that the Underwriter Defendants violated Section 12(a)(2) of the Securities Act. All Defendants have moved to dismiss all claims against them. The Yuhe Defendants and the Underwriter Defendants have also moved to strike Lead Plaintiff's CAC. For the reasons stated below, the Court DENIES the Defendants' motions, with the exception of GRANTING dismissal of the Section 11 claim against the Underwriter Defendants, GRANTING Dismissal of the Section 10(b) claim

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against Gang, and GRANTING dismissal of the Section 12(a)(2) and Section 11 claims of all subclass members whose Yuhe shares are only traceable to the second offering. Dismissal is without prejudice, except as to the Section 12(a)(2) claims.

Yuhe sells broiler chickens. (CAC ¶ 18.) On December 31, 2010, Yuhe filed a Form 8–K announcing that it entered into an agreement with Waifang Dajiang ("Dajiang") to purchase thirteen breeder farms, and that Yuhe had already paid the first of two installments on those farms. (*Id.* ¶ 44.) Another Form 8–K, filed on January 4, 2010, attached a press release that was entitled "Yuhe International, Inc. Increases Number of Breeder Farms to 27." (*Id.* ¶ 45.) Gao was quoted in this press release as stating, "By purchasing these thirteen breeder farms, we are able to quickly increase our production capacity of day-old broilers." (*Id.*) The acquisition was touted as increasing Yuhe's "capacity by 60%." (*Id.* ¶ 46.) On March 11, 2010, Yuhe reported that its independent auditor, Grant Thornton, resigned on March 5, 2010. (*Id.* ¶ 47.) Yuhe's Form–10k Annual Report for 2009 was filed on March 31, 2010, and repeated that Yuhe contracted to purchase thirteen breeder farms from Dajiang, and had paid 80% of the total consideration by December 31, 2009. (*Id.* ¶ 49.) Gao, Gang, and Yingjun signed the Form 10–K, and Gao and Gang signed its Sarbanes–Oxley certification. (*Id.* at ¶ 50.) Between March and October 2010 a number of Yuhe's SEC filings indicated that it had acquired the thirteen breeder farms from Dajiang. (*Id.* at ¶¶ 46, 48, 49, 53–59.) Yuhe's October 20, 2010 Prospectus Supplement incorporated many of the SEC filings discussed above. (*Id.* at ¶¶ 71–72.) It also incorporated the Auditor Defendant's opinion, which contained various alleged misrepresentations about the Dajiang acquisition. (*Id.* at ¶¶ 90–101.) From October 20, 2010, to November 2, 2010, Yuhe sold $4,140,000 newly-issued shares at $7 each pursuant to its second offering. (*Id.* at ¶¶ 60,61.) The Underwriter Defendants were awarded shares pursuant to this offering. (*Id.*)

*2 On May 16, 2011, Yuhe filed Form 10–Q with the SEC, with Gao and Gang signing its accompanying Sarbanes–Oxley certifications, which reaffirmed that Yuhe acquired thirteen breeder farms from Dajiang in December 2009, and had already paid Dajiang over $12 million in this transaction. (*Id.* ¶ 67.)

On June 8, 2011, GeoInvesting spoke with Mr. Xuejing Zheng ("Zheng"), Chairman and General Manager of Dajiang. (*Id.* ¶ 76.) Zheng told GeoInvesting that Yuhe never purchased breeding farms from Dajiang, nor had the two discussed such an acquisition. (*Id.* ¶ 77.) The next day, GeoInvesting again spoke with Zheng, in part because it heard that Dajiang and Yuhe actually engaged in acquisition negotiations with Yuhe in 2009. (*Id.* ¶ 78.) Zheng admitted that the two did talk, but that it was only once, and that Dajiang "did not proceed with this deal." (*Id.*) Zheng also stated that the only deal Yuhe proposed was a fake deal: "They told us to make a fake deal-it's like I lease your facilities to make a fake deal for my U.S. listing...." (*Id.* ¶ 78 (internal quotation mark omitted).)

On June 13, 2011, GeoInvesting released transcripts of its conversations with Zheng, and Yuhe's stock price dropped 12.77% that day. (*Id.* ¶¶ 75–76, 103–104.) The next day, Yuhe held a conference call, where it asserted that Zheng was asked misleading questions, and that Zheng would cooperate with Yuhe to clear up the "misunderstandings." (*Id.* ¶ 80.) Yuhe's stock closed at $4.35 on that day. (*Id.* ¶ 105.)

The next day, GeoInvesting had another conversation with Zheng, where he insisted Dajiang and Yuhe never reached an agreement: "Did not reach the agreement. After the failure to do a deal with us, I don't know why Yuhe claims this in the United States. Maybe for cheating money or for cheating to list in the United States?" (*Id.* ¶ 81.) GeoInvesting released this conversation on June 16, and Yuhe's stock dropped to $1.96 per share that day. (*Id.* ¶ 107.)

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On June 17, 2011, Yuhe hosted a conference call, where its representatives stated that the contract with Dajiang had been retracted, and that the funds for that transaction were put into a different company. (*Id.* ¶ 83.) Below are excerpts of what the CEO (Gao), CFO, and CAO said on the conference call about what happened with the Dajiang deal, why it was not disclosed, and what the company did with the money it previously asserted was already paid in that deal:

• CAO: "[W]e worried that the cancellation of the contract and refunded cash would provoke negative reactions from the capital market."

• CEO: "[M]anagement was under huge pressure to deliver what we had previously promised."

• CFO: "The contract retract happened after our previous auditor Grant Thorton resigned [March 5, 2010], so CEO worried that a retracted contract would increase negative investor sentiments and adversely affected [sic] the share price."

***3** • CEO: "[I]f the Company just put these [sic] money aside for cash reservation of purchasing additional breeder farms other than those farms from Dajiang, it wouldn't impact the financials or the Company and hence no volatility in the share price."

• When one individual on the call "pointed out that as of May 16, 2011, Yuhe represented that it had possession of the thirteen Dajiang breeding farms," the CEO responded: "After the incident, the management was under huge pressure to deliver what we had previously promised ... The CEO takes full responsibility for not disclosing the change in a timely manner...."

(*Id.* ¶¶ 47, 83.)

On June 17, 2011, the Auditor Defendant resigned, in light of the "Company's management's misrepresentation and failure to disclose material facts surrounding certain acquisition transactions and off-balance sheet related party transactions." (*Id.* ¶ 84.) On June 28, 2011, NASDAQ delisted Yuhe, citing the company's "false public disclosures, which persisted for well over a year, related to the Company's purported acquisition of farms Dajiang." (*Id.* ¶ 85.)

II. *Legal Standard*

A complaint will survive a motion to dismiss when it contains "sufficient factual matter, accepted as true, to state a claim to relief that is plausible on its face." *Ashcroft v. Iqbal,* 556 U.S. 662, 678, 129 S.Ct. 1937, 173 L.Ed.2d 868 (2009) (quoting *Bell Atl. Corp. v. Twombly,* 550 U.S. 544, 570, 127 S.Ct. 1955, 167 L.Ed.2d 929 (2007)). When considering a Rule 12(b)(6) motion, a court must "accept as true all allegations of material fact and must construe those facts in the light most favorable to the plaintiff." *Resnick v. Hayes,* 213 F.3d 443, 447 (9th Cir.2000). Although a complaint need not include "detailed factual allegations," it must offer "more than an unadorned, the-defendant-unlawfully-harmed-me accusation." *Iqbal,* 556 U.S. at 678. Conclusory allegations or allegations that are no more than a statement of a legal conclusion "are not entitled to the assumption of truth." *Id.* at 679. In other words, a pleading that merely offers "labels and conclusions," a "formulaic recitation of the elements," or "naked assertions" will not be sufficient to state a claim upon which relief can be granted. *Id.* at 678 (citations and internal quotation marks omitted).

"When there are well-pleaded factual allegations, a court should assume their veracity and then determine whether they plausibly give rise to an entitlement of relief." *Id.* at 679. Plaintiffs must allege "plausible grounds to infer" that their claims rise "above the speculative level." *Twombly,* 550 U.S. at 555–56. "Determining whether a complaint states a plausible claim for relief" is a "context-specific task that requires the reviewing court to draw on its judicial experience and common sense." *Iqbal,* 556 U.S. at 679.

III. *Analysis*

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A. ***Yuhe Defendants' Motion to Dismiss the Section 10(b) Claim***

***4** To state a claim for securities fraud under Section 10(b) of the Securities Exchange Act and Rule 10b–5 promulgated thereunder, plaintiffs must plead particularized facts demonstrating "(1) a material misrepresentation or omission of fact, (2) scienter, (3) a connection with the purchase or sale of a security, (4) transaction and loss causation, and (5) economic loss." *Zucco Partners, LLC v. Digimarc Corp.,* 552 F.3d 981, 990 (9th Cir.2009) (citations and internal quotation marks omitted).

The Yuhe Defendants argue Lead Plaintiff's Section 10(b) claim should be dismissed for several reasons. First they argue that "allegations based on the" GeoInvesting report "should be rejected." (*See generally* Docket No. 82 at 7:3–9:20.) Because the Yuhe Defendants' argument on this point closely parallels its motion to strike, it will be discussed in the analysis of that motion. Although the standard for a motion to strike is different from one to dismiss, the Yuhe Defendants' motion to dismiss argument fails for the same reason its motion to strike argument fails.

The Yuhe Defendants next state that the CAC does not plead material misrepresentations. (*Id.* at 9:21–10:13, 16:8–17:5.) In alleging a Section 10(b) claim under the Private Securities and Litigation Reform Act, a plaintiff must meet heightened standards for alleging falsity and scienter. In alleging falsity, a Plaintiff must "specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed." 15 U.S.C. 78u–4(b)(1). A statement must be false when made to be actionable. *In re Am. Apparel, Inc. S'holder Litig.,* 855 F.Supp.2d 1043, 1071 (C.D.Cal.2012). "For purposes of securities fraud, materiality depends on the significance the reasonable investor would place on the withheld or misrepresented information.... A statement is material if a reasonable investor would have considered it useful or significant." *United States v. Jenkins,* 633 F.3d 788, 802 (9th Cir.2011) (internal quotation marks and citations omitted). "Questions of materiality ... involv[e] assessments peculiarly within the province of the trier of fact.... Thus, the ultimate issue of materiality [is] appropriately resolved as a matter of law only where the omissions are so obviously important to an investor, that reasonable minds cannot differ ..." *Siracusano v. Matrixx Initiatives,* Inc., 585 F.3d 1167, 1178 (9th Cir.2009), *aff'd,* — U.S. ——, 131 S.Ct. 1309, 179 L.Ed.2d 398 (U.S.2011) (internal quotation marks and citations omitted).

Lead Plaintiff has pled that a material misrepresentation occurred.[FN2] As discussed, Zheng told GeoInvesting that no agreement was ever reached between Yuhe and Dajiang, thus making all Yuhe's SEC filings, at least one of which all of the Individual Defendants signed, reporting the contrary false.

FN2. The Court is under no obligation to evaluate every misrepresentation that was made in the CAC, because Plaintiff can survive a motion to dismiss by alleging a single material misrepresentation. *See Cunha v. Hansen Natural Corp.,* No. EDCV 08–1249–GW JCX, 2011 WL 8993148 (C.D.Cal. May 12, 2011) (holding that "there is no reason that [the Court] must address parts of the CAC that do not work.")

***5** Putting the statements that Zheng made to GeoInvesting aside, Lead Plaintiff has still shown that there was a misrepresentation. Although the Individual Defendants stated in the June 17, 2011 conference call that they had a contract with Dajiang, the CEO makes clear that the contract was cancelled by in March 2010: "From March 2010 to the present, the company had completed the acquisition of eleven breeder farms with the cash refunds from Dajiang." (CAC ¶ 83.) However, and as discussed, from March 2010 through May 2011 Yuhe

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represented to the SEC on a number of occasions that it had an agreement with Dajiang, and on one such occasion, all of the Individual Defendants signed a document containing the misrepresentation. (*Id.* ¶ 83.)

The Court does not find that these misrepresentations were immaterial as a matter of law. Materiality is rarely appropriate to decide at the motion to dismiss stage. *Siracusano,* 585 F.3d at 1178. The Yuhe Defendants' best argument that the misrepresentations were immaterial is that Yuhe began purchasing other breeding farms when the Dajiang deal failed. (CAC ¶ 83.) As the complaint states, eleven were acquired from March 2010 to June 2011. (*Id.*) However, acquiring different farms at a later date does not moot the materiality of the Dajiang misrepresentations.

The Yuhe Defendants also assert that Lead Plaintiff cannot show scienter. The scienter requirement is satisfied when "a complaint ... allege[s] that the defendant made false or misleading statements either intentionally or with deliberate recklessness." *In re VeriFone Holdings, Inc. Sec. Litig.,* No. 11–15860, 2012 WL 6634351, at *4 (9th Cir. Dec.21, 2012) (quotation marks omitted). Scienter is shown "only if a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged." *Zucco Partners, LLC v. Digimarc Corp.,* 552 F.3d 981, 991 (9th Cir.2009) (quotation marks omitted). To determine scienter, the complaint's allegations must be read "holistcally." *In re VeriFone,* 704 F.3d 694, 2012 WL 6634351, at *5. The Ninth Circuit has recently made clear that courts do not need to consider whether each allegation of scienter creates a strong inference of that mental state, because a holistic review will suffice. *Id.* at *6 (engaging in a holistic analysis, but noting a dual analysis, where allegations are analyzed individually and then holistically, is "permissible").

Lead Plaintiff has sufficiently alleged scienter as to Gao, and thus has also successfully alleged it as to Yuhe. *See Glazer Capital Mgmt., LP v. Magistri,* 549 F.3d 736, 744 (9th Cir.2008). The CEO, Gao, proposed a "fake deal" to Zheng in order to lure American investment. (CAC ¶ 78.) Moreover, Gao and the CAO, Yingjun, both made remarks at the June 17 conference call indicating that they intentionally did not reveal that the Dajiang deal was "retract[ed]":

***6** • CAO: "[W]e worried that the cancellation of the contract and refunded cash would provoke negative reactions from the capital market."

• CEO: "[M]anagement was under huge pressure to deliver what we had previously promised."

• CFO: "The contract retract happened after our previous auditor Grant Thorton resigned, so CEO worried that a retracted contract would increase negative investor sentiments and adversely affected [sic] the share price."

• CEO: "[I]f the Company just put these [sic] money aside for cash reservation of purchasing additional breeder farms other than those farms from Dajiang, it wouldn't impact the financials of the Company and hence no volatility in the share price."

(*Id.* ¶ 83.)

There is also sufficient scienter regarding Yingjun. On the June 17, 2011, conference call he expressed taking part in a scheme to hide the fact that the Dajiang deal fell through, which on that call was claimed to have occurred by March 2010: "Since we had a contract signed with Dajiang and the contract was disclosed, we worried that the cancellation of the contract and refunded cash would provoke negative reactions from the capital market." (*Id.*) The heightened scienter standard is not met for Gang, the CFO, though. The CAC avers that the CEO hid the breakdown of the Dajiang deal from Gang. (*Id.*) Additionally, the CAC does not provide enough information about Gao's duties as CFO for the Court to infer that he would have had

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knowledge of something the CEO actively hid from him. (*See Id.* ¶ 116) (describing the Individual Defendants' job duties generally, and not specifically discussing Gao's).

B. *The Section 11 Claim Against All Defendants*

The CAC states that all Defendants are liable under Section 11 of the Securities Act, because there were materially false statements about the Dajiang acquisition in the Prospectus and Prospectus Supplement for Yuhe's second stock offering. (CAC ¶¶ 129–44.) The Yuhe Defendants and the Underwriter Defendants argue Lead Plaintiff does not have standing to pursue a Section 11 claim.[FN3]

FN3. The Underwriter Defendants also argue that the Section 11 claim should be stricken for this same reason. The Underwriter Defendants motion to strike argument, thus, fails for the same reason its motion to dismiss argument does.

Section 11 of the Securities act "provides a cause of action to any person who buys a security issued under a materially false or misleading registration statement." *In re Century Aluminum Co. Sec. Litig.,* No. 11–15599, 2013 WL 11887, at *1 (9th Cir. Jan.2, 2013). To have standing to sue under Section 11 plaintiffs must show they "have purchased shares in the offering made under the misleading registration statement," or if they purchased their shares in the aftermarket standing will be found "provided they can trace their shares back to the relevant offering." *Id.* The latter approach is "often impossible," and conclusory allegations in the complaint that the shares are traceable will not suffice. *Id.* at *1–2.

The CAC alleges that on October 20, 2010 there was a second offering for Yuhe stock at a price of $7 per share. (CAC ¶ 60.) It is also alleged that Lead Plaintiff bought shares "pursuant to the October 20, 2010 Prospectus Supplement," and that it purchased stock "pursuant to the offering." (CAC ¶¶ 17, 60, 130, 139.) When plaintiffs purchase stock pursuant to an offering or a prospectus, it means that they have purchased stock from its issuer. *See In re Levi Strauss & Co. Sec. Litig.,* 527 F.Supp.2d 965, 983 (N.D.Cal.2007); *In re Nat'l Golf Properties, Inc.,* No. CV 02–1383GHK(RZX), 2003 WL 23018761, at *2. A conclusory statement that stock is traceable to a particular offering will not suffice, because it is difficult to trace the chain of custody of stock in the aftermarket. *In re Century Aluminum Co. Sec. Litig.,* 704 F.3d 1119, 2013 WL 11887, at *2 (9th Cir. Jan.2, 2013). However no such difficulty exists when stock is purchased pursuant to a prospectus or offering, so Plaintiff's allegations in paragraphs 17, 60, 130, and 139 will suffice. Nevertheless, since Plaintiff seeks to represent members of the Subclass who purchased Yuhe stock that is traceable to the secondary offering, and since Lead Plaintiff does not provide any detailed analysis as to how these Subclass members' shares can be traced to the relevant offering, the Court dismisses the Section 11 claims of these subclass members. (CAC ¶ 1; *See generally* CAC); *See In re Century Aluminum Co. Sec. Litig.,* 704 F.3d 1119, 2013 WL 11887, at *1–2.

*7 The Yuhe Defendants next state that Lead Plaintiff's Section 11 claim sounds in fraud, and that Lead Plaintiff has not alleged sufficient facts to prove such a claim. "To ascertain whether a complaint 'sounds in fraud' we must normally determine, after a close examination of the language and structure of the complaint, whether the complaint 'allege[s] a unified course of fraudulent conduct' and 'rel[ies] entirely on that course of conduct as the basis of a claim.' " *Rubke v. Capitol Bancorp Ltd,* 551 F.3d 1156, 1161 (9th Cir.2009) (citation omitted). Lead Plaintiff does not seriously contest whether the Section 11 claim against the Yuhe Defendants sounds in fraud; it only argues that it satisfied its pleading obligations should the Court find that it does. (Docket No. 111 at 22:14–19.) Lead Plaintiff has, thus, conceded that this claim against the Yuhe Defendants sounds in fraud.[FN4] Cent. Dist. L.R. 7–12.

FN4. Although Lead Plaintiff's Section 11

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claim against the Yuhe Defendants sounds in fraud, this ruling does not automatically apply to the other Defendants. *Mallen v. Alphatec Holdings, Inc.,* 861 F.Supp.2d 1111, 1125 (S.D.Cal.2012); *In re Fuwei Films Sec. Litig.,* 634 F.Supp.2d 419, 437 (S.D.N.Y.2009). The Underwriter Defendants do not argue this point. The Auditor Defendant seems to argue it in the reply brief, (Docket No. 120 at 2:8–25), but the Court need not consider new arguments first raised in a reply brief. *See Zamani v. Carnes,* 491 F.3d 990, 997 (9th Cir.2007) (affirming district court's decision to reject points raised for the first time in reply).

A Section 11 claim that sounds in fraud does not need to meet the "heightened pleading requirements of the PSLRA," but under Rule 9(b) the claim must "set forth what is false or misleading about a statement, and why it is false." *Rubke,* 551 F.3d at 1161 (citations omitted). As discussed, the October 20, 2010 Prospectus Supplement incorporated by reference a number of previous SEC filings that falsely claimed, among other misrepresentations, that Yuhe had an agreement with Dajiang. (CAC ¶¶ 71–72.) Therefore, Lead Plaintiff has met its burden regarding alleging a Section 11 claim that sounds in fraud. The Auditor Defendant argues that it is entitled to a loss causation affirmative defense as a matter of law. "To establish a 'loss causation' defense under Section 11(e), [defendant] needed to prove that the depreciation in value ... resulted from factors other than the ... material misstatement." *In re Worlds of Wonder Sec. Litig.,* 35 F.3d 1407, 1422 (9th Cir.1994) (internal quotations and citation omitted). Because of the "fact-intensive" nature of a causation analysis, it usually must be established in summary judgment or trial, not a motion to dismiss. *In re Countrywide Fin. Corp. Sec. Litig.,* 588 F.Supp.2d 1132, 1171 (C.D.Cal.2008). The burden for proving loss causation is "heavy," and the defense "can be used as a ground for dismissal on a Rule 12(b)(6) motion to dismiss only if the merits of the defense are apparent on the [complaint's] face ..." *In re DDi Corp. Sec. Litig.,* No. CV 03–7063 NM, 2005 WL 3090882 (C.D.Cal. July 21, 2005) (internal quotation marks and citations omitted).

The Auditor Defendant is alleged to have reported Yuhe's finances in a way that falsely made it look like Yuhe had purchased the Dajiang farms, when Yuhe had not. (CAC ¶¶ 91–92.) Principally, the Auditor Defendant argues: "[T]he conclusion is inescapable that the decline in the value of Yuhe's shares was due to the combination of [the Auditor Defendant's] resignation driven by events that occurred in connection with the report of GeoInvesting ..." (Docket No. 80 at 10:1–5.) However, the Auditor Defendant's resignation and the GeoInvesting Report are not so separable from the Auditor Defendant's alleged misstatements. GeoInvesting's report exposed Yuhe's misrepresentation about acquiring breeder farms from Dajiang, a misrepresentation that the Auditor Defendant's analysis of Yuhe's finances further propagated. Because the Auditor Defendant's alleged misrepresentation is interrelated to Yuhe's, because Yuhe's stock dropped when that misrepresentation was exposed, and because causation is rarely appropriate at the motion to dismiss stage, the Court cannot find that the Auditor Defendant is entitled to the loss causation defense as a matter of law.

***8** The Auditor Defendant also seeks dismissal of Lead Plaintiff's Section 11 claim on grounds that the CAC has not alleged facts sufficient to prove negligence. (Docket No. 80 at 5:18–20.) However, Section 11 only requires a plaintiff to prove "(1) that the registration statement contained an omission or misrepresentation, and (2) that the omission or misrepresentation was material, that is, it would have misled a reasonable investor about the nature of his or her investment." *Rubke,* 551 F.3d at 1161 (internal quotation marks and citation omitted). Section 11 generally holds "the issuer of the securities ... absolutely liable." *Ernst & Ernst v. Hochfelder,* 425 U.S. 185, 208, 96 S.Ct. 1375, 47 L.Ed.2d 668 (1976). However, experts, like the

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Auditor Defendant here, "who have prepared portions of the registration statement are accorded a 'due diligence' defense. In effect, this is a negligence standard." *Id.* The expert must prove it acted with due diligence. *Id.* Accordingly, with respect to the Auditor Defendant, Lead Plaintiff "need not affirmatively plead negligence." *In re Initial Pub. Offering Sec. Litig.,* 241 F.Supp.2d 281, 396 (S.D.N.Y.2003).[FN5] The Auditor Defendant only argues that the CAC does not allege negligence. It fails, because it does not argue that the CAC alleges it acted reasonably, which would be required to establish an affirmative defense at the motion to dismiss stage. *McCalden v. California Library Ass'n,* 955 F.2d 1214, 1219 (9th Cir.1990) (holding that "[f]or a complaint to be dismissed because the allegations give rise to an affirmative defense 'the defense clearly must appear on the face of the pleading.' ").

> FN5. At oral argument, the parties discussed whether Lead Plaintiff had to plead that the Auditor Defendant and the Underwriter Defendants were negligent. Cases often state that non-issuer defendants will be liable for negligence. *See, e.g., In re Morgan Stanley Info. Fund Sec. Litig.,* 592 F.3d 347, 359 (2d Cir.2010). However, this language indicates that a Section 11 claim against non-issuer defendants will ultimately come down to negligence, because these defendants may avoid liability if they prove they acted diligently. Thus, the burden is not on Plaintiff to plead negligence. A recent case from the Second Circuit is illustrative of this point. After holding that non-issuers "may be held liable for mere negligence," the Second Circuit clarified in a footnote that:
>
> > More specifically, section 11 provides several due diligence defenses available to non-issuer defendants, see 15 U.S.C. § 77k(b), and section 12(a)(2) contains a "reasonable care" defense, *Id.* § 77l (a)(2).... Generally speaking, defendants bear the burden of demonstrating the applicability of each of these defenses, which are therefore unavailing as a means of defeating a motion to dismiss pursuant to Rule 12(b)(6).
>
> *Id.* at 359, n. 7.

The Underwriter Defendants assert that the face of the CAC establishes their due diligence defense. They argue that their work on the offering and prospectus relied on the auditors' financial statements and certified expert opinions, which they were entitled to do, and which, thus, justifies their dismissal. "An underwriter need not conduct due diligence into the 'expertised' parts of a prospectus, such as certified financial statements." *In re Software Toolworks Inc.,* 50 F.3d 615, 623 (9th Cir.1994). An underwriter "need only show that it 'had no reasonable ground to believe, and did not believe ... that the statements therein were untrue or that there was an omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading.' " *Id.* Although an underwriter must prove the due diligence defense, courts look to plaintiffs to point to red flags that should have indicated to the underwriter that the financial statements were not trustworthy. *See Id.* at 623–24.

While *In re Software Toolworks* was decided at the summary judgment stage, in *In re Countrywide* a district court allowed a defendant underwriter to establish the due diligence defense at the motion to dismiss stage, because "underwriters may reasonably rely on auditors' statements, absent red flags that the underwriters were in a position to see." 588 F.Supp.2d at 1175. At least one unpublished decision in this district has disagreed with *In re Countrywide. In re China Intelligent Lighting and Electronics, Inc. Sec. Litig.,* No. CV–112768–PSG (SSx), at * 11. However, this court did not fully address the very basis of *In re Countrywide's* ruling: that underwriters occupy a special place in Section 11 jurisprudence because they are allowed to rely

on auditors' work, absent red flags. The Court here agrees with *In re Countrywide.*

*9 The CAC is essentially silent about the underwriters, other than identifying them. (CAC ¶¶ 23–26.) Lead Plaintiff's opposition argues that various red flags should have alerted the Underwriter Defendants to the misleading statements in the Auditor Defendant's work. Most notable among these are that the prior auditor, Grant Thornton, resigned. However, nothing in the disclosure regarding Grant Thornton's resignation would have alerted the Underwriter Defendants to the Dajiang deal being fraudulent. (*See Id.* ¶ 47.) Lead Plaintiff also suggests that the Auditor Defendant's production of an audit opinion in twenty-two days after Grant Thornton's resignation should have been a red flag. However, nothing before the court shows that the audit was performed too quickly. Such a determination would depend on how much information the auditors had to analyze, and how many auditors they devoted to the audit, among other factors. However, the CAC does not allege sufficient information about these matters. Moreover, the Auditor Defendant was Yuhe's auditor from March 12, 2008 until December 7, 2009, when Grant Thornton assumed that role. (*Id.* ¶ 47.) After Grant Thromton's resignation three months later, the Auditor Defendant was reappointed. (*Id.*) Thus the emphasis on the twenty-two day time span is not particularly probative, because the Auditor Defendants were likely already familiar with Yuhe. The Section 11 claim against the Underwriter Defendants is, therefore, dismissed without prejudice.

C. *The Section 12(a)(2) Claim*

The Underwriter Defendants ask this Court to dismiss Lead Plaintiff's Section 12(a)(2) claim. "Section 12(a)(2) provides for civil liability of securities sellers to purchasers if the seller used certain instruments, including a prospectus, containing untrue statements or material omissions." *In re Levi,* 527 F.Supp. at 980; 15 U.S.C. § 77l(a)(2). Section 12 "permits suit against a seller of a security by prospectus only by 'the person purchasing such security from him,' thus specifying that a plaintiff must have purchased the security directly from the issuer of the prospectus." *Hertzberg v. Dignity Partners, Inc.,* 191 F.3d 1076, 1081 (9th Cir.1999) (quoting 15 U.S.C. § 77l (a)(2)). A plaintiff who purchased shares in the aftermarket will not have standing under Section 12, even if he can trace those shares back to the relevant offering. *In re DDi Corp.,* 2005 WL 3090882, at *17 (C.D.Cal. July 21, 2005). When plaintiffs purchase stock pursuant to an offering or a prospectus, it means that they have purchased stock from its issuer. *In re Levi Strauss,* 527 F.Supp.2d at 983; *In re Nat'l Golf Properties, Inc.,* 2003 WL 23018761, at *2.

Paragraphs 17, 139, and 146 make clear that Lead Plaintiff and at least some class members purchased stock "pursuant to" the offering and "pursuant" to the prospectus. Accordingly, Lead Plaintiff has stated a claim on behalf of itself and all class members who purchased pursuant to the offering, and that is all that is needed to survive a motion to dismiss. *See In re Levi Strauss & Co. Sec. Litig.,* 527 F.Supp.2d at 983; *In re Nat'l Golf Properties,* 2003 WL 23018761, at *2. However, to the extent members of the subclass hold shares that are only traceable to the second offering, (*see* CAC ¶ 1), their claims are dismissed with prejudice. *In re DDi Corp.,* 2005 WL 3090882, at *17 (C.D.Cal. July 21, 2005).

D. *Defendant Yuhe's Motion to Strike*

***10** Yuhe has moved to strike paragraphs 2–4, 75–81, and 107 from the CAC. (Docket No. 83 at 5:23–25.) Because these paragraphs improperly rely on an outside report, Yuhe argues, they violate Plaintiffs Rule 11 duty to conduct an independent investigation on matters alleged in the complaint. (*See generally Id.* at 3:19–5:25.)

Portions of a CAC that do not comport with Rule 11's independent investigation requirement may be stricken. *See In re Connetics Corp. Sec. Litig.,* 542 F.Supp.2d 996, 1004–05 (N.D.Cal.2008); *Fraker v. Bayer Corp.,* No. CVF08–1564 AWI

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GSA, 2009 WL 5865687 (E.D.Cal. Oct.6, 2009). Under Rule 11(b), an attorney who files pleadings with a court "certifies that to the best of the person's knowledge, information, and belief, formed after an inquiry reasonable under the circumstances: ... the factual contentions have evidentiary support or, if specifically so identified, will likely have evidentiary support after a reasonable opportunity for further investigation or discovery." Fed.R.Civ.P. 11(b). Rule 11(b) recognizes a "nondelegable responsibility" for an attorney to "personally ... validate the truth and legal reasonableness of the papers filed," *Pavelic & LeFlore v. Marvel Entm't Group,* 493 U.S. 120, 126, 110 S.Ct. 456, 107 L.Ed.2d 438 (1989), and "to conduct a reasonable factual investigation," *Christian v. Mattel Inc.,* 286 F.3d 1118, 1127 (9th Cir.2002).

Yuhe states that GeoInvesting was a short-seller "seeking to benefit from the publication of negative information" about Yuhe, and that reliance on the GeoInvesting Report is insufficient to satisfy Rule 11(b)'s independent investigation requirement. (Docket No. 119 at 1:20–22, 2:7–9.) Lead Plaintiff, however, states that multiple sources informed their allegations in the challenged portions of the CAC. Lead Plaintiff states:

> The paragraphs Yuhe seeks to strike, on Rule 11 grounds no less, contain facts obtained from a Form 8–K Yuhe filed on June 20, 2011 attaching its June 14, 2011 press release, including five documents Yuhe disseminated to investors in support of its purported purchase of Dajiang's thirteen breeder farms (¶ 79); excerpts from four publicly-available transcripts of telephone calls wherein the Chairman of Dajiang repeatedly denies [to a GeoInvestiang investigator] that it sold its breeder farms to Yuhe and never received any money from it (¶¶ 76, 77, 78, and 81); and an investigatory report by GeoInvesting LLC (¶¶ 2, 75) along with a few website postings regarding its participation in an investor conference call with Yuhe (¶¶ 3, 4, 80).

(Docket No. 112 at 1:11–20.) Since Yuhe does not respond to Plaintiff's argument, they have conceded it. Cent. Dist. L.R. 7–12; *See also Figueroa v. Baja Fresh Westlake Vill., Inc.,* CV 12–769–GHK SPX, 2012 WL 2373254, at *2 (C.D.Cal. May 24, 2012); *Richter v. Mut. of Omaha Ins. Co.,* CV 05–498 ABC, 2007 WL 6723708, at *5 (C.D.Cal. Feb.1, 2007) *aff'd,* 286 F. App'x 427 (9th Cir.2008); *Westerfield v. Wade,* No. CV05–6645 ABCCWX, 2006 WL 5668264, at *4 (C.D.Cal. Oct.4, 2006).

***11** This leaves some paragraphs where the GeoInvesting report, supplemented by Lead Plaintiff's attorney's "multiple" conversations with GeoInvesting about the "basis for its investigatory report and its communications with Mr. Zheng," is the only source. (Markert Decl. ¶ 113, Docket No. 113.) The Yuhe Defendants argue that the GeoInvesting Report is not reliable, and their principle case for the point is *Zucco Partners, LLC v. Digimarc Corp.,* 552 F.3d 981, 995 (9th Cir.2009). But the portion of *Zucco* they cite deals with the appropriate way for a court to analyze a pleadings that rely on a confidential witness. *Id.* In the present case, the Yuhe Defendants do not argue, nor could they, that the GeoInvesting report is a confidential source. While the Yuhe Defendants argue that the GeoInvesting report is not credible, because, among other reasons, GeoInvesting was a short seller with an interest in diminishing Yuhe's stock value, the effects GeoInvesting's motive is "a factual dispute not appropriate for resolution at this stage." *See In re China Educ. Alliance, Inc. Sec. Litig.,* No. CV 10–9239 CAS JCX, 2011 WL 4978483, at *4 (C.D.Cal. Oct.11, 2011) (refusing to analyze motives of a short seller) (quoting *Henning v. Orient Paper Inc.,* No. CV 10–5887 VBF, 2011 WL 2909322, at *4 (C.D.Cal.Jul.20, 2011).

The Yuhe Defendants seek to distinguish *In re China Educ.* by arguing that in the instant case particular facts in the GeoInvesting report suggest that it is unreliable. Particularly, the Yuhe Defendants note that: GeoInvesting gathered its information in part by speaking to an individual, Mr. Zheng, under

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false pretenses, and, further, that Mr. Zheng gave contradicting statements at one point as to whether Yuhe ever talked with Dajiang about acquiring farms. However, just because GeoInvesting allegedly used false pretenses to speak with Zheng, does not mean it did not learn the truth from him. Additionally, it is not clear Zheng gave contradictory statements. Although he first denied that negotiations happened, when he later stated they did occur, he said the negotiation was for a "fake deal." (CAC ¶ 78.) Zheng's statements could be seen as consistent, as a negotiations for a fake deal might be considered as a non-negotiation. Any further analysis into the "truth" of the GeoInvesting report would be inappropriate, because doing so would implicate a factual dispute that should not be decided at this stage. *See Henning,* 2011 WL 2909322, at *4.

Accordingly, the Yuhe Defendants' motion to strike is DENIED.

IV. Conclusion

For the reasons stated, the Court DENIES the Defendants' motions, with the exception of GRANTING dismissal of the Section 11 claim against the Underwriter Defendants, GRANTING Dismissal of the Section 10(b) claim against Gang, and GRANTING dismissal of the Section 12(a)(2) and Section 11 claims of all subclass members whose Yuhe shares are only traceable to the second offering. Dismissal is without prejudice, except as to the Section 12(a)(2) claims.

***12** IT IS SO ORDERED.

C.D.Cal.,2013.
Feyko v. Yuhe Intern., Inc.
Not Reported in F.Supp.2d, 2013 WL 816409 (C.D.Cal.), Fed. Sec. L. Rep. P 97,312

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Indexed as:

Ontario New Home Warranty Program v. Chevron Chemical Co.

APPLICATION UNDER the Class Proceedings Act, 1992
Between
Ontario New Home Warranty Program, Kathy Adetuyi and Andrew Duke, plaintiffs, and
Chevron Chemical Company, Hart & Cooley, Inc., Eljer Manufacturing Inc. cob as Selkirk Metalbestos, Underwriters' Laboratories of Canada, Underwriter's Laboratories Inc., Armstrong Air Conditioning Inc., Consolidated Industries Corp., Welbelt Corporation, Carrier Canada Limited, Evcon Supply Inc., Evcon Industry, Inc., Goodman Manufacturing Co., Ltd., Quietflex Manufacturing Company, L.P., Wabco Standard Trane Inc., Inter-City Products Corporation (Canada), Inter-City Products Corporation (U.S.), Lennox Industries (Canada) Ltd., Nordyne, Inc., Rheem Manufacturing Company, York International Ltd. and CMIL Industries Inc., cob. as DMO Industries, the Canadian Gas Association, Canadian Gas Research Institute, International Approval Services Canada Inc., Consumers Gas Utilities Ltd., Union Gas Limited, Centra Gas Ontario Inc., Superior Propane Inc., Superior Propane Inc./Superieur Propane Inc., Southcorp Water Heaters USA, Inc. and American Water Heater-West Inc. and American Water Heater-East Inc. all cob as American Water Heater Group, Slant/Fin Ltd./Ltee, Weil-McLain division of Marley Canadian Inc., Her Majesty the Queen in Right of Ontario, and General Electric Company, defendants

[1999] O.J. No. 2245

46 O.R. (3d) 130

99 O.T.C. 384

37 C.P.C. (4th) 175

88 A.C.W.S. (3d) 1138

1999 CanLII 15098

Court File No. 22487/96

Ontario Superior Court of Justice

Winkler J.

Heard: June 8-10, 1999.
Judgment: June 17, 1999.

(37 pp.)

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Jean Iu, for Her Majesty the Queen in Right of Ontario.
Cynthia Sefton and Murdoch R. Martin, for Consumers Gas Utilities Ltd.
Glenn Leslie, for Union Gas Ltd. and Centra Gas Ontario Inc.
No appearances for CMIL Industries Inc., Superior Propane, Slant/Fin Ltd./Ltee and Weil-Mclain division of Marley Canadian Inc.

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1 **WINKLER J.**:-- This is a motion to approve the settlement of this action between the plaintiffs and Chevron Chemical Company, Hart & Cooley, Inc., Eljer Manufacturing Inc. c.o.b. as Selkirk Metalbestos, General Electric Company, Her Majesty the Queen in Right of Ontario, Goodman Manufacturing Co. Ltd., CMIL Industries Inc. cob as DMO Industries, Nordyne, Inc., Wabco Standard Trane Inc., Carrier Canada Limited, Slant/Fin Ltd/Ltee, Weil-McLean division of Marley Canadian Inc. and Underwriter's Laboratories Inc. (the "Settling Defendants").

2 The plaintiffs also seek class certification pursuant to s. 5 of the Class Proceedings Act, 1992 with respect to the Settling Defendants.

3 The plaintiffs seek to discontinue the action against certain other defendants., namely Consumers Gas Utilities Inc., Union Gas Limited, Centra Gas Ontario Inc., Superior Propane Inc., The Canadian Gas Association, the Canadian Gas Research Institute and International Approval Services Canada Inc. This motion was adjourned at the hearing pending the disposition of the motions for certification and settlement approval.

4 The Plaintiffs propose to bring a subsequent motion for certification for litigation purposes with respect to the Non-Settling Defendants which consists a group of furnace manufacturers represented by one law firm and Underwriters' Laboratories of Canada ("ULC").

The Nature of the Claim

5 This is a product liability claim concerning residential mid-efficiency gas or propane furnaces, boilers and hot water heaters with High Temperature Plastic Vent ("HTPV") exhaust systems. The claim alleges negligent design, manufacture, negligent misrepresentation, breaches of warranty and misrepresentation, negligent approval, breach of fiduciary duty, and failure to warn.

6 The action is a proposed class proceeding brought by the Ontario New Home Warranty Program ("ONHWP") and two individuals, as representative plaintiffs. The plaintiff class consists of some 11,000 Ontario homeowners who installed mid-efficiency furnaces with the allegedly defective plastic venting pipes.

7 ONHWP makes a subrogated claim in place of many new homeowners whom it paid to repair or replace appliances and HTPV piping. The two individual representative plaintiffs were homeowners with heating systems using HTPV. The settling defendants include Chevron, Hart and GEC, three companies against which allegations have been made relating to HTPV. The Non-Settling Defendants are primarily furnace manufacturers, namely, Armstrong Air Conditioning Inc., Evcon Supply Inc., Evcon Industry Inc., Inter-city Products Corporation (U.S.), Lennox Industries (Canada) Ltd., RHEEM Manufacturing Company and York International Ltd. In addition, the defendant Underwriters Laboratory is included in the non-settling group.

Background

8 Prior to the 1980's, gas or propane heating appliances used chimneys or vertical metal vents to carry exhaust gases out of homes and other buildings. In the early 1980's, mid-and high-efficiency appliances were introduced into the marketplace. These appliances could be vented horizontally through the side walls of buildings. The exhaust gas of a mid-efficiency furnace is vented at a high temperature. With the horizontal vent pipes, there was a possibility that the exhaust gas would cool during the venting process, and that the by-products in the gas would form acidic condensates in the horizontal vent pipes. These acidic condensates were known to be corrosive to metal vent pipes.

9 In response to this problem of corrosion, High Temperature Plastic Venting ("HTPV") was developed. As a result of the low cost and the corrosion resistance of HTPV, heating systems combining HTPV and mid-efficiency appliances came into wide-spread use.

10 The Plaintiffs allege that mid-efficiency gas or propane appliances, vented with HTPV, result in a defective product (the "Heating System"). As a result of residual stresses incurred during manufacture, thermal expansion and contraction of the pipe, and a build-up of acidic condensate during in-service use, HTPV pipes in the Heating System were prone to cracking or separating at the joints. This had the potential to release poisonous carbon monoxide gas into the building. Neither the appliances or the venting pipes were designed with any type of safety device which would prevent defective operation.

11 Prior to being marketed, these Heating Systems were submitted to the relevant regulatory bodies for product approval. The National Standards System, a Federation of independent organizations working towards the development of voluntary standardization in Canada is coordinated by the Standards Council of Canada ("SCC"). The SCC delegates the function of setting standards and approving testing procedures to various standards organizations which appoint key people from the relevant industry to develop standards in relation to particular products.

12 Once a standard has been agreed upon by SCC delegated members, a final draft of the standard is published. This standard must be accepted by the Ministry of Consumer and Commercial Relations ("MCCR") in the Province of Ontario before a product can be marketed. After the standard is accepted by the MCCR, manufacturers submit their product to testing and certification agencies to test the product against the standard accepted by the MCCR, in order to certify that the product meets the relevant standard.

13 In addition to the requirement for the certification of Heating Systems, each appliance manufacturer must approve and specify one or more vent product to be installed in combination with its appliances. No vent product other than those which are approved and specified by the appliance manufacturer is permitted to be installed in combination with the appliance.

14 All of the HTPV products which are the subject of this proceeding went through the process set out above. However, in response to a series of complaints concerning defective heating systems, the MCCR compiled Inspection Reports and found a high failure rate in the HTPV. As a result, in March 1994 the MCCR issued a consumer alert warning about the possibility that vent pipes found

in the heating systems might crack or separate at the joints allowing poisonous gases to escape into homes.

15 On Sept. 12, 1995 the Ontario Government, through the Ministry of Consumer and Commercial Relations, issued a Director's Safety Order in respect of heating systems with HTPV. The Director's safety order stated that certain brands of plastic heating vents had been found to be defective and required all homeowners whose furnaces incorporated those vents to replace them by August 31, 1996. Pursuant to the order, natural gas utilities and propane distributors were prohibited from supplying gas after August 31, 1996 to any building in which the vents had not been replaced. The Director's Safety Order states in relevant part:

> Director's Safety Order
> Heating Systems with High-Temperature Plastic Vents
>
> Mounting engineering and technical evidence in Ontario and elsewhere confirms that heating system's using high-temperature plastic vents are defective, that permanent failure of the vents will take place and that the risk of failure increases with length of service. Specific heating systems using plastic vents bearing the name Plexvent, Sel-vent and Ultravent are affected. Over the past two years, four bulletins and a number of consumer advisories have been issued in Ontario as this evidence has been accumulating.
>
> To eliminate the risk associated with these systems, owners are required to correct them with a fully approved heating system prior to August 31, 1996. The options for correction consist of: (a) an existing appliance with an approved alternate vent, if available, or (b) a replacement heating system consisting of vent and appliance. Temporary repairs made using improved plastic materials are not acceptable corrections after August 31, 1996.
>
> After August 31, 1996, natural gas utilities and propane distributors will no longer be permitted to supply gas to these defective systems in Ontario.

16 In consequence, all owners of such furnaces were required to replace the vents by the Director's deadline.

17 In response to the Director's Safety Order relating to the defective Heating Systems, the ONHWP was required to establish a program to identify, administer and repair those Heating Systems covered by the ONHWP warranty program.

18 Where there was an approved alternative vent product available, the predominant corrective measure involved the replacement of the HTPV with B-Vent and a side-wall power venter, although

owners were given a choice of receiving a credit towards the installation of a high efficiency heating system as an alternative. In situations where there was no approved alternative venting product, ONHWP replaced the defective Heating System with a high-efficiency heating system.

19 Not all of the homeowners with defective Heating Systems had the benefit of ONHWP coverage. Nevertheless, these homeowners were also required to comply with the Director's Safety Order. In order to comply with the Director's Safety Order, repairs similar to those described above were effected by the non-covered homeowners at their own cost.

Settlement Discussions

20 In early 1996, and continuing thereafter, settlement discussions have taken place in this action. To facilitate this process and to bring it to a conclusion, a mediation was conducted in July 1998 before a prominent American mediator, Mr. Kenneth Feinberg, who is experienced in resolving complex litigation proceedings. All Defendants were invited to participate in this process but the Non-Settling Defendants, other than Underwriters Laboratory, chose not to attend or make submissions.

21 The mediation before Mr. Feinberg resulted in a settlement with the Defendants GEC, Hart and Chevron. Subsequent to the execution of the Settlement Agreement by these Defendants, the Plaintiffs have settled their claims with the following additional Defendants:

Eljer Manufacturing Inc., c.o.b. as Selkirk Metalbestos;

Her Majesty the Queen in Right of Ontario, represented by the Ministry of Consumer and Commercial Relations;

Nordyne Inc.;

Weil McLean division of Marley Canadian Inc.;

Wabco Standard Trane Inc.;

Slant/Fin Ltd./Ltee.;

American Water Heater;

Underwriter's Laboratories Inc.;

22 In addition to these settlements, the Plaintiffs have reached an agreement with the Defendant DMO Industries, within the context of the receivership affecting that corporation, for a $50,000.00 payment.

23 The Plaintiffs have also reached agreements with the Defendants Goodman and Carrier, who have each conducted voluntary self-administered repair programs.

24 The Plaintiffs propose to discontinue the action against the following Defendants:

(a) Canadian Gas Association;
(b) Canadian Gas Research Institute;
(c) International Approval Services Canada Inc.
(d) Consumers Gas Utilities Ltd.;
(e) Union Gas Ltd.;
(f) Centra Gas Ontario Inc.;
(g) Superior Propane Inc.; and
(h) Superior Propane Inc./Superieur Propane Inc.

25 The plaintiffs intend to continue with the litigation against the following defendants:

(a) Underwriter's Laboratories of Canada
(b) Armstrong Air Conditioning
(c) Evcon Supply Inc./Evcon Industry Inc.
(d) Lennox Industries
(e) RHEEM Manufacturing
(f) Inter-City Corp. (Canada)/Inter-City Corp. (U.S.)
(g) York International Ltd.

The Settlement

26 The plaintiffs now seek certification against the Settling Defendants, concurrently therewith approval of the settlement in accordance with s. 29(2) of the Class Proceedings Act, and judgment in accordance with the provisions of the settlement agreement achieved through the mediation process. The settlement provides compensation both to ONHWP and to those individual claimants who were not covered by ONHWP and were thus forced to replace the defective Heating Systems at their own cost.

27 The compensatory amounts provided through the settlement are based upon ONHWP's costs to repair the defective systems. ONHWP's total repair costs averaged $1,160 per unit, plus internal administrative costs of $170.00 per unit. The mediated settlement figure is $800.00 per unit, exclusive of administration costs. This settlement figure takes into consideration litigation risk, the

delays associated with this complex multi-party litigation, and the Settling Defendant's assertion that the replacement costs were unreasonably high.

28 From the mediated amount of $800.00 per unit; the Settling Defendants and the plaintiffs agreed that the Settling Defendants proportionate liability was to be fixed at 65%. Consequently, ONHWP's claim as against the Settling Defendants was settled on the basis of a lump sum payment for all such claims on the 65% proportionate share of the $800, plus amounts for party and party costs, disbursements, interest, and claims administration. The total ONHWP settlement figure amounts to $5,230,000.00.

29 The Non-ONHWP claims were also settled on this basis, that is, 65% of the mediated $800.00 repair cost figure.

30 In addition, the Settling Defendants will be responsible for payment of the cost of administering the claims approval process for Non-ONHWP claims. The proposed Claims Administrator is Business Response Inc., a company located in St. Louis, Missouri ("BRI"). BRI is also the Claims Administrator in a similar action in the United States and is experienced in administering this type of settlement.

31 Non-ONHWP claimants will be able to take advantage of a simple claims approval process in which they will be compensated upon producing a proof of repair. This process will reduce legal and administrative costs and will allow claims to be processed quickly without the need for individual claimants to engage a lawyer. The period for claims submission will be five months from the mailing of the Notice of Certification and Settlement Approval.

32 A Non-ONHWP class member may be excluded from the Agreement by completing an Opt Out Form which may be obtained from the Claims Administrator. The Opt Out Deadline will be 60 days from the mailing of the Notice of Certification and Settlement Approval.

33 By virtue of this Settlement, Class Members will be eligible to receive payments within a few months of the Notice of Certification and Settlement Approval. Absent this agreement, in the face of complex multiparty proceedings, it could be a matter of years before any benefits are received by the Class.

34 The Settling Defendants support the plaintiff's motion for approval of the settlement, as long as the judgment approves the entire settlement agreement, especially those provisions which would prevent the Non-Settling Defendants from making any further claims for contribution and indemnity against the Settling Defendants in respect of any damages award to the plaintiffs at trial.

35 These clauses are the only aspects of the settlement agreement that are subject to opposition by the Non-Settling Defendants in this proceeding. Under the contested provisions, the court would be issuing an order preventing the Non-Settling Defendants from making any further claims against the Settling Defendants in relation to any damages suffered by the plaintiffs.

36 The contentious provisions are contained in clause 13 of the Settlement Agreement. They state, in pertinent part:

> ... all claims for contribution, indemnity, subrogation or other claims over shall be barred in accordance with the following terms:
>
> ...
>
> d) The plaintiffs shall not make joint and several claims against the Non-Settling Defendants or Joining Defendants but shall restrict their claims to several claims against the Non-Settling Defendants such that the plaintiffs shall be limited to the degree of liability proven against the Non-Settling Defendants at trial, but in no event shall such liability of the Non-Settling Defendants be greater than 35% of the total damages proven at trial as against each Non-Settling Defendant.
>
> e) All claims for contribution, indemnity, subrogation or other claims over, whether asserted or unasserted or asserted in a representative capacity, inclusive of interest, GST and costs, for or in respect of the subject matter of the Class Actions by or against any Non-Settling Defendants or any other person or party are barred by or against the Settling Defendants and Joining Defendants. CLARITY NOTE: The bar order deals only with claims over and is not intended to bar bona fide independent and direct claims and causes of action between settling and non-settling defendants for damages other than those claimed by the Representative Plaintiffs and the Plaintiff Class.
>
> f) Except as otherwise provided herein, nothing in this Judgment shall prejudice or in any way interfere with the rights of the Settlement Class Members to pursue all of their other rights and remedies against persons and/or entities other than Settling Defendants and Joining Defendants.
>
> g) Nothing in this Judgment affects any rights that the Non-Settling Defendants may have to move for leave for discovery and production of documents respecting the Settling Defendants and Joining Defendants pursuant to the Rules of Civil Procedure and, in particular, Rules 31.10 and 30.10.

37 The plaintiffs and Settling Defendants contend that the settlement, taken as a whole, is fair and reasonable. They assert that the contested provisions contain adequate safeguards for the Non-Settling Defendants. They point to the fact that the remaining claims of the plaintiffs have been converted from "joint and several" to several claims and that under this "several" approach, the liability of the Non-Settling Defendants will be capped at 35% of the total damages proven at trial. Indeed, the plaintiffs and the Settling Defendants state that the Non-Settling Defendants can only benefit from this provision because it limits their maximum exposure to liability in damages to the plaintiffs regardless of the ultimate apportionment of the liability as determined by the trial judge.

38 The plaintiffs and Settling Defendants characterize the prohibitive provisions as a "bar order".

In support of their submissions urging the court to accept these provisions, they rely on "substantial U.S. Authority". The plaintiffs assert in their factum that "bar orders are a common mechanism used by the courts in the United States to assist in the management of complex litigation, and to encourage settlement and provide certainty to litigants while enabling them to reduce litigation costs."

39 I am unable to accept these American authorities as being dispositive of the issue here. In many instances, the American cases turn on specific statutes providing for the issuance of "bar orders." Furthermore, even where such orders have been granted on a common law basis in the United States, the influence of the statutory regime cannot be ignored.

40 I do, however, find that the underlying principles on which "bar orders" are granted in the American cases have some application to these proceedings. Moreover, the Class Proceedings Act provides a specific mechanism through which these objectives can be achieved in class proceedings in Ontario. Under s. 13 a court may "stay any proceeding related to the class proceeding before it, on such terms as it considers appropriate." This broad discretion is buttressed by s. 12 which permits the court, on a motion by a party or class member, to make such orders as are necessary to ensure the fair and expeditious determination of the class proceeding.

41 By including ss. 12 and 13 in the Act, the legislature has given the Court a flexible tool for adapting procedures on a case specific basis. As stated in the Report of the Attorney General's Advisory Committee on Class Action Reform at 37:

> [These sections describe] the general power of the Court to control its own process and to develop procedures as needed from case to case. (Emphasis added.)

42 In view of the fact that it is apparent that a court has the statutory discretion to issue the order asked for, on appropriate terms, I turn to the objections raised by the Non-Settling Defendants. These defendants oppose the order sought on the grounds that the prohibitive provisions would prejudice them, substantively and procedurally, in presenting any defence that they might have. The Non-Settling Defendants do not object to any other terms of the settlement.

43 The plaintiffs and the Settling Defendants take the position that the Settlement Agreement must either be approved in toto or rejected by the court. Sharpe J., relying on Court of Appeal authority, enunciated this approach in Dabbs v. Sun Life Assurance Co., [1998] O.J. No. 1598 (Gen. Div.). He stated at para. 6:

> It has often been observed that the court is asked to approve or reject a settlement and that it is not open to the court to rewrite or modify its terms; Poulin v. Nadon, [1950] O.R. 219 (C.A.) at 222-3.

44 In respect of the contention of substantive prejudice, the Non-Settling Defendants assert that

they have certain rights under ss. 1 and 5 of the Negligence Act, R.S.O. 1990, c. N.1 to pursue claims against the Settling Defendants for contribution and indemnity. Thus, they state, this court has no jurisdiction to prohibit the Negligence Act claims because to do so would derogate from a substantive right. Derogation of substantive rights, it is argued, is beyond the power bestowed on the court by the provisions of the purely procedural Class Proceedings Act. In addition, they contend that they have independent claims founded in negligence and negligent misrepresentation against the Settling Defendants and that part of the damages claimed, based upon these causes of action, will include amounts they may be required to pay to the plaintiffs as a result of the trial.

45 Moreover, the Non-Settling Defendants claim that the prohibiting provisions contained in the settlement agreement are fundamentally unfair at a procedural level because the provisions deprive them of the ability to effectively ensure that they bear only their fair share of any liability to the plaintiffs. Specifically, they assert that they will be precluded from conducting effective discovery and denied evidence at trial necessary to establish the respective degrees of fault as between themselves and the Settling Defendants. This is especially prejudicial, they contend, in a context where the main issue at trial will be the nature of alleged defects in products manufactured by the Settling Defendants, rather than by the Non-Settling Defendants.

46 As a practical necessity, I will deal with the contested provisions of the Settlement Agreement prior to determining the other issues on this motion. If the provisions must be rejected on the basis of the objections raised by the Non-Settling Defendants, then the other issues will be rendered moot.

Analysis

47 The Non-Settling Defendants contend that this court lacks jurisdiction to approve the settlement and issue a concomitant order containing the prohibitive provisions because of the substantive prejudice that will enure to them. The prejudice arises in part, they assert, because of the contested provisions represent an abrogation of their rights under the ss. 1 and 5 of the Negligence Act.

48 These sections provide:

> 1. Where damages have been caused or contributed to by the fault or neglect of two or more persons, the court shall determine the degree in which each of such persons is at fault or negligent, and, where two or more persons are found at fault or negligent, they are jointly and severally liable to the person suffering loss or damage for such fault or negligence, but as between themselves, in the absence of any contract express or implied, each is liable to make contribution and indemnify each other in the degree in which they are respectively found to be at fault or negligent.
>
> 5. Wherever it appears that a person not already a party to an action is or may be wholly or partly responsible for the damages claimed, such person may be added as a party defendant to the action upon such terms as are considered just or may

> be made a third party to the action in the manner prescribed by the rules of court for adding third parties.

49 I bear in mind the words of Farley J. in Canada v. Curragh, [1994] O.J. No. 1452 (Gen. Div.), in another context, as a starting point in the analysis of the jurisdictional objection raised by the Non-Settling Defendants. He stated at para. 1:

> ... jurisdiction cannot be conferred by agreement. Jurisdiction will only be assumed (i.e. undertaken) by this Court when the Court determines that it truly has jurisdiction based upon the legal principles applicable. It will not be taken by this Court merely because it will convenience the parties.

50 Moreover, this court has noted on multiple occasions that there is no jurisdiction conferred by the Class Proceedings Act to supplement or derogate from the substantive rights of the parties. It is a procedural statute and, as such, neither its inherent objects nor its explicit provisions can be given effect in a manner which affects the substantive rights of either plaintiffs or defendants.

51 While I have full regard to the preceding caveats, in my view, the Non-Settling Defendants assertion that the Negligence Act affords them substantive rights which will be abrogated by the proposed Settlement Agreement is untenable. When the prohibitive provisions contained in the agreement are considered in total, it is apparent that they affect no claim of the Non-Settling Defendants that could be successfully asserted against the Settling Defendants under the Negligence Act or otherwise.

52 In essence, a claim for contribution and indemnity as between joint tortfeasors is a derivative claim. As stated by David Cheifetz in Apportionment of Fault in Tort, (Aurora: Canada Law Book, 1981) at 18:

> The basis of the claim for contribution and indemnity is a breach of duty owed by the tortfeasor subject to the claim of the injured person, not to the tortfeasor claiming contribution.

53 Entitlement to the claim only flows from a finding of joint liability between tortfeasors, and a requirement to pay damages, to the plaintiff. In those cases, the trial judge apportions liability as between the defendants, but the plaintiff may obtain satisfaction of the entire judgment from either of them. In the absence of a contractual obligation for indemnification, each of the defendants, on the other hand, has a right to claim contribution and indemnity from the other in accordance with the apportionment of liability found at trial. However, neither defendant may recover from the other any amount attributable to its own negligence. The responsibility for the negligence of each defendant must therefore be borne by that defendant.

54 Here, the Settling Defendants have abandoned any claim for contribution and indemnity as against the Non-Settling Defendants. In addition, the plaintiffs have chosen to seek damages only in

the amount for which the Non-Settling Defendants are "severally" liable.

55 In the result, the rights provided to the Non-Settling Defendants under s. 1 of the Negligence Act form part and parcel of the Settlement Agreement. There will be no claim for contribution and indemnity as against them by the Settling Defendants. On the other hand, since they will only be required to pay damages in accordance with their own negligence and liability to the plaintiff, if any, they will have no claim for contribution and indemnity against the Settling Defendants in respect of any such payment.

56 The right provided under s. 5 of the Negligence Act is of a different nature in that it allows the Non-Settling Defendants to join third parties who are not already party to the action. It is apparent, however, that the intent of this section is to permit a defendant to have the opportunity of limiting its liability to the plaintiff to that for which it is actually responsible. As such, there can be no concern that the rights under s. 5 will be abrogated in this case. The protections it affords have likewise been incorporated into the Settlement Agreement. The Settling Defendants have been party to the proceedings and are now attempting to settle their liability and extricate themselves. In so doing, they have accepted a proportion of the liability but, more so, by virtue of their agreement with the plaintiffs, there are clauses which prevent the plaintiffs from obtaining any damages from the Non-Settling Defendants in excess of the Non-Settling Defendants' actually liability to the plaintiffs.

57 The Non-Settling Defendants have not delivered a statement of defence to the plaintiffs' claim, nor a statement of claim against the Settling Defendants in these proceedings. In argument on this motion, counsel for the Non-Settling Defendants gave an undertaking that it is their intention to commence an action against the Settling Defendants alleging causes of action in negligence and negligent misrepresentation as against them.

58 The Non-Settling Defendants assert that the Settling Defendants owed them a duty of care which was negligently breached. This negligence, it is stated, is the direct cause of any damages that the Non-Settling Defendants may be required to pay to the plaintiffs. In consequence, the Non-Settling Defendants contend that this negligence gives rise to an independent tort claim, separate and apart from a claim for contribution and indemnity against the Settling Defendants. It is the position of the plaintiffs and the Settling Defendants that such a claim would be nothing more than a claim for contribution and indemnity by another name and, therefore, would be prohibited by the clauses in the Settlement Agreement.

59 I do not necessarily accept this characterization of the potential claim of the Non-Settling Defendants. In my view, however, the thrust of the submissions of the plaintiffs and the Settling Defendants with respect to the effect of the provisions of the Settlement Agreement is correct. The Non-Settling Defendants cannot successfully assert a claim in damages against any party based upon their own negligence, no matter how such a claim is characterized, because of s. 3 of the Negligence Act. It provides:

> In any action for damages that is founded upon the fault or negligence of the defendant if fault or negligence is found on the part of the plaintiff that contributed to the damages, the court shall apportion the damages in proportion to the degree of fault or negligence found against the parties respectively.

In the result, in any claim against the Settling Defendants, any damages of the Non-Settling Defendants attributable to their own negligence cannot be recovered.

60 On the other hand, damages which have been incurred by the Non-Settling Defendants independent of any liability to the plaintiffs in a concurrent tort can be pursued and are not foreclosed by the contested provisions of the settlement agreement. The clarity note appended to clause 13(e) of the agreement speaks to this.

61 For these reasons, I do not find that there is any substantive prejudice caused to the Non-Settling Defendants by the contested provisions, nor is there any deprivation of any protections conferred upon them by the Negligence Act.

62 I turn next to the Non-Settling Defendants' contention that the contested provisions will prejudice them on a procedural level. In support of this contention, the Non-Settling Defendants rely on a decision of the British Columbia Court of Appeal in British Columbia Ferry Corp. v. T & N plc, [1996] 4 W.W.R. 161 (B.C.C.A.). Although they rely on this case in support of their assertion of procedural prejudice, I observe that the decision supports the above reasons insofar as the allegation of substantive prejudice is concerned.

63 In the B.C. Ferry case, the plaintiffs had sued a group of asbestos manufacturers. The manufacturers sought to add the installers of the asbestos to the action by way of third party proceedings. The plaintiffs entered into agreements with several of the third parties, in which the plaintiffs agreed that they would not seek to recover from the manufacturers any portion of the damages which a court attributed to the fault of the third parties.

64 The manufacturers sought contribution and indemnity from the third parties, and in addition, damages for the out of pocket expenses incurred in defending the plaintiffs' claim as well as a declaration as to the degree of fault, if any attributable to each third party. The third parties, in a series of proceedings, moved successfully for dismissal of all of the claims against them.

65 On appeal the Court upheld the dismissal of the claim in contribution and indemnity, on the basis that the agreement between the plaintiffs and the third parties saved the defendants "harmless from any damages caused or contributed to by the fault of the concurrent tortfeasor", thus eliminating any "basis upon which the right to contribution or indemnity, ... could be exercised." In addition, the dismissal of the claim in damages for out of pocket expenses for defending the plaintiffs' claim was upheld. The Court found that the trial judge had correctly determined that there was no duty of care existing between the defendants and the third parties such that the claim could be asserted.

66 However, the appeal in respect of the claim for declaratory relief was allowed because of considerations of fairness to the defendants. Wood J.A. stated at 175-6:

> It would, in my view, be manifestly wrong if a private accord between plaintiff and third party could work to deprive a defendant of the ability to establish an element of proof essential to a just resolution of the action on which all parties had joined issue. But that is precisely what will occur here if the defendants are denied the declaratory relief they seek ... In those circumstances, I am of the view that the third party claims for declaratory relief should be allowed to proceed.

67 In respect of submissions that declaratory relief could not issue because there was no lis between the parties, Wood J.A. stated at 175:

> While I am of the view that the general rule against sanctioning actions brought for purely procedural relief will always be an important consideration governing the exercise of the court's discretion to grant declaratory relief, I do not accept the proposition that it must be regarded as a controlling consideration in all cases. There will be instances, albeit rarely, where the declaratory relief should be granted notwithstanding the fact that it is needed only for such purpose.
>
> ...
>
> One has only to consider the importance to the process of proof of such procedures as the right of discovery, the notice to admit and the ability to call parties as adverse witnesses, to realize that there will be circumstances in which the need to resort to such procedures will meet the expanded definition given to the term "relief" by Lord Justice Bankes in the Guaranty Trust Company of New York case.

68 The agreement at issue in the B.C. Ferry case was much the same in effect as the provisions of the agreement between the plaintiffs and the Settling Defendants at issue here. However, the Court of Appeal was able to address the issue of procedural prejudice, without negating the agreement, in such a manner so that the fairness to the defendants was not compromised. Although, the decision is not binding on this court, it provides an enlightened guide in the current context.

69 The procedural objection raised by the Non-Settling Defendants brings to bear the requirement of balancing the interests of the plaintiff class, on the one hand and the defendants, on the other, in a complex class proceeding. The objects of the Class Proceedings Act must be met without prejudice to either the plaintiff class or the defendants.

70 However, the settlement of complex litigation is encouraged by the courts and favoured by public policy. Indeed, according to Callaghan A.C.J.H.C. in Sparling v. Southam Inc. (1988), 66 O.R. (2d) 225 (H.C.J.) at 230-31:

> ... the courts consistently favour the settlement of lawsuits in general. To put it another way, there is an overriding public interest in favour of settlement. This policy promotes the interests of litigants generally by saving them the expense of trial of disputed issues, and it reduces the strain upon an already overburdened provincial court system.

71 In consideration of the interests which must be balanced, it is my view that the procedural objections raised by the Non-Settling Defendants can be addressed without a wholesale rejection of the proposed Settlement Agreement.

72 This Court has pointed out in Carom v. Bre-X Minerals Ltd., [1999] O.J. No. 281 (Gen. Div.), in another context, that "the CPA is a procedural statute replete with provisions guaranteeing order and fairness".

73 The Class Proceedings Act is meant to provide a mechanism for the redress of mass wrongs which are linked by an element of commonality. This is such a case. The court must remain flexible and exercise its inherent jurisdiction to meet the needs of the parties and to achieve the purpose of the statute.

74 The settlement before this court meets the underlying objective of the Act. There is no objection to its terms, save for the prohibitive provisions. However, if these provisions are not approved, the entire settlement will fail. This will seriously prejudice the plaintiff class in terms of delay and costs of litigation and further, expose the plaintiffs to the risks of litigation. Conversely, to ignore the procedural concerns advanced by the Non-Settling Defendants would unfairly prejudice those parties.

75 The Class Proceedings Act is sui generis legislation which envisions the balancing of interests between the parties. Through legislative foresight, the court has been given the necessary power to adapt procedures to ensure that the interests of all parties can be adequately protected in situations where those interests conflict. Here, the benefits of the settlement to the plaintiffs favour the approval of the settlement as presented, including the contentious prohibitive provisions. As I have stated above, these provisions do not occasion any substantive prejudice to the defendants. The procedural concerns may be adequately addressed through the terms on which the settlement is approved.

76 Accordingly, I am prepared to grant judgment on the basis of the Settlement Agreement, subject to terms I set out below. The prohibitive provisions will be entered as a "stay of proceedings", as against the Settling Defendants under s. 13 of the Act, subject to compliance by the Settling Defendants with the following terms as they relate to the conduct of the remaining portions of the action.

77 These terms generally described, are that the Non-Settling Defendants may, on motion to this court, obtain:

(1) documentary discovery and an Affidavit of Documents in accordance with the Rules of Civil Procedure from each of the Settling Defendants;
(2) oral discovery of a representative of each of the Settling Defendants, the transcript of which may be read in at trial;
(3) leave to serve a Request to Admit on each Settling Defendant in respect of factual matters;
(4) an undertaking to produce a representative to testify at trial, with such witness to be subject to cross-examination by counsel for the Non-Settling Defendants.

78 In addition, the fact of the settlement, but not the terms thereof, shall be disclosed to the trial judge at the commencement of trial.

79 Furthermore, pursuant to its case management powers under the Act, this court shall maintain an ongoing supervisory role in this action. In the event that any Settling Defendant fails to comply with an order of this court made pursuant to the above terms, the court may, in addressing any such failure, lift the stay of proceedings in respect of that defendant.

Certification

80 The next consideration is whether the proceeding against the Settling Defendants meets the requirements for certification as a class proceeding. The elements of the test for certification are set out in s. 5 of the Class Proceedings Act.

> 5(1) The court shall certify a class proceeding on a motion under section 2, 3 or 4 if,

(a) the pleadings or the notice of application discloses a cause of action;
(b) there is an identifiable class of two or more persons that would be represented by the representative plaintiff or defendant;
(c) the claims or defences of the class members raise common issues;
(d) a class proceeding would be the preferable procedure for the resolution of the common issues; and
(e) there is a representative plaintiff or defendant who,

(i) would fairly and adequately represent the interests of the class,
(ii) has produced a plan for the proceeding that sets out a workable method of advancing the proceeding on behalf of the class and of notifying class members of the proceeding, and
(iii) does not have, on the common issues for the class, an interest in conflict with the interests of other class members.

(i) Cause of Action

81 The Statement of Claim discloses a cause of action. The plaintiffs claim damages against the Settling Defendants arising from, inter alia, their negligent design, manufacture, and failure to establish appropriate and safe standards relating to the Heating Systems, as well as breaches of statutory duties, warranties and representations, and negligent misrepresentations. The plaintiffs also claim that these Defendants failed: to warn the public of the potential safety hazard presented by the defective product; to report these defects to the Ministry of Consumer and Commercial Relations; and to recall the defective and dangerous product.

(ii) Identifiable Class

82 The Plaintiffs propose that upon certification, the Class be defined as

> ONHWP and all persons or entities in the Province of Ontario, Canada who have incurred or will incur remediation expenses as a result of owning a natural gas or propane fired appliance installed with high-temperature plastic venting under the trade names PLEXVENT, ULTRAVENT or SELVENT (manufactured or sold by Chevron, Hart&Cooley and Eljer Manufacturing respectively).

This class definition meets the second element of the test for certification.

(iii) Common Issue

83 The plaintiffs propose that the common issue for the class be defined as:

> What claims does the Settlement Class have arising from the Ministry of Consumer and Commercial Relations Director's Safety Order dated September 12, 1995.

The common issue proposed satisfies the third criterion of the certification requirements.

iv) Preferable Procedure

84 A class proceeding is the preferable procedure for the resolution of the common issue as outlined above. The aggregate claims of the Class are substantial but individually, these claims cannot be litigated economically. On a practical basis, should certification be denied, the result would be to deny access to the Courts for many of the claims not covered by ONHWP. In addition to being expensive to litigate on an individual basis, the effect of multiple claims of this nature coming forward would place a heavy burden on judicial resources. In this case, a class proceeding is the preferable procedure for providing members of the Class with access to an effective remedy.

(v) Representative Plaintiff

85 Kathy Adetuyi and Andrew Duke are individuals who purchased heating systems with HTPV installed in conjunction with mid-efficiency appliances. Kathy Adetuyi's home was not enrolled in the ONHWP program and she bore the entire cost of complying with the Director's Safety Order. Andrew Duke's home was covered by ONHWP. As such, a portion of his cost to the correct the defective heating system was borne by ONHWP.

86 Kathy Adetuyi, Andrew Duke, and ONHWP are all prepared to act as representative Plaintiffs for the Class. Collectively, their actions indicate that they have fairly represented the class, and there is no evidence that they will not continue to do so. These proposed representative plaintiffs do not have interests which conflict with the interests of other Class Members and the Settlement Agreement provides a plan for the resolution of this proceeding. The proposed representative plaintiffs are acceptable to the court, thus meeting the final requirement for certification.

87 Accordingly, all of the requirements of the Act regarding certification are met.

Settlement Approval

88 Finally, I turn to the settlement. For a settlement to be approved it must be fair, reasonable and in the best interests of the Class, and, as stated in Dabbs, will generally take into account factors such as:

1. Likelihood of recovery or likelihood of success;
2. Amount and nature of discovery, evidence or investigation;
3. Settlement terms and conditions;
4. Recommendation and experience of counsel;
5. Future expense and likely duration of litigation;
6. Recommendation of neutral parties, if any;
7. Number of objectors and nature of objections; and
8. The presence of arms-length bargaining and the absence of collusion.

89 The exercise of settlement approval does not lead the court to a dissection of the settlement with an eye to perfection in every aspect. Rather, the settlement must fall within a zone or range of reasonableness. The range of reasonableness has been described by Sharpe J. in Dabbs as follows at 440:

> [All] settlements are the product of compromise and a process of give and take and settlements rarely give all parties exactly what they want. Fairness is not a standard of perfection. Reasonableness allows for a range of possible resolutions. A less than perfect settlement may be in the best interest of those affected by it when compared to the alternative of the risks and costs of litigation.

90 Furthermore, the recommendation of class counsel is a factor to be considered, though the potential for conflict must also be noted. Sharpe J. stated at 440:

> The recommendation of class counsel is clearly not dispositive as it is obvious that class counsel have a Significant financial interest in having the settlement approved. Still, the recommendation of counsel of high repute is significant. While class counsel have a financial interest at stake, their reputation for integrity and diligent effort on behalf of their clients is also on the line.

91 In Ontario, the courts have also recognized that the practical value of an expedited recovery is a significant factor for consideration. In Dabbs, Sharpe J. determined that in addition to the legal and factual risks, a practical concern favouring settlement includes the potential that the case would take several years to reach trial and exhaust all appeals.

92 Evidence sufficient to decide the merits of the issue is not required because compromise is necessary to achieve any settlement. However, the court must possess adequate information to elevate its decision above mere conjecture. This is imperative in order that the court might be satisfied that the settlement delivers adequate relief for the class in exchange for the surrender of litigation rights against the defendants. See Newberg on Class Actions (Shepard's/McGraw-Hill 3d ed 1992) ss. 11.45-46.

93 In the case at bar, the settlement proposed provides compensation to class members through a settlement mechanism that allows partial recovery for the damages of the class. I am satisfied that significant research and investigation was conducted in this matter prior to issuance of the statement of claim. Settlement negotiations between the settling parties have been ongoing since early 1996. These negotiations have been adversarial and protracted. The plaintiffs have been guided in their settlement negotiations by an understanding of the risks associated with the litigation, the potential future expense and the recommendation and experience of their counsel. Further, the terms of the settlement were arrived at as a result of intensive mediation conducted by an experienced arbitrator with specific knowledge of the factual background. The settlement benefits to the plaintiff class are well within the range of reasonableness.

94 In conclusion, I find that the settlement is fair and reasonable and in the best interests of the class as a whole.

Disposition

95 This action represents the quintessential class proceeding. It involves a single purpose product which is alleged to be defective. This core element of commonality is such that a determination of liability to the representative plaintiffs would be determinative of liability to the entire class. As stated in Chace v. Crane Canada Inc. (1997), 14 C.P.C. (4th) 197 (B.C.C.A.) at 202:

> This court recently observed that in a product liability case a determination that the product in question is defective or dangerous as alleged will advance the claims to an appreciable extent ... I agree with the chambers judge that is the situation here. The respondents are alleging an inherent defect ... This seems

> exactly the type of question for which a class action is ideally suited and remarkably similar to that concerning faulty heart pacemaker leads that was certified by the Ontario Court (General Division) in Nantais v. Telectronics Proprietary (Canada) Ltd. (1995), 25 O.R. (3d) 331. (Citations omitted).

96 This product's liability claim involves thousands of relatively small, nearly identical claims. In the absence of certification as a class proceeding, they would not present viable individual lawsuits because of the costs of litigation. Cost barriers to litigation impact on both access to justice and behavioural modification, two of the goals of the Act. Taken together with the nature of the claim and the element of commonality, the case cries out for certification. The motion for certification against the Settling Defendants is granted.

97 The Settlement Agreement taken as a whole is fair and reasonable and in the interests of the class members. It brings a significant degree of resolution to a protracted proceeding although the Non-Settling Defendants have raised some legitimate concerns about the prohibitive provisions, in light of the procedural protections available through the Class Proceedings Act, the Rules of Civil Procedure and the terms attached to the stay granted in these reasons, these procedural concerns can be addressed without rejecting the settlement. Accordingly, the settlement is approved in its entirety, subject to the terms set out above.

98 The motion raises a novel point of law and the result is divided. There shall be no order as to costs. I may be spoken to in respect of any other matters arising out of these reasons.

WINKLER J.

Case Name:

Eidoo v. Infineon Technologies AG

PROCEEDING UNDER the Class Proceedings Act, 1992
Between
Khalid Eidoo and Cygnus Electronics Corporation,
Plaintiffs, and
Infineon Technologies AG, Infineon Technologies Corporation, Infineon Technologies North America Corporation, Hynix Semiconductor Inc., Hynix Semiconductor America Inc., Hynix Semiconductor Manufacturing America, Inc., Samsung Electronics Co., Ltd., Samsung Semiconductor, Inc., Samsung Electronics America, Inc., Micron Semiconductor Products, Inc. o/a Crucial Technologies, Mosel Vitelic Corp., Mosel Vitelic Inc. and Elpida Memory, Inc., Defendants

[2012] O.J. No. 2955

2012 ONSC 3801

217 A.C.W.S. (3d) 821

41 C.P.C. (7th) 410

2012 CarswellOnt 8093

Court File No. 05-CV-4340

Ontario Superior Court of Justice

P.M. Perell J.

Heard: June 20, 2012.
Judgment: June 27, 2012.

(17 paras.)

Civil litigation -- Civil procedure -- Parties -- Class or representative actions -- Settlements -- Approval -- Motion by plaintiffs for approval of settlement of class proceeding allowed -- Action

alleged price fixing and sought damages for breach of Competition Act, civil conspiracy and tortious interference with economic interests -- Settlement agreement provided for payment of $5.75 million to class members in three provinces, required cooperation in pursuing claims against non-settling defendants through provision of data, documents and oral evidentiary proffer and proposed bar against contribution and indemnity -- Settlement was fair reasonable and in best interests of class as a whole.

Statutes, Regulations and Rules Cited:

Class Proceedings Act, 1992, S.O. 1992, c. C.6, s. 29

Competition Act, R.S.C. 1985, c. C-34,

Counsel:

Jonathan Foreman and Robert Gain, for the Plaintiffs.

Alexandra Urbanski, for Infineon Technologies AG, Infineon Technologies Corporation, Infineon Technologies North America Corporation.

Julie K. Parla, for Hynix Semiconductor Inc. Hynix Semiconductor America Inc. and Hynix Semiconductor Manufacturing America, Inc.

Cathy Beagan Flood, for Samsung Semiconductor, Inc. and Samsung Electronics America, Inc.

David W. Kent, for Micron Semiconductor Products, Inc. o/a Crucial Technologies.

Christopher P. Naudie, for Elpida Memory, Inc.

Susan E. Friedman, for Hitachi Ltd., Hitachi America Ltd., Hitachi Canada, Ltd. Hitachi Electronic Devices (USA) and Renesas Electronics Canada, Ltd.

Justin G. Necpal, for Mitsubishi Electronic Corporation, Mitsubishi Electric Sales Canada, Inc and Mitsubishi Electric & Electronics USA, Inc.

Zohaib Maladwala, for Toshiba Canada Limited.

REASONS FOR DECISION

1 P.M. PERELL J.:-- On March 28, 2012, I certified this proposed class action for the purposes of a settlement between the plaintiffs Khalid Eidoo and Cygnus Electronics Corporation and Elpida

Memory, Inc. and Elpida Memory (USA) Inc., two of the many defendants to this action. I approved a notice plan to give the Class members notice that the plaintiffs seek to have the settlement approved pursuant to s. 29 of the *Class Proceedings Act, 1992,* S.O. 1992, c. C.6. See *Eidoo v. Infineon Technologies* AG 2012 ONSC 1987. The plaintiffs now seek approval of the settlement.

2 In this action, Khalid Eidoo and Cygnus Electronics Corporation sue Infineon Technologies AG, Infineon Technologies Corporation, Infineon Technologies North America Corporation, Hynix Semiconductor Inc., Hynix Semiconductor America Inc., Hynix Semiconductor Manufacturing America, Inc. Samsung Electronics Co., Ltd., Samsung Semiconductor, Inc., Samsung Electronics America, Inc., Micron Semiconductor Products, Inc. o/a Crucial Technologies, Mosel Vitelic Corp., Mosel Vitelic Inc. and Elpida Memory, Inc. for: (a) breach of Part IV of the *Competition Act*, R.S.C. 1985, c. C-34; (b) civil conspiracy; and (c) tortious interference with economic interests. The action concerns allegations that the Defendants conspired to fix prices in DRAM (dynamic random access memory) devices.

3 There are parallel proceedings in British Columbia and Québec. I am advised that the settlement has been approved in British Columbia and a settlement approval hearing is scheduled in Québec.

4 Mr. Eidoo purchased DRAM and DRAM products during the proposed class period. Cygnus Electronics is an Ontario corporation that was a direct purchaser of DRAM and DRAM products during the proposed class period.

5 Beginning in the fall of 2010, Mr. Eidoo and Cygnus Electronics began settlement negotiations with Elpida Memory, Inc. and Elpida Memory (USA) Inc. The negotiations were adversarial and at arms-length. The Elpida defendants never admitted liability and indicated that if there was no settlement, they would defend the action on its merits.

6 The parties reached an agreement in principle in November 2010, and they signed a settlement agreement dated November 15, 2011. Under the settlement agreement, Elpida agrees to pay $5.75 million plus interest for the benefit of the class members in Ontario, British Columbia, and Québec. The settlement funds are being held in an interest-bearing trust account for the benefit of Settlement Class Members.

7 Under the terms of the Settlement Agreement, the Elpida defendants are required to cooperate with the Plaintiffs in pursuing their claims against the Non-Settling Defendants. In a price fixing conspiracy action, a defendant's co-operation is obviously beneficial to the Plaintiffs. Under the Settlement Agreement, Elpida is required to:

* (a) provide an oral evidentiary proffer relating to the allegations in the Proceedings, including information with respect to dates, locations, subject matter, and participants in any meeting or discussions between competitors

relating to the purchase, sale, pricing, discounting, marketing or distributing of DRAM Products in Canada;

* (b) provide electronic transactional data relating to sales of DRAM Products during the Settlement Class Period by Elpida to direct purchasers in Canada and respond to questions from Class Counsel regarding this data;
* (c) produce documents provided by Elpida to the Department of Justice, the Canadian Competition Bureau and to Class Counsel for the U.S. plaintiffs as part of the settlement of the US Direct Action;
* (d) to the extent permissible under the protective order issued in the U.S. Proceedings and subject to privilege and confidentiality, Elpida will provide access to all discovery evidence produced in the U.S. Actions, including transcripts or video depositions of Elpida employees; and,
* (e) make reasonable efforts to make available for testimony at trial, employees of Elpida who would be reasonably necessary to support the submission into evidence of any documents or information produced by Elpida pursuant to the Settlement Agreement.

8 As part of the Settlement Agreement, the Parties are seeking an order barring any claim for contribution or indemnity against Elpida. The terms of the bar order are set out in paragraphs 14 to 19 of the draft judgment, which state:

14. THIS COURT ORDERS that all claims for contribution, indemnity or other claims over, whether asserted, unasserted or asserted in a representative capacity, inclusive of interest, taxes and costs, relating to the Released Claims, which were or could have been brought in the Proceedings, the Ontario Additional Proceeding or otherwise, by any Non-Settling Defendant, any named or unnamed co-conspirators who are not Releasees, or any other Person or party, against a Releasee, or by a Releasee against a Non-Settling Defendant, are barred, prohibited and enjoined in accordance with the terms of this Order (unless such claim is made in respect of a claim by a Person who has validly opted-out of the Ontario Proceeding).
15. THIS COURT ORDERS that if, in the absence of paragraph 14 above, the Court determines that there is a right of contribution and indemnity or other claim over, whether in equity or in law, by statute or otherwise:

    (a) the Ontario Plaintiffs and the Ontario Settlement Class Members shall not be entitled to claim or recover from the Non-Settling Defendants and/or named or unnamed co-conspirators that are not Releasees that portion of any damages (including punitive damages, if any) restitutionary award, disgorgement of profits, interest and costs (including investigative costs

claimed pursuant to s. 36 of the *Competition Act*) that corresponds to the Proportionate Liability of the Releasees proven at trial or otherwise;

(b) the Ontario Plaintiffs and the Ontario Settlement Class Members shall limit their claims against the Non-Settling Defendants and/or named or unnamed co-conspirators that are not Releasees to, and shall be entitled to recover from the Non-Settling Defendants and/or named or unnamed co-conspirators that are not Releasees, only those claims for damages, costs and interest attributable to the aggregate of the several liability of the Non-Settling Defendants and/or named or unnamed co-conspirators that are not Releasees to the Ontario Plaintiffs and the Ontario Settlement Class Members, if any, and, for greater certainty, the Ontario Settlement Class Members shall be entitled to claim and recover on a joint and several basis as between the Non-Settling Defendants and/or named or unnamed co-conspirators who are not Releasees, to the extent provided by law; and

(c) this Court shall have full authority to determine the Proportionate Liability of the Releasees at the trial or other disposition of the Ontario Proceeding or the Ontario Additional Proceeding, whether or not the Releasees remain in the Ontario Proceeding or appear at the trial or other disposition, and the Proportionate Liability of the Releasees shall be determined as if the Releasees are parties to the Ontario Proceeding and/or Ontario Additional Proceeding and any determination by this Court in respect of the Proportionate Liability of the Releasees shall only apply in the Ontario Proceeding and/or the Ontario Additional Proceeding and shall not be binding on the Releasees in any other proceedings.

16. THIS COURT ORDERS that if, in the absence of paragraph 14 hereof, the Non-Settling Defendants would not have the right to make claims for contribution and indemnity or other claims over, whether in equity or in law, by statute or otherwise, from or against the Releasees, then nothing in this Order is intended to or shall limit, restrict or affect any arguments which the Non-Settling Defendants may make regarding the reduction of any assessment of damages, restitutionary award, disgorgement of profits or judgment against them in the Ontario Proceeding or the Ontario Additional Proceeding.

17. THIS COURT ORDERS that a Non-Settling Defendant may, on motion to this Court determined as if the Settling Defendant remained a party to the Ontario Proceeding, and on at least ten (10) days notice to counsel for the Settling Defendant, and not to be brought unless and until the action against the Non-Settling Defendants has been certified and all appeals or times to appeal have been exhausted, seek orders for the following:

(a) documentary discovery and an affidavit of documents in accordance with the *Rules of Civil Procedure*, R.R.O. 1990, Reg. 194 from the Settling Defendant;
(b) oral discovery of a representative of the Settling Defendant, the transcript of which may be read in at trial;
(c) leave to serve a request to admit on the Settling Defendant in respect of factual matters; and/or
(d) the production of a representative of the Settling Defendant to testify at trial, with such witness to be subject to cross-examination by counsel for the Non-Settling Defendants.

18. THIS COURT ORDERS that the Settling Defendant retains all rights to oppose such motion(s) brought under paragraph 17. Notwithstanding any provision in this Order, on any motion brought pursuant to paragraph 17, the Court may make such orders as to costs and other terms as it considers appropriate.
19. THIS COURT ORDERS that a Non-Settling Defendant may effect service of the motion(s) referred to in paragraph 17 above on the Settling Defendant by service on counsel of record for the Settling Defendant in the Ontario Proceeding.

9 Under the proposed bar order, the non-settling defendants are barred from claiming contribution and indemnity with respect to the claims released against Elpida Memory, Inc. and Elpida Memory (USA). However, if the Court determines that the non-settling defendants have a right to contribution and indemnity: (a) the Class members may not recover from the Non-Settling Defendants any damages that correspond to the proportionate liability of Elpida Memory, Inc. and Elpida Memory (USA); (b) the Class members may only recover damages from the Non-Settling Defendants attributable to the aggregate of the several liability of the Non-Settling Defendants; (c) the Ontario Court shall have full authority to determine the Proportionate Liability of Elpida Memory, Inc. and Elpida Memory (USA) at the trial or other disposition of the Ontario Proceeding; and (d) the Non-Settling Defendants are at liberty to arguments that any assessment of damages, restitutionary award, or disgorgement of profits should be reduced. Under the proposed bar order, the non-settling defendants may move for orders for discovery from Elpida Memory, Inc. and Elpida Memory (USA), who are entitled to resist the discovery motions.

10 Notice of this approval hearing was published. No objections to settlement approval were received by Class Counsel in response to the notice. Many of the Non-Settling Defendants attended the hearing, but none made submissions.

11 Class Counsel from across the country, who are very experienced with class action litigation, recommend the settlement. The representative plaintiffs recommend the settlement and consent to the Court approving the settlement. Elpida Memory, Inc. and Elpida Memory (USA) Inc. consent to the approval of the settlement.

12 On February 27, 2012, Elpida Memory, Inc. commenced restructuring proceedings in Japan. Elpida Memory, Inc. is restrained from making certain payments and taking certain actions by Order of the Tokyo District Court. A recognition order has not been sought in Canada. Class Counsel submits that it is in the interest of all Class members that the settlement be approved without delay.

13 To approve a settlement of a class proceeding, the court must find that in all the circumstances the settlement is fair, reasonable, and in the best interests of those affected by it: *Dabbs v. Sun Life Assurance Co. of Canada*, [1998] O.J. No. 1598 (Gen. Div.) at para. 9; *Parsons v. Canadian Red Cross Society*, [1999] O.J. No. 3572 (S.C.J.) at paras. 68-73.

14 In determining whether to approve a settlement, the court, without making findings of facts on the merits of the litigation, examines the fairness and reasonableness of the proposed settlement and whether it is in the best interests of the Class as a whole, having regard to the claims and defenses in the litigation and any objections raised to the settlement: *Baxter v. Canada (Attorney General)* (2006), 83 O.R. (3d) 481 (S.C.J.) at para. 10.

15 When considering the approval of negotiated settlements, the court may consider, among other things: (a) the likelihood of recovery or likelihood of success; (b) the amount and nature of discovery, evidence or investigation; (c) settlement terms and conditions; (d) recommendation and experience of counsel; (e) future expenses and likely duration of litigation and risk; (f) recommendation of neutral parties; (g) if any, the number of objectors and nature of objections; (h) the presence of good faith, arms-length bargaining and the absence of collusion; (i) the degree and nature of communications by counsel and the representative parties with Class Members during the litigation; and (i) information conveying to the court the dynamics of and the positions taken by the parties during the negotiation: *Dabbs v. Sun Life Assurance Co. of Canada*, [1998] O.J. No. 2811, (Gen. Div.), aff'd (1998), 41 O.R. (3d) 97 (C.A.), leave to appeal to S.C.C. refused October 22, 1998, [1998] S.C.C.A. No. 372; *Parsons v. The Canadian Red Cross Society*, [1999] O.J. No. 3572 (S.C.J.) at paras. 71-72; *Frohlinger v. Nortel Networks Corp.*, [2007] O.J. No. 148 (S.C.J.) at para. 8; *Kelman v. Goodyear Tire and Rubber Co.*, [2005] O.J. No. 175 (S.C.J.) at paras. 12-13; *Vitapharm Canada Ltd. v. F. Hoffmann-La Roche Ltd.* (2005), 74 O.R. (3d) 758 (S.C.J.) at para. 117; *Sutherland v. Boots Pharmaceutical PLC*, [2002] O.J. No. 1361 (S.C.J.) at para. 10.

16 In my opinion, the settlement is fair, reasonable, and in the best interests of the class as a whole. It provides tangible benefits to class members and a settlement is preferable when compared against the prospect of litigation with an uncertain outcome and duration.

17 At the settlement approval hearing, I approved the settlement and signed the settlement approval order.

P.M. PERELL J.

Case Name:
Sino-Forest Corp. (Re)

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 Sino-Forest Corporation, Applicant

[2012] O.J. No. 5958

2012 ONSC 7050

Court File No. CV-12-9667-00CL

Ontario Superior Court of Justice
Commercial List

G.B. Morawetz J.

Heard: December 7, 2012.
Judgment: December 10, 2012.
Released: December 12, 2012.

(79 paras.)

Counsel:

Robert W. Staley, Kevin Zych, Derek J. Bell and Jonathan Bell, for Sino-Forest Corporation.

Derrick Tay, Jennifer Stam, and Cliff Prophet for the Monitor, FTI Consulting Canada Inc.

Robert Chadwick and Brendan O'Neill, for the Ad Hoc Committee of Noteholders.

Kenneth Rosenberg, Kirk Baert, Max Starnino, and A. Dimitri Lascaris, for the Class Action Plaintiffs.

Won J. Kim, James C. Orr, Michael C. Spencer, and Megan B. McPhee, for Invesco Canada Ltd., Northwest & Ethical Investments LP and Comité Syndicale Nationale de Retraite Bâtirente Inc.

Peter Griffin, Peter Osborne and Shara Roy, for Ernst & Young Inc.

Peter Greene and Ken Dekkar, for BDO Limited.

Edward A. Sellers and Larry Lowenstein, for the Board of Directors of Sino-Forest Corporation.

John Pirie and David Gadsden, for Poyry (Beijing).

James Doris, for the Plaintiff in the New York Class Action.

David Bish, for the Underwriters.

Simon Bieber and Erin Pleet, for David Horsley.

James Grout, for the Ontario Securities Commission.

Emily Cole and Joseph Marin, for Allen Chan.

Susan E. Freedman and Brandon Barnes, for Kai Kit Poon.

Paul Emerson, for ACE/Chubb.

Sam Sasso, for Travelers.

ENDORSEMENT

1 G.B. MORAWETZ J.:-- On December 10, 2012, I released an endorsement granting this motion with reasons to follow. These are those reasons.

Overview

2 The Applicant, Sino-Forest Corporation ("SFC"), seeks an order sanctioning (the "Sanction Order") a plan of compromise and reorganization dated December 3, 2012 as modified, amended, varied or supplemented in accordance with its terms (the "Plan") pursuant to section 6 of the *Companies' Creditors Arrangement Act* ("CCAA").

3 With the exception of one party, SFC's position is either supported or is not opposed.

4 Invesco Canada Ltd., Northwest & Ethical Investments LP and Comité Syndicale Nationale de Retraite Bâtirente Inc. (collectively, the "Funds") object to the proposed Sanction Order. The Funds requested an adjournment for a period of one month. I denied the Funds' adjournment request in a separate endorsement released on December 10, 2012 (*Re Sino-Forest Corporation*, 2012 ONSC 7041). Alternatively, the Funds requested that the Plan be altered so as to remove Article 11

"Settlement of Claims Against Third Party Defendants".

5 The defined terms have been taken from the motion record.

6 SFC's counsel submits that the Plan represents a fair and reasonable compromise reached with SFC's creditors following months of negotiation. SFC's counsel submits that the Plan, including its treatment of holders of equity claims, complies with CCAA requirements and is consistent with this court's decision on the equity claims motions (the "Equity Claims Decision") (2012 ONSC 4377, 92 C.B.R. (5th) 99), which was subsequently upheld by the Court of Appeal for Ontario (2012 ONCA 816).

7 Counsel submits that the classification of creditors for the purpose of voting on the Plan was proper and consistent with the CCAA, existing law and prior orders of this court, including the Equity Claims Decision and the Plan Filing and Meeting Order.

8 The Plan has the support of the following parties:

(a) the Monitor;
(b) SFC's largest creditors, the Ad Hoc Committee of Noteholders (the "Ad Hoc Noteholders");
(c) Ernst & Young LLP ("E&Y");
(d) BDO Limited ("BDO"); and
(e) the Underwriters.

9 The Ad Hoc Committee of Purchasers of the Applicant's Securities (the "Ad Hoc Securities Purchasers Committee", also referred to as the "Class Action Plaintiffs") has agreed not to oppose the Plan. The Monitor has considered possible alternatives to the Plan, including liquidation and bankruptcy, and has concluded that the Plan is the preferable option.

10 The Plan was approved by an overwhelming majority of Affected Creditors voting in person or by proxy. In total, 99% in number, and greater than 99% in value, of those Affected Creditors voting favoured the Plan.

11 Options and alternatives to the Plan have been explored throughout these proceedings. SFC carried out a court-supervised sales process (the "Sales Process"), pursuant to the sales process order (the "Sales Process Order"), to seek out potential qualified strategic and financial purchasers of SFC's global assets. After a canvassing of the market, SFC determined that there were no qualified purchasers offering to acquire its assets for qualified consideration ("Qualified Consideration"), which was set at 85% of the value of the outstanding amount owing under the notes (the "Notes").

12 SFC's counsel submits that the Plan achieves the objective stated at the commencement of the CCAA proceedings (namely, to provide a "clean break" between the business operations of the

global SFC enterprise as a whole ("Sino-Forest") and the problems facing SFC, with the aspiration of saving and preserving the value of SFC's underlying business for the benefit of SFC's creditors).

Facts

13 SFC is an integrated forest plantation operator and forest products company, with most of its assets and the majority of its business operations located in the southern and eastern regions of the People's Republic of China ("PRC"). SFC's registered office is located in Toronto and its principal business office is located in Hong Kong.

14 SFC is a holding company with six direct subsidiaries (the "Subsidiaries") and an indirect majority interest in Greenheart Group Limited (Bermuda), a publicly-traded company. Including SFC and the Subsidiaries, there are 137 entities that make up Sino-Forest: 67 companies incorporated in PRC, 58 companies incorporated in British Virgin Islands, 7 companies incorporated in Hong Kong, 2 companies incorporated in Canada and 3 companies incorporated elsewhere.

15 On June 2, 2011, Muddy Waters LLC ("Muddy Waters"), a short-seller of SFC's securities, released a report alleging that SFC was a "near total fraud" and a "Ponzi scheme". SFC subsequently became embroiled in multiple class actions across Canada and the United States and was subjected to investigations and regulatory proceedings by the Ontario Securities Commission ("OSC"), Hong Kong Securities and Futures Commission and the Royal Canadian Mounted Police.

16 SFC was unable to file its 2011 third quarter financial statements, resulting in a default under its note indentures.

17 Following extensive arm's length negotiations between SFC and the Ad Hoc Noteholders, the parties agreed on a framework for a consensual resolution of SFC's defaults under its note indentures and the restructuring of its business. The parties ultimately entered into a restructuring support agreement (the "Support Agreement") on March 30, 2012, which was initially executed by holders of 40% of the aggregate principal amount of SFC's Notes. Additional consenting noteholders subsequently executed joinder agreements, resulting in noteholders representing a total of more than 72% of aggregate principal amount of the Notes agreeing to support the restructuring.

18 The restructuring contemplated by the Support Agreement was commercially designed to separate Sino-Forest's business operations from the problems facing the parent holding company outside of PRC, with the intention of saving and preserving the value of SFC's underlying business. Two possible transactions were contemplated:

(a) First, a court-supervised Sales Process to determine if any person or group of persons would purchase SFC's business operations for an amount in excess of the 85% Qualified Consideration;

(b) Second, if the Sales Process was not successful, a transfer of six immediate

> holding companies (that own SFC's operating business) to an acquisition vehicle to be owned by Affected Creditors in compromise of their claims against SFC. Further, the creation of a litigation trust (including funding) (the "Litigation Trust") to enable SFC's litigation claims against any person not otherwise released within the CCAA proceedings, preserved and pursued for the benefit of SFC's stakeholders in accordance with the Support Agreement (concurrently, the "Restructuring Transaction").

19 SFC applied and obtained an initial order under the CCAA on March 30, 2012 (the "Initial Order"), pursuant to which a limited stay of proceedings ("Stay of Proceedings") was also granted in respect of the Subsidiaries. The Stay of Proceedings was subsequently extended by orders dated May 31, September 28, October 10, and November 23, 2012, and unless further extended, will expire on February 1, 2013.

20 On March 30, 2012, the Sales Process Order was granted. While a number of Letters of Intent were received in respect of this process, none were qualified Letters of Intent, because none of them offered to acquire SFC's assets for the Qualified Consideration. As such, on July 10, 2012, SFC announced the termination of the Sales Process and its intention to proceed with the Restructuring Transaction.

21 On May 14, 2012, this court granted an order (the "Claims Procedure Order") which approved the Claims Process that was developed by SFC in consultation with the Monitor.

22 As of the date of filing, SFC had approximately $1.8 billion of principal amount of debt owing under the Notes, plus accrued and unpaid interest. As of May 15, 2012, Noteholders holding in aggregate approximately 72% of the principal amount of the Notes, and representing more than 66.67% of the principal amount of each of the four series of Notes, agreed to support the Plan.

23 After the Muddy Waters report was released, SFC and certain of its officers, directors and employees, along with SFC's former auditors, technical consultants and Underwriters involved in prior equity and debt offerings, were named as defendants in a number of proposed class action lawsuits. Presently, there are active proposed class actions in four jurisdictions: Ontario, Quebec, Saskatchewan and New York (the "Class Action Claims").

24 *The Labourers v. Sino-Forest Corporation Class Action* (the "Ontario Class Action") was commenced in Ontario by Koskie Minsky LLP and Siskinds LLP. It has the following two components: first, there is a shareholder claim (the "Shareholder Class Action Claims") brought on behalf of current and former shareholders of SFC seeking damages in the amount of $6.5 billion for general damages, $174.8 million in connection with a prospectus issued in June 2007, $330 million in relation to a prospectus issued in June 2009, and $319.2 million in relation to a prospectus issued in December 2009; second, there is a $1.8 billion noteholder claim (the "Noteholder Class Action Claims") brought on behalf of former holders of SFC's Notes. The noteholder component seeks damages for loss of value in the Notes.

25 The Quebec Class Action is similar in nature to the Ontario Class Action, and both plaintiffs filed proof of claim in this proceeding. The plaintiffs in the Saskatchewan Class Action did not file a proof of claim in this proceeding, whereas the plaintiffs in the New York Class Action did file a proof of claim in this proceeding. A few shareholders filed proofs of claim separately, but no proof of claim was filed by the Funds.

26 In this proceeding, the Ad Hoc Securities Purchasers Committee - represented by Siskinds LLP, Koskie Minsky, and Paliare Roland Rosenberg Rothstein LLP - has appeared to represent the interests of the shareholders and noteholders who have asserted Class Action Claims against SFC and others.

27 Since 2000, SFC has had the following two auditors ("Auditors"): E&Y from 2000 to 2004 and 2007 to 2012 and BDO from 2005 to 2006.

28 The Auditors have asserted claims against SFC for contribution and indemnity for any amounts paid or payable in respect of the Shareholder Class Action Claims, with each of the Auditors having asserted claims in excess of $6.5 billion. The Auditors have also asserted indemnification claims in respect the Noteholder Class Action Claims.

29 The Underwriters have similarly filed claims against SFC seeking contribution and indemnity for the Shareholder Class Action Claims and Noteholder Class Action Claims.

30 The Ontario Securities Commission ("OSC") has also investigated matters relating to SFC. The OSC has advised that they are not seeking any monetary sanctions against SFC and are not seeking monetary sanctions in excess of $100 million against SFC's directors and officers (this amount was later reduced to $84 million).

31 SFC has very few trade creditors by virtue of its status as a holding company whose business is substantially carried out through its Subsidiaries in PRC and Hong Kong.

32 On June 26, 2012, SFC brought a motion for an order declaring that all claims made against SFC arising in connection with the ownership, purchase or sale of an equity interest in SFC and related indemnity claims to be "equity claims" (as defined in section 2 of the CCAA). These claims encapsulate the commenced Shareholder Class Action Claims asserted against SFC. The Equity Claims Decision did not purport to deal with the Noteholder Class Action Claims.

33 In reasons released on July 27, 2012, I granted the relief sought by SFC in the Equity Claims Decision, finding that the "the claims advanced in the shareholder claims are clearly equity claims." The Auditors and Underwriters appealed the decision and on November 23, 2012, the Court of Appeal for Ontario dismissed the appeal.

34 On August 31, 2012, an order was issued approving the filing of the Plan (the "Plan Filing and Meeting Order").

35 According to SFC's counsel, the Plan endeavours to achieve the following purposes:

(a) to effect a full, final and irrevocable compromise, release, discharge, cancellation and bar of all affected claims;
(b) to effect the distribution of the consideration provided in the Plan in respect of proven claims;
(c) to transfer ownership of the Sino-Forest business to Newco and then to Newco II, in each case free and clear of all claims against SFC and certain related claims against the Subsidiaries so as to enable the Sino-Forest business to continue on a viable, going concern basis for the benefit of the Affected Creditors; and
(d) to allow Affected Creditors and Noteholder Class Action Claimants to benefit from contingent value that may be derived from litigation claims to be advanced by the litigation trustee.

36 Pursuant to the Plan, the shares of Newco ("Newco Shares") will be distributed to the Affected Creditors. Newco will immediately transfer the acquired assets to Newco II.

37 SFC's counsel submits that the Plan represents the best available outcome in the circumstances and those with an economic interest in SFC, when considered as a whole, will derive greater benefit from the implementation of the Plan and the continuation of the business as a going concern than would result from bankruptcy or liquidation of SFC. Counsel further submits that the Plan fairly and equitably considers the interests of the Third Party Defendants, who seek indemnity and contribution from SFC and its Subsidiaries on a contingent basis, in the event that they are found to be liable to SFC's stakeholders. Counsel further notes that the three most significant Third Party Defendants (E&Y, BDO and the Underwriters) support the Plan.

38 SFC filed a version of the Plan in August 2012. Subsequent amendments were made over the following months, leading to further revised versions in October and November 2012, and a final version dated December 3, 2012 which was voted on and approved at the meeting. Further amendments were made to obtain the support of E&Y and the Underwriters. BDO availed itself of those terms on December 5, 2012.

39 The current form of the Plan does not settle the Class Action Claims. However, the Plan does contain terms that would be engaged if certain conditions are met, including if the class action settlement with E&Y receives court approval.

40 Affected Creditors with proven claims are entitled to receive distributions under the Plan of (i) Newco Shares, (ii) Newco notes in the aggregate principal amount of U.S. $300 million that are secured and guaranteed by the subsidiary guarantors (the "Newco Notes"), and (iii) Litigation Trust Interests.

41 Affected Creditors with proven claims will be entitled under the Plan to: (a) their *pro rata*

share of 92.5% of the Newco Shares with early consenting noteholders also being entitled to their *pro rata* share of the remaining 7.5% of the Newco Shares; and (b) their *pro rata* share of the Newco Notes. Affected Creditors with proven claims will be concurrently entitled to their *pro rata* share of 75% of the Litigation Trust Interests; the Noteholder Class Action Claimants will be entitled to their *pro rata* share of the remaining 25% of the Litigation Trust Interests.

42 With respect to the indemnified Noteholder Class Action Claims, these relate to claims by former noteholders against third parties who, in turn, have alleged corresponding indemnification claims against SFC. The Class Action Plaintiffs have agreed that the aggregate amount of those former noteholder claims will not exceed the Indemnified Noteholder Class Action Limit of $150 million. In turn, indemnification claims of Third Party Defendants against SFC with respect to indemnified Noteholder Class Action Claims are also limited to the $150 million Indemnified Noteholder Class Action Limit.

43 The Plan includes releases for, among others, (a) the subsidiary; (b) the Underwriters' liability for Noteholder Class Action Claims in excess of the Indemnified Noteholder Class Action Limit; (c) E&Y in the event that all of the preconditions to the E&Y settlement with the Ontario Class Action plaintiffs are met; and (d) certain current and former directors and officers of SFC (collectively, the "Named Directors and Officers"). It was emphasized that non-released D&O Claims (being claims for fraud or criminal conduct), conspiracy claims and section 5.1 (2) D&O Claims are not being released pursuant to the Plan.

44 The Plan also contemplates that recovery in respect of claims of the Named Directors and Officers of SFC in respect of any section 5.1 (2) D&O Claims and any conspiracy claims shall be directed and limited to insurance proceeds available from SFC's maintained insurance policies.

45 The meeting was carried out in accordance with the provisions of the Plan Filing and Meeting Order and that the meeting materials were sent to stakeholders in the manner required by the Plan Filing and Meeting Order. The Plan supplement was authorized and distributed in accordance with the Plan Filing and Meeting Order.

46 The meeting was ultimately held on December 3, 2012 and the results of the meeting were as follows:

(a) the number of voting claims that voted on the Plan and their value for and against the Plan;

(b) The results of the Meeting were as follows:

a. the number of Voting Claims that voted on the Plan and their value for and against the Plan:

	Number of Votes	%		Value of Votes	%
Total Claims Voting For	250	98.81%	$	1,465,766,204	99.97%
Total Claims Voting Against	3	1.19%	$	414,087	0.03%
Total Claims Voting	253	100.00%	$	1,466,180,291	100.00%

b. the number of votes for and against the Plan in connection with Class Action Indemnity Claims in respect of Indemnified Noteholder Class Action Claims up to the Indemnified Noteholder Limit:

	Vote For	Vote Against	Total Votes
Class Action Indemnity Claims	4	1	5

c. the number of Defence Costs Claims votes for and against the Plan and their value:

	Number of Votes	%		Value of Votes	%
Total Claims Voting For	12	92.31%	$	8,375,016	96.10%
Total Claims Voting Against	1	7.69%	$	340,000	3.90%
Total Claims Voting	13	100.00%	$	8,715,016	100.00%

d. the overall impact on the approval of the Plan if the count were to include Total Unresolved Claims (including Defence Costs Claims) and, in order to demonstrate the "worst case scenario" if the entire $150 million of the Indemnified Noteholder Class Action Limit had been voted a "no" vote (even though 4 of 5 votes were "yes" votes and the remaining "no" vote was from BDO, who has now agreed to support the Plan):

	Number of Votes	%		Value of Votes	%
Total Claims Voting For	263	98.50%	$	1,474,149,082	90.72%
Total Claims Voting Against	4	1.50%	$	150,754,087	9.28%
Total Claims Voting	267	100.00%	$	1,624,903,169	100.00%

e. E&Y has now entered into a settlement ("E&Y Settlement") with the Ontario plaintiffs and the Quebec plaintiffs, subject to several conditions and approval of the E&Y Settlement itself.

47 As noted in the endorsement dated December 10, 2012, which denied the Funds' adjournment request, the E&Y Settlement does not form part of the Sanction Order and no relief is being sought on this motion with respect to the E&Y Settlement. Rather, section 11.1 of the Plan contains provisions that provide a framework pursuant to which a release of the E&Y claims under the Plan will be effective if several conditions are met. That release will only be granted if all conditions are met, including further court approval.

48 Further, SFC's counsel acknowledges that any issues relating to the E&Y Settlement, including fairness, continuing discovery rights in the Ontario Class Action or Quebec Class Action, or opt out rights, are to dealt with at a further court-approval hearing.

Law and Argument

49 Section 6(1) of the CCAA provides that courts may sanction a plan of compromise if the plan has achieved the support of a majority in number representing two-thirds in value of the creditors.

50 To establish the court's approval of a plan of compromise, the debtor company must establish the following:

(a) there has been strict compliance with all statutory requirements and adherence to previous orders of the court;
(b) nothing has been done or purported to be done that is not authorized by the CCAA; and
(c) the plan is fair and reasonable.

(See *Re Canadian Airlines Corporation*, 2000 ABQB 442, leave to appeal denied, 2000 ABCA 238, aff'd 2001 ABCA 9, leave to appeal to SCC refused July 21, 2001, [2001] S.C.C.A. No. 60 and Re Nelson Financial Group Limited, 2011 ONSC 2750, 79 C.B.R. (5th) 307).

51 SFC submits that there has been strict compliance with all statutory requirements.

52 On the initial application, I found that SFC was a "debtor company" to which the CCAA applies. SFC is a corporation continued under the *Canada Business Corporations Act* ("CBCA") and is a "company" as defined in the CCAA. SFC was "reasonably expected to run out of liquidity within a reasonable proximity of time" prior to the Initial Order and, as such, was and continues to be insolvent. SFC has total claims and liabilities against it substantially in excess of the $5 million statutory threshold.

53 The Notice of Creditors' Meeting was sent in accordance with the Meeting Order and the revised Noteholder Mailing Process Order and, further, the Plan supplement and the voting procedures were posted on the Monitor's website and emailed to each of the ordinary Affected Creditors. It was also delivered by email to the Trustees and DTC, as well as to Globic who disseminated the information to the Registered Noteholders. The final version of the Plan was emailed to the Affected Creditors, posted on the Monitor's website, and made available for review at the meeting.

54 SFC also submits that the creditors were properly classified at the meeting as Affected Creditors constituted a single class for the purposes of considering the voting on the Plan. Further, and consistent with the Equity Claims Decision, equity claimants constituted a single class but were not entitled to vote on the Plan. Unaffected Creditors were not entitled to vote on the Plan.

55 Counsel submits that the classification of creditors as a single class in the present case complies with the commonality of interests test. See *Re Canadian Airlines Corporation.*

56 Courts have consistently held that relevant interests to consider are the legal interests of the creditors hold *qua* creditor in relationship to the debtor prior to and under the plan. Further, the commonality of interests should be considered purposively, bearing in mind the object of the CCAA, namely, to facilitate reorganizations if possible. See *Stelco Inc.* (2005), 78 O.R. (3d) 241 (Ont. C.A.), *Re Canadian Airlines Corporation*, and *Re Nortel Networks Corporation* [2009] O.J. No. 2166 (Ont. S.C.). Further, courts should resist classification approaches that potentially jeopardize viable plans.

57 In this case, the Affected Creditors voted in one class, consistent with the commonality of interests among Affected Creditors, considering their legal interests as creditors. The classification was consistent with the Equity Claims Decision.

58 I am satisfied that the meeting was properly constituted and the voting was properly carried out. As described above, 99% in number, and more than 99% in value, voting at the meeting favoured the Plan.

59 SFC's counsel also submits that SFC has not taken any steps unauthorized by the CCAA or by court orders. SFC has regularly filed affidavits and the Monitor has provided regular reports and has

consistently opined that SFC is acting in good faith and with due diligence. The court has so ruled on this issue on every stay extension order that has been granted.

60 In *Nelson Financial,* I articulated relevant factors on the sanction hearing. The following list of factors is similar to those set out in *Re Canwest Global Communications Corporation,* 2010 ONSC 4209, 70 C.B.R. (5th) 1:

1. The claims must have been properly classified, there must be no secret arrangements to give an advantage to a creditor or creditor; the approval of the plan by the requisite majority of creditors is most important;
2. It is helpful if the Monitor or some other disinterested person has prepared an analysis of anticipated receipts and liquidation or bankruptcy;
3. If other options or alternatives have been explored and rejected as workable, this will be significant;
4. Consideration of the oppression rights of certain creditors; and
5. Unfairness to shareholders.
6. The court will consider the public interest.

61 The Monitor has considered the liquidation and bankruptcy alternatives and has determined that it does not believe that liquidation or bankruptcy would be a preferable alternative to the Plan. There have been no other viable alternatives presented that would be acceptable to SFC and to the Affected Creditors. The treatment of shareholder claims and related indemnity claims are, in my view, fair and consistent with CCAA and the Equity Claims Decision.

62 In addition, 99% of Affected Creditors voted in favour of the Plan and the Ad Hoc Securities Purchasers Committee have agreed not to oppose the Plan. I agree with SFC's submission to the effect that these are exercises of those parties' business judgment and ought not to be displaced.

63 I am satisfied that the Plan provides a fair and reasonable balance among SFC's stakeholders while simultaneously providing the ability for the Sino-Forest business to continue as a going concern for the benefit of all stakeholders.

64 The Plan adequately considers the public interest. I accept the submission of counsel that the Plan will remove uncertainty for Sino-Forest's employees, suppliers, customers and other stakeholders and provide a path for recovery of the debt owed to SFC's non-subordinated creditors. In addition, the Plan preserves the rights of aggrieved parties, including SFC through the Litigation Trust, to pursue (in litigation or settlement) those parties that are alleged to share some or all of the responsibility for the problems that led SFC to file for CCAA protection. In addition, releases are not being granted to individuals who have been charged by OSC staff, or to other individuals against whom the Ad Hoc Securities Purchasers Committee wishes to preserve litigation claims.

65 In addition to the consideration that is payable to Affected Creditors, Early Consent Noteholders will receive their *pro rata* share of an additional 7.5% of the Newco Shares ("Early

Consent Consideration"). Plans do not need to provide the same recovery to all creditors to be considered fair and reasonable and there are several plans which have been sanctioned by the courts featuring differential treatment for one creditor or one class of creditors. See, for example, *Canwest Global* and *Re Armbro Enterprises Inc.* (1993), 22 C.B.R. (3d) 80 (Ont. Gen. Div.). A common theme permeating such cases has been that differential treatment does not necessarily result in a finding that the Plan is unfair, as long as there is a sufficient rational explanation.

66 In this case, SFC's counsel points out that the Early Consent Consideration has been a feature of the restructuring since its inception. It was made available to any and all noteholders and noteholders who wished to become Early Consent Noteholders were invited and permitted to do so until the early consent deadline of May 15, 2012. I previously determined that SFC made available to the noteholders all information needed to decide whether they should sign a joinder agreement and receive the Early Consent Consideration, and that there was no prejudice to the noteholders in being put to that election early in this proceeding.

67 As noted by SFC's counsel, there was a rational purpose for the Early Consent Consideration. The Early Consent Noteholders supported the restructuring through the CCAA proceedings which, in turn, provided increased confidence in the Plan and facilitated the negotiations and approval of the Plan. I am satisfied that this feature of the Plan is fair and reasonable.

68 With respect to the Indemnified Noteholder Class Action Limit, I have considered SFC's written submissions and accept that the $150 million agreed-upon amount reflects risks faced by both sides. The selection of a $150 million cap reflects the business judgment of the parties making assessments of the risk associated with the noteholder component of the Ontario Class Action and, in my view, is within the "general range of acceptability on a commercially reasonable basis". See *Re Ravelston Corporation,* (2005) 14 C.B.R. (5th) 207 (Ont. S.C). Further, as noted by SFC's counsel, while the New York Class Action Plaintiffs filed a proof of claim, they have not appeared in this proceeding and have not stated any opposition to the Plan, which has included this concept since its inception.

69 Turning now to the issue of releases of the Subsidiaries, counsel to SFC submits that the unchallenged record demonstrates that there can be no effective restructuring of SFC's business and separation from its Canadian parent if the claims asserted against the Subsidiaries arising out of or connected to claims against SFC remain outstanding. The Monitor has examined all of the releases in the Plan and has stated that it believes that they are fair and reasonable in the circumstances.

70 The Court of Appeal in *ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corporation,* 2008 ONCA 587, 45 C.B.R. (5th) 163 stated that the "court has authority to sanction plans incorporating third party releases that are reasonably related to the proposed restructuring".

71 In this case, counsel submits that the release of Subsidiaries is necessary and essential to the restructuring of SFC. The primary purpose of the CCAA proceedings was to extricate the business of Sino-Forest, through the operation of SFC's Subsidiaries (which were protected by the Stay of

Proceedings), from the cloud of uncertainty surrounding SFC. Accordingly, counsel submits that there is a clear and rational connection between the release of the Subsidiaries in the Plan. Further, it is difficult to see how any viable plan could be made that does not cleanse the Subsidiaries of the claims made against SFC.

72 Counsel points out that the Subsidiaries who are to have claims against them released are contributing in a tangible and realistic way to the Plan. The Subsidiaries are effectively contributing their assets to SFC to satisfy SFC's obligations under their guarantees of SFC's note indebtedness, for the benefit of the Affected Creditors. As such, counsel submits the releases benefit SFC and the creditors generally.

73 In my view, the basis for the release falls within the guidelines previously set out by this court in *ATB Financial*, *Re Nortel Networks*, 2010 ONSC 1708, and *Re Kitchener Frame Limited*, 2012 ONSC 234, 86 C.B.R. (5th) 274. Further, it seems to me that the Plan cannot succeed without the releases of the Subsidiaries. I am satisfied that the releases are fair and reasonable and are rationally connected to the overall purpose of the Plan.

74 With respect to the Named Directors and Officers release, counsel submits that this release is necessary to effect a greater recovery for SFC's creditors, rather than having those directors and officers assert indemnity claims against SFC. Without these releases, the quantum of the unresolved claims reserve would have to be materially increased and, to the extent that any such indemnity claim was found to be a proven claim, there would have been a corresponding dilution of consideration paid to Affected Creditors.

75 It was also pointed out that the release of the Named Directors and Officers is not unlimited; among other things, claims for fraud or criminal conduct, conspiracy claims, and section 5.1 (2) D&O Claims are excluded.

76 I am satisfied that there is a reasonable connection between the claims being compromised and the Plan to warrant inclusion of this release.

77 Finally, in my view, it is necessary to provide brief comment on the alternative argument of the Funds, namely, the Plan be altered so as to remove Article 11 "Settlement of Claims Against Third Party Defendants". The Plan was presented to the meeting with Article 11 in place. This was the Plan that was subject to the vote and this is the Plan that is the subject of this motion. The alternative proposed by the Funds was not considered at the meeting and, in my view, it is not appropriate to consider such an alternative on this motion.

Disposition

78 Having considered the foregoing, I am satisfied that SFC has established that:

(i) there has been strict compliance with all statutory requirements and

adherence to the previous orders of the court;

(ii) nothing has been done or purported to be done that is not authorized by the CCAA; and

(iii) the Plan is fair and reasonable.

79 Accordingly, the motion is granted and the Plan is sanctioned. An order has been signed substantially in the form of the draft Sanction Order.

G.B. MORAWETZ J.

Case Name:

Zaniewicz v. Zungui Haixi Corp.

Between
Jerzy Robert Zaniewicz and Edward C. Clarke, Plaintiffs, and Zungui Haixi Corporation, E&Y, Fengyi Cai, Jixu Cai, Yanda Cai, Michelle Gobin, Michael W. Manley, Patrick A. Ryan, Elliott Wahle, Margaret Cornish, CIBC World Markets Inc., Canaccord Genuity Corp. (f.k.A. Canaccord Financial Ltd)., GMP Securities LP and Mackie Research Capital Corporation (f.k.a. Research Capital Corporation)
Defendants Proceeding under the Class Proceedings Act

[2013] O.J. No. 3894

2013 ONSC 5490

232 A.C.W.S. (3d) 319

44 C.P.C. (7th) 178

2013 CarswellOnt 11949

Court File No. 11-CV-436360-00CP

Ontario Superior Court of Justice

P.M. Perell J.

Heard: August 27, 2013.
Judgment: August 27, 2013.

(105 paras.)

Civil litigation -- Civil procedure -- Parties -- Class or representative actions -- Certification -- Class counsel -- Fees -- Definition of class -- Members of class or sub-class -- Settlements -- Approval -- Motion by plaintiffs for certification of class action for settlement purposes, approval of settlements, approval of the plan of distribution and approval of counsel fees allowed in part -- Plaintiffs alleged defendant's prospectus and financial statements were misleading -- Certification

of class action allowed and settlements approved -- Counsel fees approved -- Modified plan of distribution approved -- It was unfair to include investors who purchased shares after corrective press release in class definition but exclude them from distribution -- Such class members were to be included in distribution at 80 per cent discount -- Class Proceedings Act, s. 26(1).

Securities regulation -- Civil liability -- Misrepresentation in a prospectus -- Plaintiffs -- Purchase during period of distribution -- Secondary market disclosure -- Motion by plaintiffs for certification of class action for settlement purposes, approval of settlements, approval of the plan of distribution and approval of counsel fees allowed in part -- Plaintiffs alleged defendant's prospectus and financial statements were misleading -- Certification of class action allowed and settlements approved -- Counsel fees approved -- Modified plan of distribution approved -- It was unfair to include investors who purchased shares after corrective press release in class definition but exclude them from distribution -- Such class members were to be included in distribution at 80 per cent discount -- Class Proceedings Act, s. 26(1).

Motion by plaintiffs for certification of class action for settlement purposes, approval of settlements, approval of the plan of distribution, approval of class counsel fees, and ancillary orders. The plaintiffs purchased common shares of the defendant corporation in the primary and secondary markets. The plaintiffs advanced common law tort claims and securities law claims. The plaintiffs alleged that the defendant's initial public offering prospectus was misleading as it contained material misrepresentations, that the financial statements contained in the prospectus and other financial statements later prepared and disseminated in the secondary securities market were neither accurate nor reliable. The proposed settlement funds totalled $10,850,000. The plaintiff's plan of distribution was structured to reflect the theory of damages that the corporation's share value was artificially inflated and that this artificial inflation was removed in two share price falls. The first share price fall occurred when a report was issued alleging fraud, and the second occurred when the defendant issued a press release announcing that its auditor had suspended its audit of the corporation's financial statements for the year. One month after the press release, the auditor resigned and withdrew its opinions that the corporation's financial statements were GAAP compliant. The class definition included all persons who acquired shares during the period to and including the date of the second event. No compensation was to be paid to class members who purchased shares in the secondary market after the press release. Class counsel received one written objection to the proposed plan of allocation from a class member who purchased shares on the day of the press release, proposing that such class members be included in the distribution at a discount of 80 per cent.

HELD: Motions allowed in part. Motions to certify action and approve settlements allowed and ancillary orders allowed. Modified plan of allocation allowed. Aside from the plan of distribution, the settlement agreements were fair, reasonable, and in the best interests of the class members. The settlements were approved independent of the plan of distribution. It was inappropriate and unfair to include investors who purchased their shares on the day of the press release as class members and

exclude them from the plan of allocation. After including those purchasers as class members as part of the bargaining for the settlements, it was inappropriate for the plaintiffs to advocate a theory of the case that they were not eligible for any compensation at all. The plan of distribution was modified to include compensation for those class members at a discount of 80 per cent. Class counsel's request for fees represented 20.75 per cent of the recovery. Having regard to the risk undertaken by class counsel and the degree of success achieved, class counsel's request for approval of its legal fees in the amount of $2,807,037 was approved.

Statutes, Regulations and Rules Cited:

Class Proceedings Act, 1992, S.O. 1992, c. 6, s. 26, s. 26(1), s. 29(2)

Securities Act, R.S.O. 1990, c. S.5,

Counsel:

Charles M. Wright and *Douglas M. Worndl,* for the Plaintiffs.

Deborah Berlach, for the Defendant, Zungui Haizi Corporation.

Margaret L. Waddell, for the Defendant, Michelle Gobin.

Michael A. Eizenga, for the Defendant, Michael W.
Manley.

James S.F. Wilson, for the Defendants, Patrick A. Ryan, Elliott Wahle, and Margaret Cornish.

Linda L. Fuerst, for the Defendant Ernst & Young LLP.

Kent Thomson and *Derek Ricci*, for the Defendants, CIBC World Markets Inc., Canaccord Genuity Corp. (f.k.A. Canaccord Financial Ltd.) and Mackie Research Capital Corporation (f.k.A. Research Capital Corporation and GMP Securities LP.

REASONS FOR DECISION

P.M. PERELL J.:--

A. INTRODUCTION AND OVERVIEW

1 This is a securities class action under the *Class Proceedings Act, 1992*, S.O. 1992, c. 6 and the Ontario *Securities Act,* R.S.O. 1990, c. S.5. The Plaintiffs Jerzy Robert Zaniewicz and Edward C.

Clarke advance common law tort claims and also statutory claims with respect to the sale of the shares of Zungui Haizi Corporation in the primary and secondary markets.

2 The Plaintiffs bring this motion for: (a) certification for settlement purposes as against the Defendants CIBC World Markets Inc., Canaccord Genuity Corp., GMP Securities LP, and Mackie Research Capital Corporation (the "Underwriting Syndicate"); (b) approval of three settlements; (c) ancillary orders, including the appointment of an administrator; (d) approval of the notice program; and (e) approval of the plan of distribution (the "Plan of Allocation") for the settlement funds.

3 Class Counsel also bring a motion for approval of its counsel fees and disbursements. Class Counsel seeks $2,250,000.00, plus disbursements, interest on disbursements, and applicable taxes. The total request is for $2,807,037.56.

4 For the reasons that follow, I certify the action as against the Underwriting Syndicate for settlement purposes. I approve the three settlements and Class Counsel's request for counsel fees. I approve the requests for ancillary orders. However, I do not approve the proposed Plan of Allocation, and, rather, I have varied the plan and approved a modified Plan of Allocation.

5 As I will explain, in this case, the court has the jurisdiction to approve the settlement agreements and then establish a plan of distribution that is different than the plan of distribution proposed by the parties.

B. FACTUAL BACKGROUND TO THE CLASS ACTION

6 See *Zaniewicz v. Zungui Haixi Corp.*, 2013 ONSC 2959, which sets out most of the factual background and the procedural history. See also: *Zaniewicz v. Zungui Haixi Corp.*, *Zaniewicz v. Zungui Haixi Corp.*, 2012 ONSC 4842, *Zaniewicz v. Zungui Haixi Corp.*, 2012 ONSC 4904, and *Zaniewicz v. Zungui Haixi Corp.*, 2012 ONSC 6061.

7 In December 2009, Zungui made an initial public offering ("IPO"), and it raised approximately $40 million in Ontario's capital markets.

8 Zungui and its directors and officers had a statutory obligation under the Ontario *Securities Act* to provide Zungui's investors with timely and accurate disclosure regarding the business of Zungui, including disclosure in Zungui's interim and annual financial statements.

9 In its interim and annual financial statements, Zungui and the Defendants Yanda, Fengyi, and Zungui Cai (the "Cai Brothers") assured investors that Zungui's financial statements presented fairly, in all material respects, the financial position of Zungui in accordance with GAAP. They represented that the Zungui's offering documents contained full true and plain disclosure of all material facts relating to the offering of securities.

10 The Plaintiffs are residents of Ontario. Each purchased common shares of Zungui in the

primary market. Mr. Clarke also purchased common shares of Zungui in the secondary market.

11 On August 22, 2011, Zungui issued a press release announcing that its auditor, Ernst & Young LLP ("E&Y"), had suspended its audit of Zungui's financial statements for the year ended June 30, 2011. With that announcement, Zungui's shares immediately lost 77% of their value. Subsequently, Zungui's shares became the subject of various temporary and permanent cease trade orders, and they are now worthless.

12 On September 22, 2011, Zungui's Chief Financial Officer and all independent members of the Board resigned, in part, because the special committee formed to investigate E&Y's concerns had been prevented from fulfilling its mandate.

13 On September 23, 2011, E&Y resigned as Zungui's auditor. E&Y withdrew its opinions that Zungui's financial statements were GAAP compliant.

14 On February 2, 2012, 2012 LNONOSC 162, the Ontario Securities Commission ("OSC") ruled that Yanda, Fengyi, and Zungui Cai had engaged in conduct contrary to the public interest, and on August 28, 2012, 2012 LNONOSC 619, the OSC ordered, among other things, that Yanda and Fengyi resign as directors or officers of Zungui and be permanently prohibited from acting as directors or officers of any issuer.

15 The OSC investigation revealed that when E&Y resigned, it advised that all of its audit opinions that formed part of the IPO Prospectus, as well as Zungui's June 2010 financial statements could no longer be relied upon.

16 On October 3, 2011, Mr. Zaniewicz, commenced the action by the issuance of a Notice of Action. On November 2, 2011, he filed his Statement of Claim. On February 7, 2012 and February 10, 2012, I made orders granting leave to amend the Statement of Claim to add Mr. Clarke as a plaintiff and to correct the description of two of the Underwriters incorrectly described in the style of cause.

17 On February 8, 2012, the Plaintiffs filed their Fresh as Amended Statement of Claim.

18 In the action, the Plaintiffs sue not only Zungui and the Cai Brothers, but others allegedly responsible for ensuring that Zungui's public disclosure to primary and secondary market investors was timely and accurate in accordance with securities law. The Plaintiffs allege various statutory claims under the Ontario *Securities Act* and also common law claims.

19 The Plaintiffs allege that Zungui's IPO Prospectus was misleading as it contained material misrepresentations. The Plaintiffs allege that the representations were materially false, and Zungui's financial statements contained in the prospectus, and other financial statements later prepared and disseminated in the secondary securities market, were neither accurate nor reliable in respect of reported revenues, net income, assets, and shareholders' equity. Moreover, the Plaintiffs allege that

the financial statements did not fairly present, in all material respects, the financial condition, results of operations and cash flows of Zungui for the reporting periods presented.

20 Alan Mak, who is a chartered accountant, a member of the Institute of Chartered Accountants of Ontario, and a member of the Association of Certified Fraud Examiners opined that the audits conducted by Ernst & Young were not in accordance with GAAP and that Ernst & Young's unqualified audit opinions should not have been given for the 2006 through 2010 reporting periods. E&Y does not admit that it was negligent.

21 In the class action, the Class Definition is as follows:

> All persons or entities wherever they may reside or be domiciled, other than Excluded Persons and Opt-Out Parties, who acquired Eligible Shares.
>
> Eligible Shares means the Shares acquired by a Class Member or Opt-Out Party during the Class Period.
>
> Class Period means the period from and including August 11, 2009 to and including August 22, 2011.
>
> Excluded Persons means each Defendant, the past or present subsidiaries or affiliates, officers, directors, partners, legal representatives, consultants, agents, successors and assigns of Zungui and any member of each Defendant's families, their heirs, successors or assigns, and includes any Southern Zungui Acquirers who acted as a consultant or provided other professional services to Zungui or its subsidiaries in connection with the IPO.

22 The Class is comprised of three (3) types of acquirers of Zungui common shares: (1) primary market purchasers; (2) secondary market purchasers; and (3) share exchange acquirors (i.e. anyone who was a shareholder of Zungui's subsidiary, Southern Trends International Holding Company (BVI), who entered into an agreement with Zungui, before its IPO, to exchange their Southern Trends shares for Zungui common shares on a basis of 1:5,000.

23 Paul Mulholland, a US based certified forensic accountant, was retained by the Plaintiffs, to among other things, calculate the damages of class members. Mr. Mulholland's estimate of damages was $23.76 million comprised of: (a) $10.1 million in damage to primary market purchasers; $12.9 million in damage to secondary market Purchasers; and $0.7 million in damage to share exchange acquirors. (The original Statement of Claim sought damages of $30 million.)

24 The Defendants, of course, do not admit liability or the amount of the Class Member's alleged

losses.

C. CERTIFICATION FOR SETTLEMENT PURPOSES

25 I have already certified this action for settlement purposes as against Zungui, Michelle Gobin, Michael W. Manley, Patrick A. Ryan, Elliott Wahle, and Margaret Cornish (the "Zungui Defendants") and against Ernst & Young LLP and the Cai Brothers.

26 I am satisfied that that action should now be certified for settlement purposes as against the Underwriting Syndicate, and an Order should issue accordingly.

D. SETTLEMENT APPROVAL

27 The Plaintiffs have concluded three settlements: (1) the Auditor Settlement; (2) the Zungui Settlement; and (3) Underwriter Settlement.

28 The Auditor Settlement is for $2 million. The Zungui Settlement is for $8 million, and the Underwriter Settlement is for $750,000.00.

29 The Zungui Defendants have agreed to contribute an additional $100,000.00 if the Plaintiffs: (a) settled their claims against the Underwriting Syndicate before the scheduled settlement approval hearings for the Auditor Settlement and the Zungui Settlement; and (b) obtained the Court's approval of a settlement with the Underwriting Syndicate. Thus, if all the settlements are approved, the settlement funds will total $10,850,000.00 plus interest before deductions for counsel fee and administrative expenses.

30 The settlement funds under the Auditor Settlement were received on May 17, 2013, and have been accruing interest since that date. The settlement funds under the Zungui Settlement were received on May 24, 2013, and have been accruing interest since February 22, 2013. The settlement funds under the Underwriter Settlement will be paid within fourteen days of execution of the Underwriter Agreement (i.e., by September 2, 2013).

31 The Settlement Amounts that have been received are currently invested at RBC in interest bearing accounts. Each settlement amount is held in a separate escrow account.

32 Class Counsel has been informed that, as of August 16, 2013, the escrow accounts contain: (1) Zungui Escrow Account, $7,984,781.20; and (2) Auditor Escrow Account, $1,995,373.52. These accounts reflect the payment of $48,931.32 for the publication of the First Notice (allocated, $39,145.07 from the Zungui Escrow Account and $9,786.25 from the Auditor Escrow Account) and the accrual of $23,926.27 in interest on the Zungui Settlement Amount and $5,159.68 in interest on the Auditor Settlement Amount.

33 Notice of the certification of the action as against the Zungui Defendants, Ernst & Young LLP, and the Cai Brothers has been given to the Class Members. There were no opt-outs. The

notice also provided notice of the Auditor Settlement and the Zungui Settlement.

34 Notice of the proposed Underwriter Settlement has recently been given to the Class Members pursuant to a recent court order made at a case conference. Having already had a right to opt-out, class members do not have a right to opt-out with respect to the certification of the action as against the Underwriting Syndicate. When there are partial or progressive certifications of a class action, provided that there was adequate notice, the right to opt-out is a procedural right that may only be exercised once: *Eidoo v. Infineon Technologies AG*, 2012 ONSC 7299 at paras. 29-32; *Nutech Brands Inc. v. Air Canada*, [2008] O.J. No. 1065 (SCJ).

35 Under the settlements, the Plaintiffs and the Class will provide releases to all of the Defendants. The Cai Brothers will be released as part of the Zungui Settlement. The settlements, if approved, would complete the class action.

36 The key terms of the settlement agreements are as follows:

* The settlement will be administered by an Administrator;
* the Defendants will pay their respective settlement amounts for the benefit of the Class;
* the settlement funds will be distributed, after payment of any administration expenses and Class Counsel fees, disbursements, and taxes as awarded by the Court;
* the settlement funds will be distributed in accordance with a Plan of Allocation that is in a form satisfactory to the Defendants or as fixed by the Court;
* if the settlement is approved by the court, the Notices of the Settlement will provide Class Members with information concerning their right to participate by filing a Claim Form;
* the settlement funds will be distributed among all Class Members who timely submit valid Claim Forms to the Administrator;
* there are no rights of reversion;
* the Plan of Allocation provides for the possibility of a *cy près* distribution to the Small Investor Protection Association Canada in the event that less than $25,000.00 remains 180 days from the date on which the Administrator distributes the net settlement amount; and
* the Plaintiffs and the Class Members will release the Defendants and certain identified associated entities.

37 Under the Plan of Notice, the Short Form Notice of Settlement will be published: (a) in the English language, in the business/legal section of the national weekend editions of the *National Post* and the *Globe and Mail*; (b) in the French language, in the business section of *La Presse*; and (c) in the French and English languages across *Marketwire*, a major business newswire in Canada.

38 Under the Plan of Notice, the Long Form Notice of Settlement will be: (a) posted in both the French and English languages on www.classaction.ca; (b) posted in both the French and English languages on the Administrator's website; and (c) mailed or emailed, along with the Claim Form and the Opt-Out Form, directly to persons that have contacted Class Counsel and have provided their contact information.

39 Also in accordance with the Plan of Notice, the Long Form Notice of Settlement and the Claim Form will be sent by the Administrator: (a) directly to persons identified as Class Members by way of a computer-generated list provided by Zungui's litigation receiver to Class Counsel and the Administrator; and (b) to the brokerage firms in the Administrator's proprietary databases, requesting that these firms either send a copy of these materials to all individuals and entities identified as Class Members, or to send the names and addresses of all such individuals and entities to the Administrator, who will mail these materials to the individuals and entities so identified.

40 The estimated cost of implementing the Plan of Notice, excluding the First Notice that has already been published and paid for, will be approximately $140,000.00 (before tax). Of that amount, approximately $85,000.00 is attributable to the cost of effecting direct notice.

41 David Weir, the President of NPT RicePoint Class Action Services, the proposed Administrator, deposes that the broker outreach portion of the notice plan is likely to bring the settlement to the attention of the Class Members in a manner consistent with other notice programs in securities class actions.

42 Class Counsel believes that the Approval Notices, disseminated in accordance with the Plan of Notice, will come to the attention of a substantial portion of the Class.

43 Class Counsel recommends that the court approve the settlements. Class Counsel is of the view that the settlement terms and conditions are fair and reasonable, and represent a significant recovery for Class Members in a securities class action.

44 Based on the expert opinion of Paul Mulholland, CFA, Class Counsel believes that the combined settlement amounts represent close to 50% of the damages allegedly suffered by the Class Members as calculated by Mr. Muhlholland. I would calculate the class's gross recovery as 46% of the damages allegedly suffered and the class's net recovery after the payment of administrative expenses and legal fees, as claimed, as approximately 33%.

45 The Plaintiffs have instructed Class Counsel to seek approval of the settlements.

46 No objections to the quantum of the Settlements have been received to date. However, Class Counsel has received: (a) one objection to the release provisions in the Zungui Agreement insofar as they apply to the Cai Brothers; and (b) one written objection to the proposed Plan of Allocation, discussed below, concerning the proposed ineligibility for any payment to Class Members for shares purchased in the secondary market after the alleged corrective press release on August 22,

2011.

47 Section 29(2) of the *Class Proceedings Act, 1992* provides that a settlement of a class proceeding is not binding unless approved by the court. To approve a settlement of a class proceeding, the court must find that, in all the circumstances, the settlement is fair, reasonable, and in the best interests of the class: *Fantl v. Transamerica Life Canada*, [2009] O.J. No. 3366 (S.C.J.) at para 57; *Farkas v. Sunnybrook and Women's Health Sciences Centre*, [2009] O.J. No. 3533 (S.C.J.), at para. 43; *Kidd v. Canada Life Assurance Company*, 2013 ONSC 1868.

48 In determining whether a settlement is reasonable and in the best interests of the class, the following factors may be considered: (a) the likelihood of recovery or likelihood of success; (b) the amount and nature of discovery, evidence or investigation; (c) the proposed settlement terms and conditions; (d) the recommendation and experience of counsel; (e) the future expense and likely duration of litigation; (f) the number of objectors and nature of objections; (g) the presence of good faith, arm's-length bargaining and the absence of collusion; (h) the information conveying to the court the dynamics of, and the positions taken by, the parties during the negotiations; and, (i) the nature of communications by counsel and the representative plaintiff with class members during the litigation. See: *Fantl v. Transamerica Life Canada, supra* at para 59; *Corless v. KPMG LLP*, [2008] O.J. No. 3092 (S.C.J.), at para. 38; *Farkas v. Sunnybrook and Women's Health Sciences Centre, supra,* at para. 45; *Kidd v. Canada Life Assurance Company*, 2013 ONSC 1868.

49 In my opinion -- independent of the matter of the Plan of Allocation (the plan of distribution) -- having regard to the various criteria set out above, the three settlement agreements taken together are fair, reasonable, and in the best interests of the Class Members.

50 Therefore, independent of the matter of the Plan of Allocation, which I will discuss next, I approve the three settlements.

E. DISTRIBUTION PLAN

1. The Court's Jurisdiction to Approve the Distribution Plan

51 In the case at bar, the court's authority to approve the plan of distribution, the Plan of Allocation, comes from the settlement agreements, where the plan of distribution is referred to as a Plan of Allocation.

52 The settlement agreements define the "Plan of Allocation" as follows:

> Plan of Allocation means the distribution plan distributing the proposed settlement in a form satisfactory to the Settling Defendants or as fixed by the Court.

53 As I interpret the settlement agreements, and as confirmed by the Plaintiffs during argument, I

can approve the settlements independent of approving the Plan of Allocation, which is what I have done. In other words, I have approved the settlements, which are now binding on the parties and on the Class Members, and I shall determine or fix the Plan of Allocation.

54 For reasons that I will set out below, I do not approve of the Plan of Allocation proposed by the parties, but I shall vary it, and I shall approve a different plan of distribution.

55 Had the settlement agreements in the case at bar not left it to the court to ultimately determine what is an appropriate plan of distribution, I would not have approved the settlements, because I do not think the proposed Plan of Allocation is fair and reasonable and in the best interests of the class. I also would not have approved Class Counsel's fees because the settlements would not have been approved.

2. The Test for Approving a Distribution Plan

56 In the situation where there is a judgment in a certified class action, the court's authority to determine or approve a plan of distribution comes from s. 26 of the *Class Proceedings Act, 1992*, which states:

> *Judgment distribution*
>
> 26.(1) The court may direct any means of distribution of amounts awarded under section 24 or 25 that it considers appropriate.
>
> *Idem*
>
> (2) In giving directions under subsection (1), the court may order that,
>
> (a) the defendant distribute directly to class members the amount of monetary relief to which each class member is entitled by any means authorized by the court, including abatement and credit;
> (b) the defendant pay into court or some other appropriate depository the total amount of the defendant's liability to the class until further order of the court; and
> (c) any person other than the defendant distribute directly to class members the amount of monetary relief to which each member is entitled by any means authorized by the court.

Idem

(3) In deciding whether to make an order under clause (2) (a), the court shall consider whether distribution by the defendant is the most practical way of distributing the award for any reason, including the fact that the amount of monetary relief to which each class member is entitled can be determined from the records of the defendant.

Idem

(4) The court may order that all or a part of an award under section 24 that has not been distributed within a time set by the court be applied in any manner that may reasonably be expected to benefit class members, even though the order does not provide for monetary relief to individual class members, if the court is satisfied that a reasonable number of class members who would not otherwise receive monetary relief would benefit from the order.

Idem

(5) The court may make an order under subsection (4) whether or not all class members can be identified or all of their shares can be exactly determined.

Idem

(6) The court may make an order under subsection (4) even if the order would benefit,

(a) persons who are not class members; or
(b) persons who may otherwise receive monetary relief as a result of the class proceeding.

Supervisory role of the court

(7) The court shall supervise the execution of judgments and the distribution of awards under section 24 or 25 and may stay the whole or any part of an execution or distribution for a reasonable period on such terms as it considers appropriate.

Payment of awards

(8) The court may order that an award made under section 24 or 25 be paid,

(a) in a lump sum, forthwith or within a time set by the court; or
(b) in instalments, on such terms as the court considers appropriate.

Costs of distribution

(9) The court may order that the costs of distribution of an award under section 24 or 25, including the costs of notice associated with the distribution and the fees payable to a person administering the distribution, be paid out of the proceeds of the judgment or may make such other order as it considers appropriate.

Return of unclaimed amounts

(10) Any part of an award for division among individual class members that remains unclaimed or otherwise undistributed after a time set by the court shall be returned to the party against whom the award was made, without further order of the court.

57 It may be noted that under s. 26(1) of the *Class Proceedings Act, 1992*, the court may direct any means of distribution of amounts awarded that it considers appropriate. I am not aware of any caselaw actually applying s. 26(1), although numerous cases have suggested that the court has ample discretion and ample scope for creativity in employing s. 26.

58 In the case at bar, as noted above, the court's authority to approve the plan of distribution comes from the settlement agreements, where the plan of distribution is referred to as a Plan of Allocation, and, as noted above, as I interpret the settlement agreements, I can determine or fix the Plan of Allocation as I think appropriate.

59 In determining what is appropriate, I intend to apply the same test or standard that the court applies when deciding whether to approve a settlement. Thus, a plan of distribution will be appropriate if in all the circumstances, the plan of distribution is fair, reasonable, and in the best interests of the class.

3. The Proposed Plan of Allocation

60 For reasons that I will set out below, I do not approve of the Plan of Allocation proposed by the parties, but I shall vary it and approve a different plan of distribution.

61 Class Counsel, with Mr. Mulholland's assistance, developed the Plan of Allocation. This plan was structured to reflect Mr. Mulholland's opinion that Zungui suffered two share price falls that were statistically significant, net of external market factors. These events occurred on: (1) June 2, 2011, when Muddy Waters LLC issued a report about Sino-Forest Corporation in which a fraud was alleged; and (2) August 22, 2011, when Zungui issued the press release announcing the suspension of 2011 audit procedures by Ernst & Young LLP.

62 The Plaintiffs' damages theory is that the value of Zungui's common shares was at all times artificially inflated by misrepresentation and that the artificial inflation, equivalent to $1.52 per share, was removed from the share value by the close of TSX-V trading on August 22, 2011. The Plaintiff's theory is that the artificial inflation was removed: in part, on June 2, 2011, in an amount of $0.26; and in balance, on August 22, 2011, in an amount of $1.26.

63 The amount of each Class Member's compensation will depend upon: whether the Class Member is a Primary Market Purchaser and/or a Secondary Market Purchaser and/or Share Exchange Acquiror; the number and price of Zungui common shares purchased by the Class Member during the Class Period; whether and when the Class Member sold Zungui common shares purchased during the Class Period, and the price at which these common shares were sold; whether the Class Member continues to hold some or all of the Zungui common shares purchased during the Class Period; and the total number and value of all claims for compensation filed with the Administrator.

64 The Plan of Allocation provides that no compensation shall be paid for any shares disposed of before June 2, 2011, which is consistent with Mr. Mulholland's opinion that June 2, 2011 was the first time that Zungui's common shares were subject to a statistically significant event, net of external market factors.

65 The Plan of Allocation provides that no compensation shall be paid for any shares purchased after the time of the making of the alleged corrective disclosure on August 22, 2011. The main rationale for the disqualification of these shares is that they purchased when it was publicly known that audit issues existed. I note, however, that it was not until another month later that E&Y disavowed that Zungui's financial statements were GAAP compliant.

66 In any event, although a purchaser of Zungai shares on Aug 22, 2011 is a Class Member, under the proposed Plan of Allocation, he or she is not entitled to receive compensation.

67 These background circumstances bring me to the written objection to the Plan of Allocation delivered by Dr. Christopher Lane, which I set out below:

> My name is Dr. Christopher Lane (psychologist) and I would like to register an objection to the terms of the proposed "Plan of Allocation," particularly under the heading "Secondary Market Purchasers," and under "VII" which states: "No Nominal Entitlement shall be recognized for any Eligible Shares purchased after the time of the making of the alleged corrective disclosure on August 22, 2011." This statement appears to eliminate the right of anyone who purchased shares of ZUN on August 22, 2011 to receive any compensation whatsoever and to thereby lose 100% of their investment. I happen to be one of those individuals who purchased shares on that fateful August 22, 2011 day, as did my brother, Brian Lane. Indeed, I bought a total of 117,000 shares of ZUN that day at a "book value" (according to my bank statements) of $47,735.83 (average cost per share of 40.8 cents). As one might expect, I am very upset by the wording of the proposed "Plan of Allocation" and would like to offer a suggestion of a fairer settlement, as the one proposed is, in my mind, overly punitive and leaves investors in my position with a feeling of defeat and lack of justice.
>
> ... While it is true that the announcement indicated that Ernst & Young suspended procedures until Zungui "clarifies and substantiates its position with respect to issues pertaining to the current and prior year" this does not clearly foreshadow the events that followed, which turned out to be devastating to the investors who held the stock and represented a "worst case scenario" with the stock never trading again after August 22, 2011. Clearly this was bad news and sent the stock tumbling from approximately 1.50 down to trading around 40 cents per share for most of the day on August 22, 2011 and ending the day around 34 cents per share. Of course, in hindsight it is easy to suggest that one shouldn't have bought stock in ZUN that day, but at that time there were also many who felt the negative reaction was entirely overblow and that clarification of the issues could logically prevail and substantiate the position of the company. In short, there was no way of knowing that the worst possible outcome would come to pass, with investors unable to trade their shares ever again.
>
> I submit that eliminating shareholders who bought ZUN stock on August 22, 2011 from any form of compensation is overly harsh and punitive. It was clear that an important issue existed at that time but issues emerge with Venture

Exchange listed stocks quite frequently but without these catastrophic consequences. And it is important to note that investors such as myself have suffered considerably due to this loss of capital. In my case, I lost all of my RRSP, almost all of my cash trading account holdings and a good part of my TFSA. With children entering university I am hard-pressed to pay my part of the costs as well as funding home and business expenses. Indeed, these losses have had a significant negative effect on my quality of life and that of my family and have led to me working long hours to pay for our needs, thereby creating significant hardship.

Hence, I ask that the court consider changing the section dealing with ZUN purchasers of August 22, 2011 to include them in providing some compensation in the class action lawsuit. Of course, I believe that to be fair, the compensation for purchasers on August 22, 2011 should be much less than for those who purchased earlier at prices of $1.52 per share or higher. I would suggest that a discount of 80% of the amount often quoted in the "Plan of Allocation" ($1.52) would be appropriate, which would amount to payment of 30.4 cents per share for individuals who bought shares of ZUN on August 22, 2011. I ask that the court consider this proposal to be fair to all shareholders of ZUN without singling out any in a harsh or punitive manner. We all lost money in this investment and have suffered as a result and it's unfair to single out a subsection of individuals for exclusion of all compensation.

68 The Plan of Allocation contemplates that for some Class Member's entitlements, a notional amount of damage based on the application of the calculations in the Plan of Allocation before distribution proration, will be discounted to reflect the risks facing the claimants. Class Counsel considered that the question of whether a discount to a Nominal Entitlement ought to apply for a particular type of acquisition should be determined by considering the particular strengths and weaknesses of the common law and statutory claims are common to all groups

69 With a view to ensuring that any discount was arrived at in a manner that was objective and fair, a formal mediation session was held on April 29, 2013. Joel Wiesenfeld was the mediator. Mr. Wiesenfeld practiced law as a broker/dealer litigation and securities regulatory counsel for 31 years.

70 At the mediation, the claimant groups were represented by Class Members holding Eligible Shares as follows: (a) the Plaintiffs, who bought substantially all of their shares in Zungui's IPO, represented Primary Market Purchasers; (b) Nick Angellotti CA, IFA and President and Managing Director of Williams & Partners Forensic Accountants Inc., the representative of a partnership that purchased Zungui's shares in the secondary market, represented Secondary Market Purchasers; and (c) Avi Grewal, President and Chief Executive Officer of Cinaport Capital Inc., a private investment firm which acts as advisor for the Cinaport China Opportunity Fund, a fund with investments in

private and public PRC based companies, represented Share Exchange Acquirors.

71 The representatives were represented by counsel; namely: Charles Wright and Nicholas Baker of Siskinds LLP for the Plaintiffs; Kirk Baert of Koskie Minsky LLP for Mr. Angellotti; and John J. Longo of Aird & Berlis LLP for Mr. Grewal.

72 I pause here to note that nobody represented the interests of secondary market purchasers who, like Dr. Lane, purchased shares on August 22, 2011.

73 The negotiations were all conducted at arm's length and the position of each claimant group was advanced by their counsel. The full-day mediation session concluded with the Primary Market Purchasers and Secondary Market Purchasers reaching agreement that the proposed Plan of Allocation should provide for the Nominal Entitlements of primary market purchasers to be un discounted and the Nominal Entitlements of secondary market purchasers should be discounted by 8%.

74 The representatives were unable to agree on a discount to be applied to the claims of Share Exchange Acquirors at the mediation, and so the Plaintiffs proposed (and posted on Class Counsel's website) a draft Plan of Allocation with a discount of 60% for Share Exchange Acquiror claims. Subsequently, Class Counsel agreed, to amend the Share Exchange Acquiror Discount to 40 %.

75 Class Counsel submits that an 8% discount for secondary market purchasers is fair and reflects that: (a) the secondary market purchasers were required to obtain leave under Part XXIII.1 of the Ontario *Securities Act* before asserting the right of action for misrepresentation in Zungui's secondary market disclosure documents, and such leave would be contested; (b) Part XXIII.1 provides defendants with a number of defences to liability for secondary market misrepresentation, and in this case, the secondary market purchasers could expect to face the "reasonable investigation" defence, an expert reliance defence, and a due diligence; and (c) the secondary market purchasers may not be able to recover the full estimated damages they have suffered, due to liability limits.

76 Class Counsel submits that no discount for primary market purchasers is fair because it reflects that: (a) these purchasers did not need to obtain leave of the Court to assert their claim; (b) damages are not limited for primary market purchasers in the same way as they are limited for secondary market purchasers; (c) if a prospectus is found to have contained a misrepresentation, then the issuer is strictly liable, (d) certain defendants, such as the issuer's directors and officers, are generally liable, unless they demonstrate on a balance of probabilities that they exercised reasonable diligence prior to issuance of the prospectus; and (e) liability is joint and several and damages can be recovered from any defendant with the means to pay.

77 Class Counsel initially considered that a 60% discount for Share Exchange Acquirors was fair. However, the Significant Shareholder Group through their counsel at Aird and Berlis LLP, and certain members of the Significant Shareholder Group indicated that they had higher expectations

than a settlement with the Underwriting Syndicate at $750,000.00, in part, based on the fact that the Underwriting Syndicate had earned fees of approximately $2.75 million for underwriting the IPO.

78 However, the Significant Shareholder Group were prepared to support the proposed settlement with the Underwriting Syndicate if two (2) conditions were met: (1) Class Counsel would limit their request for Class Counsel Fees to an agreed amount; and (2) the discount applicable to Share Exchange Acquirors under the proposed Plan of Allocation would be amended from 60% to 40%.

79 Class Counsel estimates that the impact on the combined settlement fund of the amendment to the discount applicable to Share Exchange Acquirors under the proposed Plan of Allocation will be at most $262,200.00 and more likely the impact will be less, because the maximum impact assumes no proration, which is unlikely to be the case.

80 Class Counsel communicated with each Class Member who participated in the mediation relating to the Plan of Allocation, and they have instructed that the proposed amended discount applicable to Share Exchange Acquirors is acceptable.

81 The Plan of Allocation provides for the possibility of a *cy près* distribution to the Small Investor Protection Association Canada in the event that less than $25,000.00 remains in the Allocation Pool 180 days from the date on which the Administrator distributes the Net Settlement Amount to Authorized Claimants.

82 Notwithstanding the objection to the Plan of Distribution, Class Counsel is of the view that the Plan of Allocation was carefully considered and promotes the interests of the class as a whole, and that it is fair and reasonable and ought to be approved.

83 At the argument of the fairness hearing, Class Counsel argued that should the court consider it appropriate to have purchasers like Dr. Lane participants in the Plan of Allocation, their claims should be discounted by 98.5%.

4. Discussion and Analysis of the Proposed Plan of Allocation

84 I do not regard the Proposed Plan of Allocation as appropriate, fair, reasonable, or in the best interests of the class.

85 In my opinion, Dr. Lane's objection to the Plan of Allocation and his suggestion as to how the plan should be revised has considerable merit.

86 Although perhaps unlikely to occur, it seems inappropriate and unfair to me that the proposed Plan of Allocation provides for a *cy près* distribution to a small investor association and does not provide any compensation for an investor like Dr. Lane, who is a member of the class. More to the point, in my opinion, it is inappropriate and unfair to include August 22, 2011 purchasers as Class Members and then exclude them from the Plan of Allocation.

87 Notwithstanding that it was the Defendants who urged that these purchasers be included as Class Members as part of the bargaining for the settlements, once Class Counsel and the Representative Plaintiffs agreed to the joinder of these Class Members, it was unfair and inappropriate for Class Counsel and the Representative Plaintiffs to advocate a theory of the case that August 22, 2011 purchasers were not eligible for any compensation at all.

88 If Dr. Lane, his brother, and other August 22, 2011 purchasers had appreciated that the parties had included them in the class as a bargaining chip but had excluded them from the theory of the claim and would exclude them from the Plan of Allocation, these putative class members sensibly should have opted-out of the class action rather than add the unrequited value of their releases to the consideration or *quid quo pro* that the Defendants will be receiving for the settlement payments. As it stands, Dr. Lane and those similarly situated are bound by the settlement but receive nothing themselves for being a Class Member.

89 In my opinion, the appropriate Plan of Allocation is the one proposed by Dr. Lane.

90 Accordingly, I shall revise the Plan of Allocation in accord with Dr. Lane's suggestion, which I regard as fair and reasonable, and I approve the Plan of Allocation as revised.

F. ADMINISTRATION OF THE SETTLEMENT

91 Class Counsel proposes the appointment of NPT RicePoint Class Action Services as the Administrator. NPT has already served as the Notice Advisor in the Action. NPT has also been administering bilingual class action settlements for over 9 years. In Class Counsel's opinion, NPT has the experience and resources that make them capable of administering the Settlements.

92 NPT's administration proposal provides for a minimum administration fee of $35,000, and a maximum administration fee cap of $195,000.00, before taxes.

93 I approve the appointment of NPT RicePoint Class Action Services as the Administrator.

G. FEE APPROVAL

94 Turning to the matter of Class Counsel's fee request of $2,807,037.56.

95 The Retainer Agreements with the Plaintiffs provide that Class Counsel may seek a fee of up to 30% of the recovery. Class Counsel are seeking a recovery of 20.75% (a 3.3 multiplier).

96 As at August 12, 2013, Class Counsel had docketed time of $648,386.00, excluding applicable taxes, disbursements of $226,670.44, exclusive of applicable taxes.

97 Class Counsel is not seeking to recover, and will not return to request payment of the time and disbursements required to complete the administration of the settlement, which is estimated to be at least $50,000.00.

98 Class Counsel has agreed to pay, from Class Counsel's fee award the accounts of Aird & Berlis LLP rendered to the Significant Shareholder Group in the amount of $105,796.50, taxes in the amount of $13,896.73 and disbursements in the amount of $1,101.36.

99 Class Counsel proposes to pay Wolf Popper LLP $105,689.00 (US$) in fees, and (US$) $1,466.73 in disbursements from the Class Counsel's fee award. Mr. Clarke, a representative plaintiff, initially contacted this U.S. law firm to investigate his potential claim. Ms. Patricia Avery, of Wolf Popper LLP, has been a member of the Class Counsel team prosecuting the Action, and Wolf Popper LLP undertook certain tasks that were within the competence of the firm, such as researching risk disclosure practices in North American securities offering documents for issuers with substantial operations in the People's Republic of China.

100 The disbursements included $40,465.42 in agent fees for investigations in the People's Republic of China, location of the Cai Brothers, translation of correspondence and pleadings, Hague Convention service on the Cai Brothers and the cost of paying for independent counsel to attend at the Plan of Allocation mediation.

101 The disbursements include $156,842.05 in expert fees and mediation fees for Mr. Mulholland, Mr. Mak, William H. Purcell, a U.S. investment banking expert, in relation to underwriting due diligence practices for companies with substantially all operations in the People's Republic of China, and Mr. Wisenfeld.

102 The fairness and reasonableness of the fee awarded in respect of class proceedings is to be determined in light of the risk undertaken by the lawyer in conducting the litigation and the degree of success or result achieved: *Parsons v. Canadian Red Cross Society*, [2000] O.J. No. 2374 (S.C.J.), at para. 13; *Smith v. National Money Mart*, [2010] O.J. No. 873 (S.C.J.), at paras. 19-20; *Fischer v. I.G. Investment Management Ltd.*, [2010] O.J. No. 5649 (S.C.J.), at para 25.

103 Factors relevant in assessing the reasonableness of the fees of class counsel include: (a) the factual and legal complexities of the matters dealt with; (b) the risk undertaken, including the risk that the matter might not be certified; (c) the degree of responsibility assumed by class counsel; (d) the monetary value of the matters in issue; (e) the importance of the matter to the class; (f) the degree of skill and competence demonstrated by class counsel; (g) the results achieved; (h) the ability of the class to pay; (i) the expectations of the class as to the amount of the fees; (j) the opportunity cost to class counsel in the expenditure of time in pursuit of the litigation and settlement: *Smith v. National Money Mart, supra*, at paras. 19-20; *Fischer v. I.G. Investment Management Ltd., supra,* at para 28.

104 Having regard to these various factors, I approve Class Counsel's request for approval of its legal fees.

H. CONCLUSION

105 Orders accordingly.

P.M. PERELL J.

United States District Court,
S.D. New York.
In re WORLDCOM, INC. SECURITIES LITIGATION

Nos. 02 Civ.3416, 02 Civ.3419, 02 Civ.3508, 02 Civ.3537, 02 Civ.3647, 02 Civ.2750, 02 Civ.3771, 02 Civ.4719, 02 Civ.4945, 02 Civ.4946, 02 Civ.4958, 02 Civ.4973, 02 Civ.4990, 02 Civ.5057, 02 Civ.5071, 02 Civ.5087, 02 Civ.5108, 02 Civ.5224, 02 Civ.5285, 02 Civ.8226, 02 Civ.8227, 02 Civ.8228, 02 Civ.8229, 02 Civ.8230, 02 Civ.8234, 02 Civ.9513, 02 Civ.9514, 02 Civ.9515, 02 Civ.9516, 02 Civ.9519, 02 Civ.9521, 03 Civ.2841, 03 Civ.3592, 03 Civ.6229.
Sept. 21, 2005.

Background: Lead plaintiffs in securities fraud class action moved for approval of settlement agreements.

Holdings: The District Court, Cote, J., held that:
(1) settlement agreement was fair, and
(2) lead counsel was entitled to recover reasonable attorney fees and costs.

Settlements approved.

West Headnotes

[1] Compromise and Settlement 89 ⚷57

89 Compromise and Settlement
89II Judicial Approval
89k56 Factors, Standards and Considerations; Discretion Generally
89k57 k. Fairness, adequacy, and reasonableness. Most Cited Cases

Compromise and Settlement 89 ⚷59

89 Compromise and Settlement
89II Judicial Approval
89k56 Factors, Standards and Considerations; Discretion Generally
89k59 k. Adequacy or representation; collusion. Most Cited Cases

In determining whether to approve class action settlement, district court must carefully scrutinize settlement to ensure its fairness, adequacy and reasonableness, and that it was not product of collusion. Fed.Rules Civ.Proc.Rule 23(e), 28 U.S.C.A.

[2] Compromise and Settlement 89 ⚷57

89 Compromise and Settlement
89II Judicial Approval
89k56 Factors, Standards and Considerations; Discretion Generally
89k57 k. Fairness, adequacy, and reasonableness. Most Cited Cases

Compromise and Settlement 89 ⚷59

89 Compromise and Settlement
89II Judicial Approval
89k56 Factors, Standards and Considerations; Discretion Generally
89k59 k. Adequacy or representation; collusion. Most Cited Cases

District court determines class action settlement's fairness by examining negotiating process leading up to settlement as well as settlement's substantive terms; court must ensure that settlement resulted from arm's-length negotiations and that plaintiffs' counsel engaged in discovery necessary to effective representation of class's interests. Fed.Rules Civ.Proc.Rule 23(e), 28 U.S.C.A.

[3] Compromise and Settlement 89 ⚷57

89 Compromise and Settlement
89II Judicial Approval
89k56 Factors, Standards and Considerations; Discretion Generally
89k57 k. Fairness, adequacy, and reasonableness. Most Cited Cases

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Factors district court must consider when evaluating substantive fairness of proposed class action settlement, are: (1) complexity, expense and likely duration of litigation, (2) reaction of class to settlement, (3) stage of proceedings and amount of discovery completed, (4) risks of establishing liability, (5) risks of establishing damages, (6) risks of maintaining class action through trial, (7) ability of defendants to withstand greater judgment, (8) range of reasonableness of settlement fund in light of best possible recovery, and (9) range of reasonableness of settlement fund to possible recovery in light of all attendant risks of litigation. Fed.Rules Civ.Proc.Rule 23(e), 28 U.S.C.A.

[4] Compromise and Settlement 89 ⚷2

89 Compromise and Settlement
89I In General
89kl Nature and Requisites
89k2 k. In general. Most Cited Cases

Public policy favors settlement, especially in case of class actions.

[5] Compromise and Settlement 89 ⚷65

89 Compromise and Settlement
89II Judicial Approval
89k56 Factors, Standards and Considerations; Discretion Generally
89k65 k. Securities law actions. Most Cited Cases

Proposed settlements of securities fraud class actions against officers, directors, and outside auditor were procedurally and substantively fair, and thus were entitled to approval; arms-length negotiations had followed thorough investigation of extraordinarily complex case, very few class members had objected, and settlement amount was reasonable. Fed.Rules Civ.Proc.Rule 23(e), 28 U.S.C.A.

[6] Compromise and Settlement 89 ⚷68

89 Compromise and Settlement
89II Judicial Approval
89k66 Proceedings
89k68 k. Notice and communications. Most Cited Cases

Federal Civil Procedure 170A ⚷179

170A Federal Civil Procedure
170AII Parties
170AII(D) Class Actions
170AII(D)2 Proceedings
170Ak177 Notice and Communications
170Ak179 k. Sufficiency. Most Cited Cases

Standard for measuring adequacy of settlement notice in class action is reasonableness; notice is adequate if it could be understood by average class member. Fed.Rules Civ.Proc.Rule 23(e), 28 U.S.C.A.

[7] Compromise and Settlement 89 ⚷67

89 Compromise and Settlement
89II Judicial Approval
89k66 Proceedings
89k67 k. Class, existence and determination; parties. Most Cited Cases

Potential member of securities fraud class action who did not file proof of claim lacked standing to object to proposed settlement agreement.

[8] Compromise and Settlement 89 ⚷68

89 Compromise and Settlement
89II Judicial Approval
89k66 Proceedings
89k68 k. Notice and communications. Most Cited Cases

Federal Civil Procedure 170A ⚷179

170A Federal Civil Procedure
170AII Parties
170AII(D) Class Actions
170AII(D)2 Proceedings

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170Ak177 Notice and Communications
170Ak179 k. Sufficiency. Most Cited Cases

Definition of class as those who were "injured" as result of relevant securities purchases, in notice of proposed settlement of securities fraud class action, was not unreasonably vague; definition gave potential class members who believed they had colorable legal claims arising from relevant purchases enough information to alert them that they needed to opt out of class if they wished to pursue their claims separately.

[9] Compromise and Settlement 89 ⚷56.1

89 Compromise and Settlement
89II Judicial Approval
89k56 Factors, Standards and Considerations; Discretion Generally
89k56.1 k. In general. Most Cited Cases

Releases provided for in class action settlement agreements may include claims not presented and even those which could not have been presented as long as released conduct arises out of same factual predicate as settled conduct.

[10] Compromise and Settlement 89 ⚷59

89 Compromise and Settlement
89II Judicial Approval
89k56 Factors, Standards and Considerations; Discretion Generally
89k59 k. Adequacy or representation; collusion. Most Cited Cases

Adequate representation of particular class action claim, for purpose of determining fairness of proposed settlement agreement, is determined by alignment of interests of class members, not proof of vigorous pursuit of that claim. Fed.Rules Civ.Proc.Rule 23(e), 28 U.S.C.A.

[11] Compromise and Settlement 89 ⚷65

89 Compromise and Settlement
89II Judicial Approval
89k56 Factors, Standards and Considerations; Discretion Generally
89k65 k. Securities law actions. Most Cited Cases

Release given to defendants in proposed settlement of securities fraud class action was not unfairly overinclusive, even though it barred claims arising from securities purchases made prior to class period; release was implicitly limited to claims having same factual predicate as complained-of fraud, and there was evidence that such fraud did not cause significant injury prior to class period. Fed.Rules Civ.Proc.Rule 23(e), 28 U.S.C.A.

[12] Compromise and Settlement 89 ⚷56.1

89 Compromise and Settlement
89II Judicial Approval
89k56 Factors, Standards and Considerations; Discretion Generally
89k56.1 k. In general. Most Cited Cases

Fact that release contained in proposed settlement agreement covers claims not actually pursued by plaintiff in class action does not render release unfairly overbroad. Fed.Rules Civ.Proc.Rule 23(e), 28 U.S.C.A.

[13] Compromise and Settlement 89 ⚷57

89 Compromise and Settlement
89II Judicial Approval
89k56 Factors, Standards and Considerations; Discretion Generally
89k57 k. Fairness, adequacy, and reasonableness. Most Cited Cases

Allocation formula for class action settlement agreement proceeds need only have reasonable, rational basis, particularly if recommended by experienced and competent class counsel. Fed.Rules Civ.Proc.Rule 23(e), 28 U.S.C.A.

[14] Compromise and Settlement 89 ⚷65

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89 Compromise and Settlement
89II Judicial Approval
89k56 Factors, Standards and Considerations; Discretion Generally
89k65 k. Securities law actions. Most Cited Cases

Allocation plan for proceeds of proposed settlement in securities fraud class action, which accorded smaller recovery for class member losses sustained prior to date complained-of fraud was publicly disclosed, was reasonable; it was unlikely that any predisclosure losses were attributable to fraud.

[15] Compromise and Settlement 89 ⚷65

89 Compromise and Settlement
89II Judicial Approval
89k56 Factors, Standards and Considerations; Discretion Generally
89k65 k. Securities law actions. Most Cited Cases

Proposed settlement of securities fraud class action reasonably valued bondholders' claims at consideration they actually received for bonds in corporation's bankruptcy proceeding. Fed.Rules Civ.Proc.Rule 23(e), 28 U.S.C.A.

[16] Compromise and Settlement 89 ⚷65

89 Compromise and Settlement
89II Judicial Approval
89k56 Factors, Standards and Considerations; Discretion Generally
89k65 k. Securities law actions. Most Cited Cases

Proposed settlement of securities fraud class action reasonably allocated proceeds as between class members' Securities Act and Exchange Act claims. Securities Act of 1933, § 1 et seq., 15 U.S.C.A. § 77a et seq.; Securities Exchange Act of 1934, § 1 et seq., as amended, 15 U.S.C.A. § 78a et seq.; Fed.Rules Civ.Proc.Rule 23(e), 28 U.S.C.A.

[17] Compromise and Settlement 89 ⚷65

89 Compromise and Settlement
89II Judicial Approval
89k56 Factors, Standards and Considerations; Discretion Generally
89k65 k. Securities law actions. Most Cited Cases

Proposed settlement of securities fraud class action reasonably declined, when allocating proceeds among class members, to distinguish amount of damages suffered based on identity of member's broker.

[18] Attorney and Client 45 ⚷155

45 Attorney and Client
45IV Compensation
45k155 k. Allowance and payment from funds in court. Most Cited Cases

When attorneys create "common fund" from which members of class are compensated for common injury, they are entitled to reasonable fee, set by court, to be taken from fund.

[19] Attorney and Client 45 ⚷155

45 Attorney and Client
45IV Compensation
45k155 k. Allowance and payment from funds in court. Most Cited Cases

Factors court should consider when calculating reasonable attorney fees to be paid from common fund in class action, whether using lodestar or percentage method, are: (1) time and labor expended by counsel; (2) magnitude and complexities of litigation; (3) risk of litigation; (4) quality of representation; (5) requested fee in relation to settlement; and (6) public policy considerations.

[20] Attorney and Client 45 ⚷155

45 Attorney and Client
45IV Compensation
45k155 k. Allowance and payment from funds in court. Most Cited Cases

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Percentage method is preferred when calculating attorney fees in common fund class actions, with lodestar method being used only as cross-check of reasonableness.

[21] Attorney and Client 45 ⚷155

45 Attorney and Client
45IV Compensation
45k155 k. Allowance and payment from funds in court. Most Cited Cases

Attorney fee award of $141.5 million was reasonable, following settlement of securities fraud class action; amount was 5.5% of settlement proceeds, was equivalent to a lodestar multiple of 4, came within limits of retainer agreement negotiated with sophisticated lead plaintiff, and was sought by counsel who had achieved superior results in complex case. Securities Exchange Act of 1934, § 21D(a)(6), as amended, 15 U.S.C.A. § 78u–4(a)(6).

[22] Attorney and Client 45 ⚷155

45 Attorney and Client
45IV Compensation
45k155 k. Allowance and payment from funds in court. Most Cited Cases

Lead counsel in securities fraud class action was entitled to reimbursement, from $3.558 billion settlement fund, of $10,736,948.25 in reasonable costs and expenses, plus interest.

***321** Max W. Berger, John P. Coffey, Steven B. Singer, Chad Johnson, Beata Gocyk–Farber, Jennifer L. Edlind, John C. Browne, David R. Hassel, Bernstein Litowitz Berger & Grossmann LLP, New York, New York, Leonard Barrack, Gerald J. Rodos, Jeffrey W. Golan, Mark R. Rosen, Jeffrey A. Barrack, Pearlette V. Toussant, Regina M. Calcaterra, Chad A. Carter, Barrack, Rodos & Bacine, Philadelphia, Pennsylvania, for the Lead Plaintiff.

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David M. Millman, Michael L. Cook, Schulte Roth & Zabel LLP, New York, New York, for the Cerberus Objectors.

Joseph H. Weiss, Weiss & Lurie, New York, New York, for Kenneth D. Laub.

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OPINION & ORDER

COTE, District Judge.
This Document Relates to: ALL ACTIONS

This Opinion considers the fairness of settle-

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ments reached this year in the securities class action litigation arising from the collapse of telecommunications giant WorldCom, Inc. ("WorldCom"). These settlements include the series of settlements between the Lead Plaintiff and the seventeen Underwriter Defendants; [FN1] and those between the Lead Plaintiff and the twelve Director Defendants, [FN2] WorldCom's former auditor Arthur Andersen LLP ("Andersen"), former WorldCom CEO Bernard J. Ebbers ("Ebbers"), former WorldCom CFO Scott D. Sullivan ("Sullivan"), and former WorldCom officers Buford Yates ("Yates") and David Myers ("Myers") (collectively, the "2005 Settlements"). The 2005 Settlements total $3.558 billion. Together with the settlement between the Lead Plaintiff and the Citigroup Defendants (the "Citigroup Settlement"), which received final approval on November 14, 2004, the Class will recover $6.133 billion, plus interest.

FN1. The seventeen Underwriter Defendants consist of ABN/AMRO Inc. ("ABN Amro"); Banc of America Securities LLC ("BOA"); Blaylock & Partners, L.P. ("Blaylock"); BNP Paribas Securities Corp. ("BNP"); Caboto Holding SIM S.p.A. ("Caboto"); Credit Suisse First Boston Corp. ("CSFB"); Deutsche Bank Securities, Inc. ("Deutsche Bank"), f/k/a Deutsche Bank Alex. Brown, Inc.; Fleet Securities Inc. ("Fleet"); Goldman, Sachs & Co. ("Goldman Sachs"); J.P. Morgan Securities, Ltd. and J.P. Morgan Securities, Inc. (now including Chase Securities Inc.) ("JP Morgan"); Lehman Brothers Inc. ("Lehman Brothers"); Mizuho International plc ("Mizuho"); Mitsubishi Securities International plc ("Mitsubishi"), f/k/a Tokyo–Mitsubishi International plc; UBS Warburg LLC ("UBS"); Utendahl Capital ("Utendahl"); and Westdeutsche Landesbank Girozentrale ("West LB").

FN2. The Director Defendants are James C. Allen, Judith Areen, Carl J. Aycock, Max E. Bobbitt, Clifford L. Alexander, Jr., Francesco Galesi ("Galesi"), Stiles A. Kellett, Jr. ("Kellett"), Gordon S. Macklin, John A. Porter ("Porter"), Bert C. Roberts ("Roberts"), the Estate of John W. Sidgemore, and Lawrence C. Tucker.

***323** Very few Class Members have filed objections to the 2005 Settlements. No one has objected to the amounts of the 2005 Settlements and there is only a single objection to the request for attorneys' fees and expenses submitted by Lead Counsel for the Class. [FN3] Only a brief, conclusory objection was made to the Plans of Allocation, which determine according to claim type how settlement funds will be distributed. Most of the objections address the scope of the claims release to be imposed pursuant to the 2005 Settlements and the proposed Supplemental Plan of Allocation distributed to the Class with a July 1, 2005 Notice.

FN3. One Class Member filed a timely objection to the requested attorneys' fees, but the objection was later withdrawn. Another individual filed a late objection to the attorneys' fees, but she has provided no evidence to rebut Lead Plaintiff's contention that she is not a Class Member. The substance of her objection will nevertheless be addressed.

With the three modifications to the Supplemental Plan described below, the petition for approval of all of the 2005 Settlements is granted. Lead Counsel's application for attorneys' fees and expenses is also granted.

Background

The relevant history of the *Securities Litigation* through November 12, 2004 is described in an Opinion pertaining to the Citigroup Settlement. *See In re WorldCom, Inc. Sec. Litig.,* No. 02 Civ. 3288(DLC), 2004 WL 2591402, at *1–*9 (S.D.N.Y. Nov.12, 2004). That description, and the definitions therein, are incorporated by reference into this Opinion.

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In brief, WorldCom announced a massive restatement of its financial statements for 2000 and 2001 on June 25, 2002 (the "Restatement"), spurring numerous class actions and other lawsuits.[FN4] Virtually all federal litigation was transferred to this Court by the Judicial Panel on Multi–District Litigation. The securities class actions were consolidated on August 15, 2002, and the New York State Common Retirement Fund ("NYSCRF") was selected as the Lead Plaintiff. The Lead Plaintiff filed a Consolidated Class Action Complaint on October 11, 2002. The securities class action, scores of actions filed by individual plaintiffs (the "Individual Actions"), many of them large pension funds, and other related securities actions were consolidated on December 23, 2002 for pretrial purposes and are referred to as the *Securities Litigation.*

> FN4. The litigation even preceded the June 25 announcement: the first securities class action was filed in this district on April 30, 2002.

An Opinion of May 19, 2003 decided various motions to dismiss addressed to the class action complaint. *In re WorldCom, Inc. Sec. Litig.,* 294 F.Supp.2d 431 (S.D.N.Y.2003); *see also In re WorldCom, Inc. Sec. Litig.,* No. 02 Civ. 3288(DLC) 2003 WL 21488087 (S.D.N.Y. June 25, 2003) (deciding Andersen's motions to dismiss); *In re WorldCom, Inc. Sec. Litig.,* No. 02 Civ. 3288(DLC), 2003 WL 23174761 (S.D.N.Y. Dec.3, 2003) (deciding motions to dismiss by members of the Audit Committee of WorldCom's board of directors). An Amended Complaint was filed on August 1, 2003; a Corrected Amended Complaint was filed on December 1, 2003.

An Opinion of October 24, 2003 certified a class consisting of all persons and entities who purchased or otherwise acquired publicly traded securities of WorldCom during the period beginning April 29, 1999 through and including June 25, 2002, and who were injured thereby. *See In re WorldCom, Inc., Sec. Litig.,* 219 F.R.D. 267, 274–75 (S.D.N.Y.2003). Putative Class Members received a December 11, ***324** 2003 Notice of Class Action (the "December 2003 Notice"). That notice informed Class Members that they could opt out of the class action by February 20, 2004, a date which was later extended to September 1, 2004.[FN5] *See WorldCom,* 2004 WL 2591402, at *5.

> FN5. Prior to February 20, approximately 6,400 investors opted out of the Class; in total, approximately 14,220 investors opted out. Counsel in the class action attribute the number of opt-outs to the aggressive solicitation of Class Members by attorneys, but Lead Counsel nonetheless characterizes the number of opt-outs as "small" given the large number of WorldCom investors.

The $2.575 billion Citigroup Settlement was announced in May 2005. *Id.* Class Members received an August 2, 2004 Notice of the proposed Citigroup Settlement (the "Citigroup Settlement Notice"), which also informed them that the opt-out date had been extended to September 1 and gave them instructions on how to submit proofs of claim. A fairness hearing regarding the Citigroup Settlement was held on November 5, 2004, and that settlement was approved in a November 12, 2004 Opinion. *WorldCom,* 2004 WL 2591402, at *9, *11. The following is an overview of the significant events in the class action litigation since the announcement of the Citigroup Settlement.

Completion of Discovery

The Citigroup Defendants settled with the Lead Plaintiff just weeks before the conclusion of fact discovery. A three-week stay was entered to allow the Lead Plaintiff and the Underwriter Defendants an opportunity to determine whether they could also resolve the litigation. The Underwriter Defendants rejected an offer to settle with the Class using the same formula that resolved Securities Act of 1933 ("Securities Act") claims in the Citigroup Settlement (the "Citigroup Formula"). Fact discovery resumed and was concluded on July 9, 2004. During June and July, the Lead Plaintiff took forty-one

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depositions.

During the late summer and fall, the parties exchanged expert reports and conducted expert discovery. The Lead Plaintiff produced reports from five experts.

Summary Judgment Opinion Regarding the Underwriter Defendants

The Underwriter Defendants faced Securities Act Section 11 and Section 12(a)(2) liability stemming from massive bond offerings in 2000 (the "2000 Offering") and 2001 (the "2001 Offering"). They filed motions for partial summary judgment on several grounds, including their reliance defense under Section 11. They argued that they were entitled to rely on WorldCom's audited financial statements and had no duty to investigate their reliability unless they had reasonable grounds to believe that the statements were not accurate. A December 15, 2004 Opinion denied summary judgment on the reliance defense, noting that, while underwriters generally may rely on audited financial statements, a jury could find that one or more "red flags" triggered a duty for the Underwriter Defendants to conduct further investigation of WorldCom's financial status. *See In re WorldCom Sec. Litig.,* 346 F.Supp.2d 628, 678–81 (S.D.N.Y.2004). The Opinion also ruled that the Underwriter Defendants were not entitled to summary judgment because of their receipt of Andersen's comfort letters for the unaudited quarterly financial statements incorporated into the Registration Statements for the 2000 and 2001 Offerings. Rather, although the comfort letters were one factor a jury could consider, the Underwriter Defendants still had to establish that they had performed a reasonable investigation regarding any unaudited financials in order***325** to establish their due diligence defense under Section 11. *See id.* at 681–85.

The Lead Plaintiff filed its own motion for partial summary judgment against the Underwriter Defendants. It succeeded on the issue of whether the Registration Statement for the 2001 Offering was false and misleading, but was denied summary judgment in regard to the 2000 Offering. *Id.* at 661.

Initial Settlement with the Director Defendants

Following settlement discussions spanning more than twenty months, the Lead Plaintiff and ten of the twelve Director Defendants executed a Memorandum of Agreement in May 2004. In the following months, the Lead Plaintiff reviewed detailed financial information provided by those ten directors, and the negotiations between the directors and several insurers that had issued excess directors and officers insurance policies to WorldCom (the "Excess Insurers") continued.[FN6] On January 6, 2005, a settlement was reached between the Lead Plaintiff, the ten Director Defendants, and the Excess Insurers. The settlement was for a total of $54 million; notably, the settlement amount included $18 million paid personally by the settling Director Defendants, representing more than twenty percent of those individuals' cumulative net worth, excluding their primary residences, retirement accounts, and certain joint marital property.[FN7] The balance of the settlement amount, $36 million, represented the Excess Insurers' contribution.

FN6. The Excess Insurers had taken the position that the policies they had issued were null and void.

FN7. The Court makes no judgment as to the wisdom of making personal monetary contributions by outside directors a condition of settlement. Commentators have noted that this tactic may "trouble some executives so much that they may think twice about serving on boards," Joann S. Lublin et al., *Directors Are Getting the Jitters: Recent Settlements Tapping Executives' Personal Assets Put Boardrooms on Edge,* Wall St. J., Jan. 13, 2005, at B1, a development that would not bode well for shareholders in the long run.

Portions of the January 6 settlement agreement that were conditioned on the Court's staying the lawsuit brought by Roberts, a non-settling Director

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Defendant, against the Excess Insurers and deferring a decision on Roberts' application for an order to advance defense costs were rejected by the Court in a conference on January 11.[FN8] The parties to the settlement submitted a revised Stipulation of Settlement that omitted those provisions on January 18 (the "January 18 Stipulation").

FN8. An Opinion mandating that the Excess Insurers advance Roberts' defense costs was issued on February 3, 2005. *In re WorldCom, Inc. Sec. Litig.,* 354 F.Supp.2d 455 (S.D.N.Y.2005).

The January 18 Stipulation retained a provision known as a judgment reduction formula (the "Judgment Reduction Formula") that provided, in essence, that any damages awarded against non-settling defendants would be reduced by the greater of the settlement amount or the proportionate liability of the settling Director Defendants, as found at trial, adjusted to reflect any limitation on the financial capability of the settling Director Defendants to pay. The settlement was conditioned on approval of the Judgment Reduction Formula, which paralleled a formula that had received the Court's approval in the WorldCom *ERISA Litigation. See In re WorldCom, Inc. ERISA Litig.,* 339 F.Supp.2d 561, 571 (S.D.N.Y.2004). Several non-settling defendants objected to the portion of the Judgment Reduction Formula that took into account settling Director ***326** Defendants' ability to pay, arguing that it violated 15 U.S.C. § 78u–4(f)(7)(B)(I), the applicable provision of the Private Securities Litigation Reform Act of 1995 ("PSLRA").

In an Order of February 2, the Court ruled that the Judgment Reduction Formula in the January 18 Stipulation was impermissible under the PSLRA. An Opinion of February 10 explained this ruling in detail; a Corrected Opinion was issued soon thereafter. *In re WorldCom, Inc. Sec. Litig.,* No. 02 Civ. 3288(DLC), 2005 WL 335201 (S.D.N.Y. Feb.14, 2005). That Opinion lamented the fact that the applicable PSLRA provision rendered it highly unlikely that plaintiffs bringing Securities Act claims would be willing to settle with outside directors before reaching settlements with "deep pockets" such as underwriters. *See id.* at *14–*15. This policy concern was well-founded. Soon after the Judgment Reduction Formula ruling was announced, the Lead Plaintiff exercised its right to withdraw from the settlement. The Director Defendants were given until February 25 to file a pretrial order for the rapidly approaching trial, which was then scheduled to begin on February 28, 2005.

Summary Judgment Opinion Regarding Andersen

Andersen, which was facing claims under Securities Act Section 11 and Securities Exchange Act of 1934 ("Exchange Act") Section 10(b), filed a motion for partial summary judgment on August 23, 2004. It argued that Lead Plaintiff had failed to present sufficient evidence that the 1999 WorldCom financial statements audited by Andersen contained a material misstatement. In addition, Andersen contended that there was no evidence of scienter sufficient to support a finding under Section 10(b) that Andersen certified the 1999, 2000, and 2001 WorldCom financial statements recklessly or with knowledge that material misstatements or omissions were present.

A January 18, 2005 Opinion denied summary judgment for Andersen. It ruled that whether various accounting treatments, including WorldCom's use of purchase method accounting for its 1998 acquisition of MCI, Inc. ("MCI") and its assignment of a forty-year lifespan to the MCI goodwill, complied with Generally Accepted Accounting Principles (GAAP) and thus did not constitute misstatements, were issues of fact for a jury to decide, precluding summary judgment on the 1999 financials. *See In re WorldCom, Inc. Sec. Litig.,* 352 F.Supp.2d 472, 493–94 (S.D.N.Y.2005). That Opinion also ruled that issues of fact existed regarding whether Andersen's audits of WorldCom financials were so deeply flawed that Andersen acted with reckless disregard and whether certain "red flags" should have prompted Andersen to reevaluate its audit plans. *See id.* at 497–98.

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Motions in Limine

On January 7, 2005, motions *in limine* and the Joint Pretrial Order were filed by the Lead Plaintiff and various non-settling defendants. The Lead Plaintiff filed six motions *in limine;* the Underwriter Defendants filed eleven, as well as a motion to phase the trial; Andersen filed eight; Director Defendant Galesi filed thirty. On February 8, an Order was issued denying the Underwriter Defendants' motion to phase the trial and providing preliminary rulings on most of the Lead Plaintiff's and Underwriter Defendants' motions. Full Opinions regarding most of the pending motions *in limine* were issued on February 17. *See In re WorldCom, Inc. Sec. Litig.,* No. 02 Civ. 3288(DLC) 2005 WL 375315 (S.D.N.Y. Feb.17, 2005) (Lead Plaintiff's motions *in limine* and Underwriter Defendants' motion to phase the ***327** trial); *In re WorldCom, Inc. Sec. Litig.,* No. 02 Civ. 3288(DLC) 2005 WL 375314 (S.D.N.Y. Feb.17, 2005) (Underwriter Defendants); *In re WorldCom, Inc. Sec. Litig.,* No. 02 Civ. 3288(DLC) 2005 WL 375313 (S.D.N.Y. Feb.17, 2005) (Andersen). Several pending motions were further addressed at pretrial conferences and in later Opinions. Motions *in limine* by Galesi were addressed on March 4, *In re WorldCom, Inc. Sec. Litig.,* No. 02 Civ. 3288(DLC) 2005 WL 517333 (S.D.N.Y. Mar.4, 2005), and those brought by other Director Defendants were decided in a Memorandum Opinion of March 16, 2005.

Significant motions *in limine* included that of the Lead Plaintiff to exclude evidence from the plenary trial relating to individualized issues of the class representatives. The Lead Plaintiff's motion was granted in an Opinion of February 22. *See In re WorldCom, Inc. Sec. Litig.,* No. 02 Civ. 3288(DLC), 2005 WL 408137 (S.D.N.Y. Feb.22, 2005). Motions brought by both the Underwriter Defendants and Andersen to preclude Lead Plaintiff's expert from presenting an aggregate damages calculation to the jury were denied. *See WorldCom,* 2005 WL 375314, at *7–*8; *WorldCom,* 2005 WL 375313, at *2–*5; *In re WorldCom, Inc. Sec. Litig.,* No. 02 Civ. 3288(DLC), 2005 WL 491397 (S.D.N.Y. Mar.3, 2005). Andersen filed a motion to exclude evidence of the Restatement, arguing, *inter alia,* that the Restatement was irrelevant and based on hearsay. Andersen's motion was denied on the basis that the Restatement was clearly relevant to, and in fact highly probative of, the issues being tried. The Restatement was ruled an admissible business record under Rule 803(6), Fed.R.Evid. *See WorldCom,* 2005 WL 375313, at *6–*9.

Andersen also moved to preclude evidence of corporate wrongdoing, including evidence of its indictment in connection with its role as Enron's auditor and evidence of other litigation in which Andersen had been involved. An Opinion of March 4 ruled that references to most other litigation against Andersen would be barred, but that decision would be deferred on references to Enron, as the Lead Plaintiff had pointed to evidence that the Enron scandal directly affected certain decisions made by WorldCom's management in regard to Andersen. *See In re WorldCom, Inc. Sec. Litig.,* No. 02 Civ. 3288(DLC), 2005 WL 578109, at *1–*2 (S.D.N.Y. Mar.4, 2005). That Opinion also deferred a ruling on the Underwriter Defendants' motion to bar evidence of the spinning of "hot" IPO shares by Salomon Smith Barney ("SSB"), a co-lead underwriter in the 2000 and 2001 Offerings and one of the Citigroup Defendants. *See id.* at *2–*4.

Extension of Trial Date

In October 2004, in light of a two-month delay in the date of Ebbers' criminal trial, the class action trial date was moved from January 10, 2005 to February 28, 2005. In a pretrial conference of February 18, 2005, the trial was rescheduled for March 17, 2005. The delay was attributable to the Government's reluctance to allow several "embargoed" witnesses who were testifying in Ebbers' criminal trial to submit to depositions by counsel for parties to the class action until the evidentiary portion of the criminal trial had concluded. *See WorldCom,* 2004 WL 2591402, at *4.

Underwriters' Settlements

In early February 2005, the Lead Plaintiff com-

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menced settlement negotiations with BOA and several junior underwriters who had participated in the 2000 Offering only, and after those proved successful, opened negotiations with the remaining Underwriter Defendants. The seventeen Underwriter Defendants had coordinated their litigation strategy; as trial approached, however, they procured separate ***328** settlement counsel and broke rank.[FN9] In the period from March 3 through March 16, 2005, settlements totaling $3,427,306,840 were achieved between the Lead Plaintiff and each of the Underwriter Defendants (the "Underwriters' Settlements").

> FN9. SSB, which was also a lead underwriter for both Offerings, was separately represented and had settled with the Lead Plaintiff as part of the Citigroup Settlement.

On March 3, the Lead Plaintiff informed the Court that it had reached a settlement with BOA and Fleet, two Underwriter Defendants that had combined after their participation in the 2000 and 2001 Offerings, for a total of $460.5 million (the "BOA Settlement"). Of this amount, 13.61% has been allocated to Class Members who purchased bonds in the 2000 Offering ("2000 Purchasers"), and 86.39% to those who purchased bonds in the 2001 Offering ("2001 Purchasers"). The Plan of Allocation for the BOA Settlement and each of the subsequent settlements is based on the number of bonds the Underwriter Defendant was allocated in each Offering, as well as the Securities Act Section 11 damages provision, 15 U.S.C. § 77k(e). The BOA Settlement amount was calculated using the Citigroup Formula. As already noted, all Underwriter Defendants had been offered the opportunity to settle at the Citigroup Formula rate in May 2004, at the time the Citigroup Settlement was announced.

On March 4, four more settlements were announced (the "March 4 Settlements"): Lehman Bros. settled for $62,713,582, and CSFB, Goldman Sachs, and UBS Warburg each agreed to pay $12,542,716. Those defendants participated only in the 2000 Offering, so all recovery from the March 4 Settlements will go to 2000 Purchasers. The March 4 Settlements likewise followed the Citigroup Formula. With two minor exceptions, all of the settlements with the Underwriter Defendants that followed included a premium over the Citigroup Formula. The Lead Plaintiff reached settlements with four more Underwriter Defendants on March 9 (the "March 9 Settlements"): ABN AMRO agreed to pay $278,365,600; Mitsubishi agreed to pay $75 million; and BNP and Mizuho settled for $37.5 million each. On March 10, Deutsche Bank settled for $325 million; Caboto settled for $37.5 million; and WestLB agreed to pay $75 million (the "March 10 Settlements"). With the exception of Deutsche Bank, all defendants involved in the March 9 and March 10 Settlements participated only in the May 2001 Offering; recovery from those settlements will thus go only to 2001 Purchasers. Of the Deutsche Bank settlement monies, 4.15% is to be distributed to 2000 Purchasers, and 95.85% to 2001 Purchasers.

A conference was held on March 9 to address preliminary approval of the BOA Settlement and the March 4 Settlements. Preliminary approval was delayed, however, until the Court could address objections by JP Morgan to the Judgment Reduction Formula and Bar Order in the BOA Settlement. JP Morgan was a co-lead underwriter with SSB in both the 2000 and 2001 Offerings. A March 15 Opinion rejected JP Morgan's objections. *In re WorldCom, Inc. Sec. Litig.*, No. 02 Civ. 3288(DLC), 2005 WL 613107 (S.D.N.Y. Mar.15, 2005). That Opinion performed a theoretical but detailed calculation of the damages faced by JP Morgan should it proceed to trial. *See id.* at *7. All settlements that had been announced through March 10 received preliminary approval in a March 16 conference.

On March 16, JP Morgan settled for $2 billion. This was $630 million more than ***329** the Lead Plaintiff had been willing to accept in settlement in May 2004, at the time of the Citigroup Settlement,

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and thus represents a significant premium over the Citigroup Formula. Of the $2 billion sum, 22.75% will go to 2000 Purchasers, and 77.25% to 2001 Purchasers. The same day, Blaylock and Utendahl agreed to pay $572,840 and $234,000, respectively.[FN10] The amount recovered from Utendahl will go entirely to 2001 Purchasers, while 43.02% of the Blaylock monies will be distributed to 2000 Purchasers and 56.98% to 2001 Purchasers. The final three settlements received preliminary approval in a March 18 conference.

FN10. The Blaylock and Utendahl Settlements were below the Citigroup Formula.

Because the Underwriter Defendants faced only Securities Act claims stemming from the 2000 and 2001 Offerings, the amounts recovered in the Underwriters' Settlements are allocated solely to those claims.[FN11] Thus, the recovery will go to Class Members who purchased bonds in the 2000 and 2001 Offerings, not to purchasers of WorldCom stock or bonds issued prior to those Offerings. The Underwriters' Settlements, and almost all settlements in the class action litigation, were achieved with significant involvement by the Honorable Robert W. Sweet, U.S. District Judge for the Southern District of New York, and the Honorable Michael H. Dolinger, U.S. Magistrate Judge of the Southern District of New York.

FN11. Some of the Underwriter Defendants participated in only one of the two bond offerings at issue in the case, and, as already noted, proceeds from those settlements are allocated accordingly.

Severance of the Claims Against Ebbers, Sullivan, Myers, and Yates

An Order of March 16, 2005 severed the claims against defendants Ebbers, Sullivan, Myers, and Yates pursuant to Rule 21, Fed.R.Civ.P.[FN12] Severance was granted in light of the criminal prosecution of those four defendants; the class action litigation against them had previously been stayed for the same reason. In addition, the Order deemed that any testimony given by the four severed defendants at Ebbers' criminal trial would be admissible in the class action trial. No party to the class action litigation had objected to this accommodation.

FN12. The same Order severed the claims against Porter, one of the Director Defendants, because he had filed for bankruptcy.

Director Defendants' Settlement

After the Underwriter Defendants had settled with the Lead Plaintiff, the Director Defendants and Excess Insurers were able to resurrect their settlement agreement (the "Directors' Settlement"). On March 16, the Court was informed that a settlement with the Director Defendants was imminent; a Stipulation of Settlement was executed on March 18, 2005. Former directors Galesi and Roberts, neither of whom had been a party to the original Director Defendants' settlement, joined the settlement—Galesi in the first instance, and Roberts on March 21. Roberts' personal contribution was $4.5 million, which Lead Counsel represents to be significantly more than twenty percent of Roberts' personal net worth, thus representing a premium over what was obtained from the other directors.

The total amount of the Directors' Settlement is $60.75 million. Of that amount, $24.75 million was paid by the Director Defendants personally, and $36 million was contributed by the Excess Insurers. With a prior payment of $15 million, this contribution is approximately one-half of the available insurance proceeds. Unlike the January 18 Stipulation to which ten of the ***330** twelve Director Defendants were parties, the March 21 Stipulation contains a Judgment Reduction Formula that conforms to the PSLRA. The Directors' Settlement was granted preliminary approval on March 21, 2005.

The Plan of Allocation for the Directors' Settlement provides that 80% of the funds are to be allocated to purchasers of WorldCom stock and other publicly traded debt securities. The remaining 20% will be distributed to purchasers of bonds in the 2000 and 2001 Offerings. Of this amount, 4.774%

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will go to purchasers in the 2000 Offering, and 15.226% to purchasers in the 2001 Offering. The Directors' Settlement also reserved other funds from the Excess Insurers for the Director Defendants' defense of the claims pending against them in the various Individual Actions.

Summary Judgment Opinion Regarding Roberts

Roberts, chairman of the WorldCom board of directors throughout the Class Period and one of the Director Defendants, had also filed a summary judgment motion. Roberts argued that he had established his due diligence defense under Securities Act Section 11; that he was not a "controlling person" under Exchange Act Section 20(a); and that he had established his affirmative defenses under Section 20(a) and Securities Act Section 15. In an Opinion of March 21, 2005, which was issued hours before Roberts agreed to join the Directors' Settlement, Roberts' summary judgment motion was denied on all counts. *See In re WorldCom, Inc. Sec. Litig.*, No. 02 Civ. 3288(DLC), 2005 WL 638268 (S.D.N.Y. Mar.21, 2005).

Andersen Trial and Settlement

Jury selection in the class action trial against Andersen, the only remaining defendant against which the litigation had not been severed, began on March 23, 2005.[FN13] Individualized voir dire was conducted on March 28, and opening statements began the following morning. The Lead Plaintiff presented eleven fact witnesses, three of whom testified live at trial, and four expert witnesses. Andersen presented a number of fact witnesses, including two Andersen audit and engagement partners, and one expert witness. Only two more experts were set to testify on Andersen's behalf when the jury was dismissed because the Lead Plaintiff and Andersen had reached a settlement.[FN14] The jury was remarkably attentive throughout the proceedings.

FN13. In a conference on March 16, 2005, the trial date was further delayed for approximately a week pending preliminary approval of the Directors' Settlement and several of the Underwriters' Settlements. On March 23, members of the venire completed a brief questionnaire addressed to questions such as any burden imposed by the anticipated length of the trial and ownership of WorldCom or MCI securities.

FN14. Time limits of fifty hours apiece had been imposed on the Class and Andersen for opening statements and presentation of evidence (whether through direct or cross-examination). When the trial ended, the Class was set to use every minute of that time; Andersen was expected to complete its presentation of evidence with hours of its allotted time to spare.

The testimony from three of the Lead Plaintiff's witnesses was particularly memorable. Richard Roscitt, the former president of AT & T Business Services from December 1999 to January 2001, described his amazement at WorldCom's E/R ratio as reported in its quarterly and annual financial statements, and the concerted efforts he and his team made over a period of months to try to understand why WorldCom's reported performance of such a critical indicator was so superior to AT & T's ***331** comparable ratio.[FN15] The Lead Plaintiff offered this testimony, a videotaped deposition which had been noticed by underwriter defendants in an Individual Action, to establish that a "red flag" existed which put Andersen on notice that WorldCom might not be accurately recording its line costs, which were its largest operating expense. If the E/R ratio constituted a red flag, it required Andersen to conduct a reasonable audit of the WorldCom records associated with the reporting of its E/R ratio. The Lead Plaintiff also offered the evidence to show that Andersen had acted in willful blindness to WorldCom's financial condition and in abrogation of its duty as an auditor, rendering it liable under Exchange Act Section 10(b).

FN15. A discussion of WorldCom's reported E/R ratio and why it raised an issue of fact as to whether it constituted a "red flag" that imposed on the Underwriter De-

fendants a duty to investigate the reliability of these figures in WorldCom's audited financial statements is contained in the Opinion addressing the Underwriter Defendants' summary judgment motion. *See WorldCom,* 346 F.Supp.2d at 678–80.

Eugene Morse ("Morse"), who worked in WorldCom's Internal Audit department, was the single most important individual in the discovery of the scheme at WorldCom to capitalize line costs in order to improve WorldCom's reported revenue and E/R ratio. WorldCom's Internal Audit department did not perform financial audits until early 2002. In May 2002, Morse noticed a discrepancy of well over $1 billion between the numbers reflected in the capital expenditures report he was reviewing and WorldCom's publicly reported numbers. The executive director of the capital budget attributed the discrepancy to "prepaid capacity." Morse searched for the source of the so-called prepaid capacity using a computer software called Essbase that allows one to navigate the company's general ledger, and quickly found a series of entries of large round-number entries such as $500 million. After further investigation, often performed alone at night in WorldCom's offices, he found that the amounts were transfers originating from line costs. Line costs were the company's largest operating expense and therefore not an item that should be capitalized. The suspicious entries were made after the closing of the quarters they affected and directly preceded the dates on which WorldCom issued press releases announcing its financial results. Morse found $1.7 billion of fraud in the first few days of his investigation, and a total of $3 billion, dating as far back as the first quarter of 2001, within a couple of weeks. Cynthia Cooper, the head of the Internal Audit department, encouraged Morse throughout his investigation and reported the findings to the audit committee of WorldCom's board of directors on June 20, 2002. The fraud at WorldCom was disclosed to the public several days later.

Finally, Ralph Stark testified as one of the Lead Plaintiff's experts. In December 2004, the Lead Plaintiff obtained access to WorldCom's computerized general ledger for the year 2001.[FN16] In just half an hour, using a protocol to examine using Essbase the largest categories in WorldCom's balance sheet and income statement for any large, post-closing adjustments, Stark and his team found the first "unusual" journal entry, or financial input, in WorldCom's general ledger. Within hours, he found many large, round-number, post-closing ***332** entries. Stark testified that a junior financial analyst, accountant, or auditor with basic training in Essbase could have readily discovered the same entries in an audit of the general ledger. The Lead Plaintiff offered this evidence to illustrate how easily Andersen could have discovered the WorldCom fraud if it had audited WorldCom's general ledger for post-closing adjustments. The Lead Plaintiff's examination at trial of Andersen's auditors showed that Andersen's audit planning had identified post-closing adjustments to the general ledger as one of the ways in which WorldCom could commit fraud, but that Andersen did not access the computerized general ledger to perform such an audit during the years in question.

FN16. MCI, the successor to WorldCom, granted experts from Lead Plaintiff and Andersen access to the WorldCom general ledger for the year 2001. Andersen had initiated the request for this access but did not seek to offer at trial any testimony about its expert's examination of the general ledger.

At the end of two weeks of trial testimony, the Court asked the parties to renew their settlement negotiations. The next week Andersen shared information regarding its financial condition with the Lead Plaintiff for the first time. On April 22, 2005, at the end of the fourth week of trial and a few short days before closing arguments, the Lead Plaintiff and Andersen reached a settlement (the "Andersen Settlement"). In an April 22 Stipulation of Settlement, Andersen agreed to pay $65 million in cash,

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plus contingent payments equivalent to 20% of any amount paid out by Andersen to present or former partners and certain other individuals in repayment of any subordinated notes issued in respect of paid-in capital or subordinated loans. The Stipulation of Settlement also contained a "most favored nation clause" entitling the Class to receive an additional amount if Andersen pays from its own funds more than $65 million in any other settlement.

On April 26, preliminary approval of the Andersen Settlement was granted, the money was transferred to Lead Plaintiff's escrow account, and the jury was dismissed. The Plan of Allocation for the Andersen Settlement distributes the settlement funds between Exchange Act and Securities Act claims in the same proportion as the Directors' Settlement Plan of Allocation. Because the first alleged misstatement by Andersen was made on March 30, 2000, however, Exchange Act monies will only be allocated to Class Members who purchased WorldCom securities on or after that date. Judge Sweet and Magistrate Judge Dolinger released an April 22, 2005 Mediators' Statement attesting that, based on the information available to them and their discussions with the parties, "this Settlement was negotiated in good faith, and ... the Settlement and the allocation between the Securities Act and Exchange Act claims are in the public interest."

Notice to the Class

A Hearing Order of June 14, 2005 (the "Hearing Order") established the schedule for final approval of the settlements with the Underwriter Defendants, the Director Defendants, and Andersen, and approved a Summary Notice of Class Settlements ("Summary Notice"); a Summary of Supplemental Plan of Allocation ("Summary Supplemental Plan"); and a full-length Notice of Settlements of Class Action ("Class Notice"), which included the proposed Supplemental Plan of Allocation (the "Supplemental Plan"). It also extended the deadline by which Class Members could file proofs of claim from March 4, 2005 to August 26, 2005. The Hearing Order required the Lead Plaintiff to begin mailing the Class Notice (with the Supplemental Plan) by July 1, 2005 to those members of the Class who had already filed a proof of claim. Beginning on June 28, the mailings of these documents were made to over 800,000 Class Members who had filed proofs of claim. The Class Notice and Summary Supplemental Plan ***333** were mailed at the same time to approximately 3.5 million other potential Class Members.[FN17] Summary Notices were published in the *Wall Street Journal* and the *New York Times* and over the PR Newswire and Bloomberg News in early July.

FN17. The Summary Supplemental Plan ran two pages, while the Supplemental Plan itself was eighty-five pages long.

The Class Notice presented the definition of the Class, which encompasses "[a]ll persons or entities who purchased or acquired publicly traded securities of WorldCom ... during the period from April 29, 1999 through and including June 25, 2002, and who were injured thereby" (the "Class Definition"). It gave a detailed Statement of Potential Outcome, which described the issues confronting the parties and the various risks involved in prosecuting the class claims against the settling defendants, and recounted the history of the litigation. It set forth the language of the Release to be imposed pursuant to the settlements and defined the Settling Defendant Releasees. Released Claims are defined as

> *all claims and causes of action of every nature* and description, known and unknown, whether under federal, state, common, or foreign law, whether brought directly or derivatively, *based upon,* arising out of, or relating in any way to *investments* (including, but not limited to, purchases, sales, exercises, and decisions to hold) *in securities issued by WorldCom,* including without limitation all claims arising out of or relating to any disclosures, public filings, registration statements or other statements by WorldCom, as well as all claims asserted by or that could have been

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asserted by Plaintiffs or any member of the Class in the Action against the Settling Defendant Releasees.[FN18]

FN18. The Release also states that Class Members are not precluded from claiming with respect to funds made available from the WorldCom bankruptcy or WorldCom's settlement with the Securities and Exchange Commission ("SEC") or any other regulatory agency fund.

(Emphasis supplied.)

The Class Notice outlined the Underwriters', Directors', and Andersen Settlements, listing settlement dates and dollar amounts and setting forth the Plans of Allocation. It also specified the maximum amount of attorneys' fees and costs that Lead Counsel would seek. It set a deadline of August 12, 2005 for any objections to the settlements and announced a September 9, 2005 fairness hearing (the "Fairness Hearing"). The Class Notice informed Class Members that they would receive no further mailing if settlements were reached with Ebbers, Sullivan, Myers, and/or Yates unless they submitted a request to the Claims Administrator for written notice of any additional settlements. Rather, notice of further settlements would be provided on www.worldcomlitigation.com, the website maintained by Lead Counsel ("Lead Counsel Website"), and in several specified publications. This method of notice was approved in light of the fact that any settlement with the remaining defendants would not materially increase recovery for the Class, whereas another mailed notice would constitute a significant expenditure.[FN19]

FN19. The expense associated with providing notice to every member of the WorldCom class can be gleaned from these figures, which reflect only some of the costs of notice. The cost of disseminating the July 1, 2005 Class Notice and Supplemental Plan to 600,000 Class Members was $588,000; the cost of disseminating the Class Notice and Summary Supplemental Plan to approximately 3.5 million other potential class members was $2,360,000.

The Supplemental Plan specifies the methodology for calculating a "Recognized ***334** Amount" for each Class Member's losses, based on the type of security purchased and the date it was sold or redeemed. It also specifies that there will be no recovery for WorldCom securities sold or redeemed on or before January 28, 2002, explaining that the first decline in the price of WorldCom securities that could be said to be caused by WorldCom's misrepresentation of its financial condition was a decline on or after January 29, 2002.[FN20] The tables accompanying the Supplemental Plan lay out the dollar amount of artificial inflation inhering in the market price of each type of WorldCom security for each day of the Class Period, as estimated by the Lead Plaintiff.

FN20. The Lead Plaintiff has proposed that this provision be altered to allow a small recovery for Class Members who sold their securities on or before January 28, 2002. This proposed modification to the Supplemental Plan is discussed in detail below.

Ebbers Settlement

The Lead Plaintiff reached a settlement with Ebbers on July 6, 2005 (the "Ebbers Settlement"). The settlement results in the surrender of substantially all of Ebbers' assets. Pursuant to the Ebbers Settlement, the Class will receive $5,636,543.69 in cash. The Class is also entitled to approximately 75% of the net proceeds from the sale of various assets held by Ebbers, including a house, several plots of land, certain farm equipment, and interests in various businesses, and will receive approximately two-thirds of the net proceeds from the sale of the Joshua Timberlands, another Ebbers asset. The balance of the proceeds from the sale of Ebbers' assets will go to settle debts Ebbers owes to MCI. The Lead Plaintiff estimates that the sale of Ebbers' assets will result in an additional $18 million to $28

million of recovery for the Class. The Ebbers Settlement also includes a Confidential Supplemental Stipulation allowing Ebbers to retain a specified amount to pay legal bills, to fund his defense in other litigation, and to pay $450,000 owed on a note to the class plaintiffs in the WorldCom *ERISA Litigation*. The Plan of Allocation for the Ebbers Settlement is identical to those proposed for the Directors' and Andersen Settlements. Lead Counsel have chosen not to apply for any additional attorneys' fees on the basis of the Ebbers Settlement. A hearing regarding preliminary approval of the Ebbers Settlement was held on July 11, and a Preliminary Approval Order was issued on the same date.

Ebbers was indicted on criminal charges for his involvement in the WorldCom fraud on March 2, 2004; a jury convicted him of nine felony counts on March 15, 2005, after a trial before the Honorable Barbara S. Jones, U.S. District Judge for the Southern District of New York. In recognition of the Ebbers Settlement, the Office of the U.S. Attorney for the Southern District of New York ("U.S. Attorney's Office") agreed not to seek further monetary restitution from Ebbers. In addition, the New York State Attorney General agreed to dismiss certain claims against Ebbers that were pending in a New York state court. On July 13, Judge Jones sentenced Ebbers to twenty-five years in prison.

Myers, Yates, and Sullivan Settlements

On July 21, 2005, the Lead Plaintiff reached a settlement agreement with Myers and Yates (the "Myers–Yates Settlement"), embodied in a Stipulation of Settlement of July 26. It does not require either Myers or Yates to pay money to the Class, as the Lead Plaintiff determined that both defendants lack adequate financial resources and that the expense of further prosecution of the claims against ***335** those defendants would thus be detrimental to the Class.

A settlement with Sullivan was announced on July 25, 2005 (the "Sullivan Settlement"). As was true for the Ebbers Settlement, the Sullivan Settlement results in the surrender of substantially all of Sullivan's assets. Pursuant to the terms of the Stipulation of Settlement with Sullivan, dated July 26, 2005, the Class will receive 90% of Sullivan's MCI 401(k) account, representing approximately $200,000. It will also receive approximately 90% of the net proceeds from the sale of a Boca Raton, Florida house owned by Sullivan. Five percent of the proceeds of the sale of the Boca Raton house will be held in escrow by Sullivan's attorneys to fund his defense in other litigation, including the WorldCom Individual Actions. The balance of the proceeds from the 401(k) and the sale of the house will be distributed to the plaintiff class in the WorldCom *ERISA Litigation*. The sale of the Florida house is expected to result in a net payment of between $4 and $5 million to the Class.

The Plan of Allocation for the Sullivan Settlement is identical to those for the Directors' Settlement, Andersen, and Ebbers Settlements. As with the Ebbers Settlement, Lead Counsel chose to forego any request for attorneys' fees based on the Sullivan Settlement. Preliminary approval was given to the Sullivan and Myers–Yates Settlements in a hearing on July 28.

Sullivan, Myers, and Yates had all pleaded guilty to criminal charges pending against them. In light of the Sullivan Settlement, the U.S. Attorney's Office did not seek further monetary restitution from him. On August 9, Judge Jones sentenced Yates to a year and a day in prison, and the following day, Myers received a one-year sentence. On August 11, Sullivan was sentenced to five years in prison. Yates', Myers', and Sullivan's sentences were significantly reduced because they had cooperated with the Government in its prosecution of Ebbers.

Notice to the Class of the Ebbers, Myers–Yates, and Sullivan Settlements

As provided in the Hearing Order, no notice of the Ebbers, Myers–Yates, and Sullivan Settlements (collectively, the "Officers' Settlements") was mailed to the Class. A Notice of Proposed Settle-

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ments of Class Action ("Officers' Settlement Notice") appeared through the channels prescribed by the Hearing Order. That document once again set forth the definition of the Class, described the Officers' Settlements and the corresponding Plans of Allocation by claim, announced that the Officers' Settlements would be considered at the previously scheduled September 9, 2005 Fairness Hearing, and informed Class Members of the sources from which they could receive previous Notices and proof of claim forms. As of the very end of August, only eighteen class members had contacted the Claims Administrator to request that a copy of the Officers' Settlement Notice be mailed to them directly.

Reaction of the Class to the 2005 Settlements

Over four million putative Class Members were sent notice of the 2005 Settlements. Approximately 834,000 Class Members ultimately filed proofs of claim.[FN21] Despite the significant participation of the Class in the claims process, only seven Class Members—a minuscule percentage—filed timely objections to the 2005 ***336** Settlements. Notably, the objectors did not attack the amounts obtained in the settlements; by and large, their objections addressed the scope of the Release and the provisions of the Supplemental Plan. The objectors are Roslyn Berger ("Berger"), who objects to the scope of the Release; Cerberus Partners, L.P., Cerberus International Ltd., Cerberus Institutional Partners, L.P.—Series Two, and Cerberus Institutional Partners America, L.P. (the "Cerberus Objectors"), who object to four aspects of the Supplemental Plan; Kenneth D. Laub ("Laub"), who objects to the Supplemental Plan;[FN22] Cynthia R. Levin Moulton ("Moulton"), who objects to the Class Notice, the scope of the Release, and the Plans of Allocation; W. Caffey Norman, III, who objects to the Supplemental Plan; Richard F. Reynolds ("Reynolds"), who objects to the scope of the Release; and Charles Lee Thomason ("Thomason"), who objects to the format of the Proof of Claim Form.[FN23] Their objections are discussed in detail below.

FN21. Approximately 535,000 Class Members had submitted proofs of claim by March 4, 2005, the original deadline.

FN22. Although they did not file objections, several Class Members, Dennis G. Baxter, Larry Kolko, and Tom Roberts, submitted correspondence to the Court and/or to Lead Counsel voicing a similar objection to those briefed by Laub: namely, that the allocation of settlement funds only to those Class Members who sold or held their WorldCom securities on or after January 29, 2002 is unfair. The fairness of that allocation is discussed below with respect to the Laub objection.

FN23. An eighth objection, which was filed late by a WorldCom investor who has provided no proof of class membership and who submitted her claim form after the deadline, addresses the issue of attorneys' fees and is described below.

Fairness Hearing

The Fairness Hearing was held on September 9, 2005. Lead Counsel and counsel for additional Named Plaintiffs Fresno County Employees Retirement Association; the County of Fresno, California; and HGK Asset Management, Inc. appeared at the hearing, as did Alan P. Lebowitz, General Counsel for the Comptroller of the State of New York, representing the NYSCRF; and Liaison Counsel for the Individual Actions. Also present were counsel for various Underwriter Defendants, the Citigroup Defendants, Andersen, various Director Defendants, and Ebbers. The Cerberus Objectors, Laub, Moulton, Norman, and Reynolds were also represented by counsel at the Fairness Hearing; these objectors were all given the opportunity to be heard.

Discussion

Judicial Approval of Class Action Settlements Under Rule 23(e)

Pursuant to Rule 23(e), Fed.R.Civ.P., any settlement of a class action must be approved by the court. The following discussion of the requirements

of Rule 23(e) draws heavily from an October 18, 2004 Opinion approving a settlement in the WorldCom *ERISA Litigation, see In re WorldCom ERISA Litig.*, No. 02 Civ. 4816(DLC), 2004 WL 2338151, at *5–*6 (S.D.N.Y. Oct.18, 2004), and from the November 12 Opinion approving the Citigroup Settlement, *see WorldCom*, 2004 WL 2591402, at *10.

[1] In determining whether to approve a class action settlement, the district court must "carefully scrutinize the settlement to ensure its fairness, adequacy and reasonableness, and that it was not a product of collusion." *D'Amato v. Deutsche Bank*, 236 F.3d 78, 85 (2d Cir.2001) (citation omitted); *see also Joel A. v. Giuliani*, 218 F.3d 132, 138 (2d Cir.2000). In so doing, the court must "eschew any rubber stamp approval" yet simultaneously "stop short of the detailed and thorough investigation that it would undertake if it were actually ***337** trying the case." *City of Detroit v. Grinnell Corp.*, 495 F.2d 448, 462 (2d Cir.1974).

[2] A district court determines a settlement's fairness "by examining the negotiating process leading up to the settlement as well as the settlement's substantive terms." *D'Amato*, 236 F.3d at 85. The court should analyze the negotiating process in light of "the experience of counsel, the vigor with which the case was prosecuted, and the coercion or collusion that may have marred the negotiations themselves." *Malchman v. Davis*, 706 F.2d 426, 433 (2d Cir.1983) (citation omitted). A court must ensure that the settlement resulted from "arm's-length negotiations" and that plaintiffs' counsel engaged in the discovery "necessary to effective representation of the class's interests." *D'Amato*, 236 F.3d at 85.

[3] In evaluating the substantive fairness of a settlement, a district court must consider factors enumerated initially in *Grinnell:*

> (1) the complexity, expense and likely duration of the litigation, (2) the reaction of the class to the settlement, (3) the stage of the proceedings and the amount of discovery completed, (4) the risks of establishing liability, (5) the risks of establishing damages, (6) the risks of maintaining the class action through the trial, (7) the ability of the defendants to withstand a greater judgment, (8) the range of reasonableness of the settlement fund in light of the best possible recovery, [and] (9) the range of reasonableness of the settlement fund to a possible recovery in light of all the attendant risks of litigation.

D'Amato, 236 F.3d at 86 (citation omitted).

[4] Finally, public policy favors settlement, especially in the case of class actions. "There are weighty justifications, such as the reduction of litigation and related expenses, for the general policy favoring the settlement of litigation." *Weinberger v. Kendrick*, 698 F.2d 61, 73 (2d Cir.1982).

[5] Procedurally, not a modicum of doubt exists as to the fact that the 2005 Settlements were achieved after painstaking negotiations between extraordinarily well-represented adversaries. In addition, Lead Counsel attests that a thorough investigation of the financial status of the Director Defendants, Andersen, and the Officer Defendants was performed to assess what resources these defendants could contribute to their respective settlements. Substantively, consideration of the *Grinnell* factors strongly supports approval of the settlements.

1. Complexity, expense, and likely duration of the litigation

The litigation was extraordinarily complex, and even though the Court made every effort to conduct the litigation as efficiently as possible, it was a costly undertaking for all parties, particularly given the late stages in which the 2005 Settlements were reached. Nevertheless, further litigation would have resulted in considerable additional expense. By settling when they did, all defendants but Andersen avoided the expense of conducting a full trial, and all parties avoided the expense of the nearly inevitable post-trial briefing and appeals. Particularly with respect to the less-wealthy defendants, further litigation would have only served to extinguish the

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funds available to settle the Class claims.

2. Reaction of the Class

Out of some four million potential Class Members, more than 830,000 of whom submitted proofs of claim, only seven filed timely formal objections to the 2005 Settlements. The very low number of objections ***338** evidences the fairness of those settlements. *See Grinnell,* 495 F.2d at 462.

3. Stage of the proceedings and the risk of further litigation

The Underwriters' and Directors' Settlements were accomplished on the eve of trial; the Andersen Settlement, after several weeks of trial, immediately preceding closing arguments; and the Officers' Settlements, after those defendants had testified in the criminal case against Ebbers FN24 and after the Andersen trial had ceased. All parties were thus superbly equipped to evaluate the strengths and weaknesses of their cases.

FN24. Ebbers took the stand in his own defense, and Sullivan, Myers, and Yates were Government witnesses.

Even at these late stages of the litigation, however, there were significant risks on all sides, many of which were described in the Class Notice. With respect to both Securities Act and Exchange Act claims, the falsity of many alleged misstatements was in dispute. All active defendants FN25 facing Securities Act Section 11 claims stemming from the 2000 and 2001 Offerings had asserted due diligence defenses and might have been successful at establishing the adequacy of their efforts at trial. Active Section 11 defendants, with the exception of Andersen, might have been able to establish that no "red flags" put them on notice of wrongdoing and that they were thus entitled rely on WorldCom's audited financial statements. Defendants facing Securities Act Section 12(a)(2) claims might have been able to establish that they exercised reasonable care.FN26 In addition, the Lead Plaintiff might not have been able to establish that Andersen and Kellett, who faced Exchange Act 10(b) claims, acted knowingly or recklessly with respect to the misstatements. *See* 15 U.S.C. § 78j; 17 C.F.R. § 240.10b–5. (Such a state of mind clearly existed on the part of the Officer Defendants, however, who were found guilty of or pleaded guilty to criminal charges.) The Director Defendants, all of whom faced liability under Exchange Act Section 20(a), might have been able to prove that they "acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action." 15 U.S.C. § 78t(a). The Director Defendants and Andersen also argued that their proportionate share of responsibility was minimal compared to the WorldCom insiders who perpetrated the fraud.FN27 In addition, with respect to both Securities Act and Exchange Act claims, the defendants contested the extent to which the decline in the prices of WorldCom securities was due to the WorldCom accounting fraud as opposed to other market forces.

FN25. As noted above, by the time the 2005 Settlements were achieved, the claims against Ebbers, Sullivan, Myers, and Yates had been severed.

FN26. The various Securities Act defenses are described in the Opinion pertaining to the Underwriter Defendants' summary judgment motion. *See WorldCom,* 346 F.Supp.2d at 662–63.

FN27. The proportionate liability scheme of the Exchange Act is described in *WorldCom,* 2005 WL 335201, at *6–*8.

4. The range of reasonableness of the settlement fund and the ability of defendants to withstand a greater judgment

The 2005 Settlements are, in virtually each instance, of historic proportions. Purchasers of the WorldCom bonds issued in the 2000 and 2001 Offerings, who accordingly possessed Securities Act claims against all defendants, will recover approximately $4.852 billion—$3.452 billion from ***339** the present settlements, and $1.4 billion from the

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Citigroup Settlement. The bonds issued in the 2000 and 2001 Offerings were worth approximately $16.9 billion, of which $15.3 billion was still outstanding at the end of the Class Period, and Lead Plaintiff's damages model attributed some $10.6 billion of damages to the alleged misstatements in the Registration Statements for the offerings. The Lead Plaintiff estimates that the average recovery per $1000 face amount of the bonds issued in the 2000 and 2001 Offerings will be $426.66, based on the total funds recovered through the Citigroup Settlements and the 2005 Settlements, the number of bonds outstanding at the end of the Class Period, and the estimated amount of bonds held by persons who opted out of the Class. This recovery does not include the significant amount that bondholders have already recovered through the WorldCom bankruptcy proceedings.[FN28] Given the risks that would have been inherent in proceeding with the trial and any appeals, the settlement amount that will be allocated to the Securities Act claims is more than reasonable; it is remarkable. The Underwriter Defendants obviously have the financial resources to pay more than they have, but the Underwriters' Settlements have contributed to a total recovery that goes a long way toward making bondholders whole.

FN28. The amount of the bankruptcy recovery will be discussed below in respect to the objection by the Cerberus Objectors.

Purchasers of other WorldCom securities stand to recoup a far smaller percentage of their losses.[FN29] Even combined with the approximately $1.175 billion allocated to Exchange Act claims in the Citigroup Settlement, the funds received in the 2005 Settlements represent only a fraction of the recovery achieved for purchasers of bonds in the 2000 and 2001 Offerings.

FN29. As one Class Member, S. Kaiser, expressed in an e-mail message to the Victim/Witness Coordinator at the U.S. Attorney's Office, WorldCom shareholders will receive "peanuts" in comparison to purchasers of bonds issued in the 2000 and 2001 Offerings.

The only defendants involved in the 2005 Settlements who faced Exchange Act claims are Andersen, now defunct and retaining limited assets; the Director Defendants,[FN30] who have collectively given up twenty percent of certain personal assets and whose settlements were supplemented by $36 million in contested insurance funds; and the Officer Defendants. Of the Officer Defendants, Ebbers and Sullivan have contributed substantially all of their personal assets to this and other settlements, and Yates and Myers are effectively insolvent. Thus, the pool of resources from which the Lead Plaintiff could seek recovery through this round of settlements for purchasers of stock and pre-existing bonds was relatively shallow, and because purchasers of stock and pre-existing bonds incurred aggregate losses many times greater than those of bond purchasers in the 2000 and 2001 Offerings, the recovered sums will be diffused much more widely.[FN31]

FN30. The Director Defendants faced control-person claims under the Exchange Act. A single Director Defendant, Kellett, also faced an Exchange Act Section 10(b) claim.

FN31. The Lead Plaintiff estimates that approximately 2.49 billion shares of WorldCom common stock were capable of being traded during the Class Period, which conveys some idea of how thinly the recovery must be spread. Holders of bonds issued prior to the 2000 and 2001 Offerings may recover on Exchange Act claims as well.

The Lead Plaintiff has included protections in the settlement agreements with the Exchange Act defendants providing ***340** recourse for the Class should these defendants' financial representations be false. The Lead Plaintiff—who, it should be noted, was not a purchaser of bonds in the 2000 and 2001 Offerings and thus will recoup the same pro-

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portion of its losses as all other Class Members with only Exchange Act claims—estimates that Class Members will recover only an average of $0.56 per share of common stock. It has nonetheless still recovered a fair and, when the Citigroup Settlement is considered, even a remarkable amount for shareholders, given the circumstances.

Objections by Class Members

1. Objection to the Class Notice [FN32]

FN32. A number of objectors make arguments relating to the Class Notice. All but one of these are more appropriately addressed in the discussions of the Release and Supplemental Plan that follow.

[6] The standard for measuring the adequacy of a settlement notice in a class action is reasonableness. *Wal–Mart Stores, Inc. v. Visa U.S.A., Inc.*, 396 F.3d 96, 113 (2d Cir.2005). "There are no rigid rules to determine whether a settlement notice to the class satisfies constitutional or Rule 23(e) requirements; the settlement notice must fairly apprise the prospective members of the class of the terms of the proposed settlement and of the options that are open to them in connection with the proceedings." *Id.* at 114 (citation omitted). "Notice is adequate if it may be understood by the average class member." *Id.* (citation omitted).

[7] Moulton, who purchased a total of 54 shares of WorldCom stock during the Class Period, resulting in a loss of approximately $404, argues that the Class Notice was defective because the Class Definition is vague. Moulton did not file a proof of claim and therefore does not have standing to bring her objections.[FN33] *See State of New York by Vacco v. Reebok Int'l, Ltd.*, 96 F.3d 44, 47 (2d Cir.1996) ("For standing to exist, a would-be litigant must have sustained a palpable injury that is likely to be redressed by a favorable decision."). In any event, Moulton's objections are frivolous.

FN33. Several days after the Fairness Hearing, Moulton submitted a "Notice Regarding the Court's Inquiry Regarding Standing" reaffirming that Moulton had an out-of-pocket loss arising from her purchase of WorldCom securities during the Class Period, but she still does not contradict the Lead Plaintiff's contention that she did not submit a proof of claim.

[8] Moulton contends that the phrase "who were injured thereby" necessitates "a subjective, merits-based inquiry far beyond a simple determination of whether a given person did or did not purchase or acquire WorldCom, Inc. securities during the class period," rendering Class membership "unknowable." She also argues in conclusory form and without explanation that the relief described in the Class Notice regarding the settlement is "vague and confusing." Acknowledging that the 2005 Settlements achieved a "remarkable" recovery for the class, Moulton's attorney elaborated on her objection at the Fairness Hearing, explaining that the Class Definition might be confusing to a person who had isolated losses but net gains from securities purchased during the Class Period, or who faced divergent results from purchases of different types of securities.

A purchaser of WorldCom securities who believed that she had a legally cognizable injury attributable to those purchases would have been on notice that she was included in the Class. It is sufficient that the Class Definition gave putative Class Members who believed they had colorable legal claims arising from purchases ***341** of WorldCom securities enough information to alert them that they needed to opt out of the Class if they wished to pursue their claims separately. Moulton's objection based on the alleged vagueness of the Class Definition is accordingly rejected.

Moulton's objection to the description of the relief provided by the Class Notice must likewise be rejected. The Class Notice and the Executives' Settlement Notice together listed the amounts of all of the 2005 Settlements. The Supplemental Plan de-

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scribes in detail the allocation of the settlement proceeds among Class Members who filed proofs of claim.

2. Objections to the Scope of the Release

[9][10] Three Class Members, Berger, Reynolds, and Moulton, have objected to the scope of the Release to be imposed pursuant to the 2005 Settlements. As the Second Circuit recently noted, "Practically speaking, class action settlements simply will not occur if the parties cannot set definitive limits on defendants' liability." *Visa,* 396 F.3d at 106 (citation omitted). The scope of a settlement release is limited by the "identical factual predicate" and "adequacy of representation" doctrines. *Id.* "The law is well-established in this Circuit and others that class action releases may include claims not presented and even those which could not have been presented as long as the released conduct arises out of the 'identical factual predicate' as the settled conduct." *Id.* at 107. "[A]dequate representation of a particular claim is determined by the alignment of interests of class members, not proof of vigorous pursuit of that claim." *Id.* at 113.

a. Berger

[11] Berger, who purchased 250 shares of WorldCom stock in 1998 and 100 shares on September 20, 2000,[FN34] contends that the Release is overinclusive because it bars claims against settling defendants arising from the purchase of WorldCom securities prior to the Class Period, which began on April 29, 1999, and that Class Members were not given adequate notice that such claims would be barred. Berger, who has filed a Statement of Claim against SSB, one of the Citigroup Defendants, with the National Association of Securities Dealers ("NASD"),[FN35] represents that she did not opt out of the Class because she did not believe claims arising from her 1998 purchases would be barred by the Release. Additionally, Berger argues that the 2005 Settlements do not provide adequate consideration for the release of claims arising from purchases made prior to the Class Period.

FN34. Berger sold 75 shares of WorldCom stock on December 28, 2001. She presumably held the rest until they were exchanged for MCI stock pursuant to the WorldCom bankruptcy reorganization.

FN35. Berger's arbitration claims against SSB were enjoined by this Court after a show cause hearing on August 26, 2005, on the grounds that they are barred by the claims release imposed pursuant to the Citigroup Settlement. All of Berger's arbitration claims concerning her WorldCom investments unquestionably arise from the identical factual predicate that forms the core of the allegations brought by the Class against SSB. Berger has filed a proof of claim in the class action.

To the extent that Berger objects to the Release imposed pursuant to the Citigroup Settlement, her objection is untimely and has been waived. Moreover, because the Release may only be applied to bar claims based on the same factual predicate as those brought by the Lead Plaintiff in the class action, its scope is entirely appropriate under the standards set forth in *Visa* ***342** and earlier cases.[FN36]

FN36. The Release does not state that its application is bounded by the "identical factual predicate" doctrine, but the addition of language releasing claims "arising from the same facts," or similar formulations, would be unnecessary and redundant. It is, after all, a given that the Release will only be applied insofar as its application conforms to the law. For example, on numerous occasions, parties have litigated before this Court whether claims may be enjoined pursuant to the Citigroup Settlement release. That the "identical factual predicate" and "adequate representation" doctrines limit the effect of that identically worded release has never been disputed. Because the determination whether a given

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claim is predicated on identical facts as the class action claims is inherently an individualized, fact-specific one, adding broad language specifying that only claims arising from an identical factual predicate are to be released would certainly not reduce litigation over the release of specific claims and may even be more likely to produce claims that Class Members were confused or misled. Nor, given the numerous factual allegations in the complaint, would it be feasible to provide in the Release a full description of the factual scenarios on which the class action claims were based. It should be noted that the Lead Counsel Website gave Class Members access to all of the class action pleadings and the Opinions issued in the *Securities Litigation,* among many other documents.

Berger and other Class Members were given fair and adequate notice that they were members of the Class and that they would be bound by the terms of any settlement in the litigation. The Class Definition has featured prominently in every notice sent out to date, including the December 2003 Notice. That Notice set forth the Class Definition in its very first lines and stated, underscored and in bold: "If you do not request to be excluded from the Class ... you will be bound by the decisions and outcome of this lawsuit." No representation was ever made that the dates bounding the Class Period would correspond to any release, or to anything other than the definition of the Class. Class Members were given an extraordinarily long period of time in which to opt out. *See WorldCom,* 2004 WL 2591402, at *5.

There is obviously no legal requirement that a notice of the pendency of a class action include a description of a release that may someday be negotiated to resolve claims brought in the class action, and the Class did not receive notice of the Release to be applied pursuant to the 2005 Settlements prior to the opt-out date. Nevertheless, because of the extension of the opt-out period, Class Members effectively *did* have the opportunity to opt out upon knowledge of the scope of the Release: the Class received notice of the identical claims release imposed pursuant to the Citigroup Settlement approximately a month prior to the opt-out date. At the time of the Citigroup Settlement, only one Class Member objected to the scope of the claims release, and that objection was of a different nature. *See WorldCom,* 2004 WL 2591402, at *12–*13. In any event, the Second Circuit has explicitly rejected the contention that Class Members must be given a second opportunity to opt out after the terms of a settlement are announced. *See Visa,* 396 F.3d at 114. Given the notices distributed to the Class, and the opportunities granted to the Class to opt out and later to object to the 2005 Settlements, there is no reason here to permit a second opportunity to opt out.

Nor is there any merit to the contention that Berger and those Class Members who also made pre-Class Period purchases of WorldCom securities are receiving inadequate compensation for their claims, as it appears highly unlikely that they could establish a factual basis for recovery. At the Fairness Hearing, Lead Counsel confirmed that April 29, 1999 was chosen as the beginning of the Class Period because it was the first date on which the Lead *343 Plaintiff could point to evidence of a misstatement by WorldCom of its financial information.[FN37] Lead Counsel noted that the SEC chose the same date for its civil enforcement proceedings against WorldCom for the same reason.

FN37. While the statute of limitations for the class action allowed claims to be brought for the three-year period before April 30, 2002, the defendants never challenged the choice of a class period beginning one day earlier.

Additionally, the inflation in WorldCom's stock price, as allocated by the Lead Plaintiff based on its experts' evaluation of the relevant evidence, was concentrated toward the end of the Class Period. It

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is telling in this regard that no one in the Class has objected to that portion of the Supplemental Plan, explained at Paragraph 14 and demonstrated in various charts appended to the Supplemental Plan, which calculates that the inflation started with relatively smaller percentages during the first quarters of the Class Period and gradually increased to nearly 100% toward the end of 2001.[FN38] This allocation of inflation reflects the relationship that each quarter's earnings overstatement bore to the total amount of the earnings overstatements in WorldCom's SEC filings.

FN38. For example, the artificial inflation was approximately $1 of the $55.90 closing price of WorldCom common stock as of April 29, 1999, but $12.50 of the $14 closing price on December 31, 2001.

Thus, in addition to other barriers an investor may face in obtaining recovery for losses from WorldCom investments purchased prior to the Class Period, including the statute of limitations, there is compelling evidence that WorldCom's manipulations of its financial reporting did not impact prior periods in any material way that requires compensation in order for the settlements to be approved as fair. Settlement proceeds may be allocated according to the strengths and weaknesses of the various claims possessed by Class Members. *See In re Holocaust Victim Assets Litig.,* 413 F.3d 183, 186 (2d Cir.2001) (reissued 2005) ("Any allocation of a settlement of this magnitude and comprising such different types of claims must be based, at least in part, on the comparative strengths and weaknesses of the asserted legal claims."). Fairness does not require that Class Members be compensated for losses stemming from purchases at prices that it would be extraordinarily difficult to argue were inflated by the malfeasance alleged in the complaint.

Had Berger wished to press her claims outside the confines of the class action, she had an opportunity to opt out. Because she chose to remain a Class Member, there is no unfairness in applying the Release to all of her claims, even if they involve securities purchased prior to the Class Period, so long as they are predicated on the same facts alleged in the class action complaint. Her objection is thus rejected.

b. Reynolds

Reynolds is another Class Member who has pursued separate litigation against WorldCom (the "Reynolds Action"). Reynolds lawsuit was enjoined in April 2005 by Judge Arthur J. Gonzales of the U.S. Bankruptcy Court for the Southern District of New York, who oversaw the WorldCom bankruptcy proceedings, on the ground that Reynolds' claims are derivative and are therefore the exclusive property of the bankruptcy estate. *See In re WorldCom, Inc.,* 323 B.R. 844, 856 (Bankr.S.D.N.Y.2005). Reynolds' appeal of that injunction is pending.

The Reynolds Action alleged that the WorldCom board of directors declared a ***344** dividend for shares of MCI Tracking Stock on March 6, 2002, and later, on July 11, 2002, announced that the dividend would not be paid. It pleaded four claims against certain of the Director Defendants in the class action, two of which Reynolds represents to be premised on the shareholders' right to receive the withdrawn dividend, two of which regard "conduct ... affect[ing] the individual right of the holders of [WorldCom and MCI Tracking Stock shares] to make voting and investment decisions based upon accurate information." Reynolds argues that the Reynolds Action claims were not based on factual predicates identical to those underlying the class action claims. He argues that the scope of the Release should thus be modified to exclude his claims.

The Release is not overly broad in its present form. As noted above, the effect of the Release is limited by the "identical factual predicate" and "adequacy of representation" requirements that the Second Circuit has imposed. Given that Reynolds will only be able to litigate his Reynolds Action claims if he succeeds on his appeal of the bank-

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ruptcy court's determination, his objection to the Release is based on highly speculative concerns. Whether the specific claims pleaded in the Reynolds Action are barred by the Release is not a determination that needs to be made at this time. It should be noted, however, that Reynolds' complaint relies on allegations that WorldCom's board of directors had knowledge that WorldCom's financial statements were inaccurate and declared the dividend in March 2002 anyway. Such allegations fall squarely within the Class Period and concern the same financial wrongdoing addressed by the class action.

c. Moulton

Moulton contends that the Release is overly broad in that it releases claims "that were never investigated nor prosecuted against the released parties." She also argues that the Release is improper because it extends to persons and entities never sued. Each objection is made generally and without identifying any specific claim or person. Moreover, Moulton's counsel pursued neither contention during his oral presentation at the Fairness Hearing. Moulton contends that, based on these arguments, the breadth of the Release renders the 2005 Settlements unfair due to lack of consideration.

[12] As *Visa* makes clear, the fact that a release covers claims not actually pursued by a plaintiff in a class action does not render the release overbroad. *See Visa,* 396 F.3d at 107. Moulton's argument that the Release applies to claims against persons and entities uninvolved in the class action litigation is inaccurate; the Release applies by its terms only in respect to certain Settling Defendant Releasees, each of whom is properly released because of a direct connection to a settling defendant or because of its contribution to the settlements. Accordingly, her argument that the settlements are unfair lacks merit.

3. Objections to the Supplemental Plan

[13] "To warrant approval, the plan of allocation must also meet the standards by which the settlement was scrutinized—namely, it must be fair and adequate." *Maley v. Del Global Technologies Corp.,* 186 F.Supp.2d 358, 367 (S.D.N.Y.2002) (citation omitted). "An allocation formula need only have a reasonable, rational basis, particularly if recommended by experienced and competent class counsel." *Id.* (citation omitted).

a. Laub

[14] Laub is a Class Member who purchased WorldCom securities during the Class Period and sold them on a series of ***345** dates prior to January 29, 2002. Laub's purchases add up to $59.2 million; his losses total more than $5 million. The Supplemental Plan, as originally proposed by the Lead Plaintiff and described in the Class Notice, provides no recovery to Class Members who sold securities prior to January 29, 2002, which is the earliest date on which Lead Plaintiff found evidence that a partial disclosure of WorldCom's prior financial misstatements was made. Laub argues, first, that Class Members should have had notice before the opt-out period closed that damages would be allocated in this manner. The fact that Class Members who sold prior to January 29, 2002 would not recover was not apparent to the Class until the Supplemental Plan was mailed out in July 2005, well after the opt-out date of September 1, 2004. Second, Laub argues that this allocation of damages is unfair, citing the loss causation analysis in *In re Parmalat Securities Litigation,* 375 F.Supp.2d 278, 305–06 (S.D.N.Y.2005).

In response to these objections, the Lead Plaintiff has proposed an alternative allocation for Exchange Act claimants that it opines would also be fair and reasonable. This alternative would provide recovery for losses incurred in sales of WorldCom securities prior to January 29, 2002, but would limit the Recognized Amount for such losses to ten percent of the Recognized Amount for losses from sales on or after that date. It would be entirely reasonable to adhere to the Supplemental Plan as originally proposed by the Lead Plaintiff and provide recovery under the Exchange Act to only those Class Members who sold or held securities on or after January 29, 2002. As discussed below, it is

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unlikely that any losses sustained in the trading of WorldCom securities before that date can as a matter of law or fact be attributed to the filing of false financial statements by WorldCom. Nonetheless, it is also reasonable and perhaps fairer to give some modest recovery to Class Members who suffered losses prior to January 29, 2002.

One plea from a Class Member illustrates the problem. In an e-mail message to the U.S. Attorney's Office Victim/Witness Coordinator that was forwarded to the Court, Class Member Tom Roberts argues that fraud was occurring while he held his stock and justifies some recompense. He believed something was wrong about WorldCom's reported performance and "tried to be proactive" by selling promptly. He sold all of his WorldCom stock by January 21, 2000, suffering losses of approximately $174,000, and would have suffered an even greater loss if he had waited until 2002 to sell. He feels he should not be excluded from all recovery because of his prescience and diligence.

None of the notices sent to the Class before the opt-out period closed advised Class Members that January 29, 2002, or any other date, might be the cut-off date for recovery. While it was not feasible or necessary to give such notice, in its absence, Class Members may have formed an expectation that they could participate in any recovery that the Lead Plaintiff would be able to achieve for the Class.

The Lead Plaintiff's proposal that the recovery for those who sold before January 29, 2002 be limited to ten percent of the settlement fund strikes the proper balance. Under Exchange Act Section 10(b), FN39 loss causation "is the causal link ***346** between the alleged misconduct and the economic harm ultimately suffered by the plaintiff." *Lentell v. Merrill Lynch & Co.*, 396 F.3d 161, 172 (2d Cir.2005) (citation omitted); *see also* 15 U.S.C. § 78u-4(b)(4). It is "often compared ... to the tort law concept of proximate cause, meaning that the damages suffered by plaintiff must be a foreseeable consequence of any misrepresentation or material omission." *Emergent Capital Investment Mgmt., LLC v. Stonepath Group, Inc.*, 343 F.3d 189, 197 (2d Cir.2003) (citation omitted). In *Lentell,* the Second Circuit reiterated two requirements for establishing loss causation. A plaintiff must prove "both that the loss [was] foreseeable *and* that the loss [was] caused by the materialization of the concealed risk." *Lentell,* 396 F.3d at 173 (emphasis in original).

> FN39. The loss causation analysis under Securities Act Section 11 is a "mirror image" of that under Section 10(b). *WorldCom,* 2005 WL 375314, at *6. Under Section 11, that a plaintiff's losses were attributable to factors other than disclosure of the alleged misstatements is an affirmative defense; that the alleged misstatements caused the plaintiff's losses is an element of a Section 10(b) offense. *See id.*

Laub's counsel indicated in a reply brief and at the Fairness Hearing that Laub objected to the ten percent allocation, so Laub's original objection will be construed as one to the revised Supplemental Plan. In *Parmalat,* the case on which Laub relies, the court concluded that evidence of a corrective disclosure, such as that to which the January 29, 2002 date is tied in this class action, is not necessary to establish loss causation under Exchange Act Section 10(b). *See Parmalat,* 375 F.Supp.2d at 305. *Parmalat* cited *Suez Equity Investors, L.P. v. Toronto–Dominion Bank,* 250 F.3d 87, 98 (2d Cir.2001), for the proposition that no corrective disclosure is needed when "plaintiffs allege that the *subject* of the misrepresentations and omissions caused their loss." *Parmalat,* 375 F.Supp.2d at 306 (emphasis added). In *Suez Equity,* the alleged misrepresentations regarded the skills and experience of the principal of the company in question. The court ruled that "[s]ince defendants reasonably could have foreseen that [the individual's] concealed lack of skill would cause the company's eventual liquidity problems, defendants' misrepresentations may be the causal precursor to the

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[company's] final failure." *Suez Equity,* 250 F.3d at 98. In *Lentell,* the Second Circuit explicitly stated that interpreting *Suez Equity* to stand for the proposition that a plaintiff need not prove that investors' losses were caused by the materialization of a concealed risk would be a misreading of the case. *Lentell,* 396 F.3d at 173. *Parmalat* was wholly consistent with *Lentell,* making clear that the risk disguised by the misrepresentation alleged in that case had materialized—Parmalat, which had massive undisclosed debt, began defaulting in its payments to bondholders—and hence had "arguably caused the decline in shareholder and bondholder value." *Parmalat,* 375 F.Supp.2d at 307.

Neither Laub nor any other objector has identified any partial disclosure of the WorldCom fraud that occurred earlier than January 29, 2002. At the Andersen trial, Lead Plaintiff's expert attributed all declines in the market price of WorldCom's stock before January 29, 2002 to market conditions or industry factors, and Lead Counsel has submitted charts in connection with its application for approval of the modified Supplemental Plan which show that the declines in the price of WorldCom stock [FN40] prior to January 29, 2002 were consistent with the declines in the stock prices of AT & T and Sprint, WorldCom's chief competitors. Moreover, Laub does not point to an earlier date on which a concealed risk materialized in *any* manner. His arguments for why the reasoning of *Parmalat* should apply here are thus unconvincing.

FN40. Since the price of WorldCom bonds did not fall below par until after January 29, 2002, those Class Members who sold bonds before that date did not sustain any compensable loss and are unaffected by this dispute.

***347** Laub argues that WorldCom's fraudulent reporting of its line costs, its misclassification of assets in connection with acquisitions to inflate earnings, its failure to record timely impairment in the value of goodwill, and a dubious analytical model used by SSB securities analyst Jack Grubman [FN41] to tout WorldCom securities "were all subjects of Defendants' material misrepresentations and omissions that caused WorldCom investors' losses and it was foreseeable that they would eventually do so." Without materialization of a concealed risk, however, such allegations are insufficient to prove loss causation, as all that they establish is that the price of WorldCom securities was inflated by the misrepresentations. As the Supreme Court recently confirmed in *Dura Pharmaceuticals, Inc. v. Broudo,* 544U.S. 336, 125 S.Ct. 1627, 161 L.Ed.2d 577 (2005), "[n]ormally ... an inflated purchase price will not itself constitute or proximately cause the relevant economic loss." *Id.* at 1631. Unless Laub can establish that his losses were attributable to some form of revelation to the market of the wrongfully concealed information, they are not recoverable in a private securities action. Such actions are available, after all, "not to provide investors with broad insurance against market losses, but to protect them against those economic losses that misrepresentations actually cause." *Id.* at 1633.

FN41. Grubman was one of the Citigroup Defendants.

In light of this loss causation analysis, the new Supplemental Plan providing ten percent of the normal recovery to those who sold their stock before January 29, 2002 is fair. It would be highly unlikely, based on the facts unearthed through significant investigation and discovery in this case, that a plaintiff could establish that losses from the sale of WorldCom securities prior to that date were attributable to the WorldCom fraud. Indeed, the financial manipulation at WorldCom kept the prices of its securities artificially inflated and illegally protected WorldCom investors to some degree before the corrective disclosures were made. The Lead Plaintiff would have been highly motivated to find evidence of disclosures of the WorldCom fraud to the market prior to January 29, 2002, as such evidence would have allowed it to submit a damages calculation under which a smaller proportion of the

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decline in the price of WorldCom stock was attributable to other factors.[FN42] The Court is thus confident that the interests of Laub and similarly situated Class Members were well-represented in this regard.

FN42. Even the defendants, who were highly motivated to locate the earliest "inquiry notice" date possible to support their statute of limitations motion brought against certain WorldCom Individual Actions, only argued that investors were on notice of the fraud as of April 20, 2002. *See In re WorldCom, Inc. Sec. Litig.*, 294 F.Supp.2d 431, 446–47 (S.D.N.Y.2003).

Laub argues that his substantial losses from trading that ended by January 11, 2000 deserve equal treatment with losses incurred by investors who sold or held securities after January 29, 2002. Lead Counsel points out that all of Laub's trading occurred when WorldCom was still trading above $40 per share, while after January 29, 2002, WorldCom traded from approximately $10 to $1 per share. Depending on when they had purchased their shares, the Class Members who sold their shares in the latter period (or who retained their shares) suffered devastating losses.

Laub argues that only speculators bought WorldCom securities after January 29, 2002, and that speculators are less entitled to recovery than investors like him. Laub, who made ten purchases between***348** May 1999 and January 2000, buying between $2 million and $9 million of stock on each occasion, sold his WorldCom stock within a few weeks or even a few days of purchase. This is not the pattern of a long-term investor. In any event, the Supplemental Plan distinguishes among Class Members by their date of sale, not their date of purchase. Laub has provided no basis to find that the investors who sold after January 29, 2002 also purchased their securities after that date, or any other basis to denigrate this entire category of investors as speculators. Moreover, the Supplemental Plan provides the larger recovery not just to those investors who sold their shares after January 28, 2002, but also to those who still held their shares as of June 25, 2002.

As noted above with respect to the Berger objection, settlement proceeds may be allocated with respect to the strengths and weaknesses of various claims. *In re Holocaust Victim Assets Litig.*, 413 F.3d at 186. The Lead Plaintiff cites at least four cases that approve a much smaller settlement distribution to class members with pre-disclosure sales of securities. *See Global Techs. Corp.*, 186 F.Supp.2d at 367 (awarding twenty percent of their recognized losses); *In re MicroStrategy, Inc. Sec. Litig.*, 148 F.Supp.2d 654, 668 (E.D.Va.2001) (ten percent); *In re Ikon Office Solutions, Inc. Securities Litigation,* 194 F.R.D. 166, 184 (E.D.Pa.2000) (ten percent and less); *In re Sapiens Securities Litigation,* No. 94 Civ. 3315(RPP), 1996 WL 689360, at *2 (S.D.N.Y. Nov.27, 1996) (thirty percent); *cf. also In re Charter Communications, Inc.*, No 4:02–CV–1186 CAS, 2005 U.S. Dist. LEXIS 14772, at *33 (E.D. Mo. June 30, 2005) (allocating settlement funds on basis of the relative strengths and weaknesses of class members' individual claims and the timing of purchases and sales of the securities at issue); *In re Gulf Oil/Cities Serv. Tender Offer Litig.*, 142 F.R.D. 588, 596 (S.D.N.Y.1992) (same).

Laub argues in his reply brief that the proposed allocation of ten percent of the regular Recognized Amount for sales prior to January 29, 2002 is entirely arbitrary. There is no mathematical formula that can be used to determine precisely how much of the Exchange Act settlement funds should be shared with investors who have only a very remote probability of any recovery through litigation but who for the reasons already explained deserve a modest share of recovery. The Lead Plaintiff has chosen a figure that is fair and reasonable in the circumstances.

Finally, Class Members had fair and adequate notice that they would be bound by the terms of any judgment or settlement unless they opted out of the

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class action by the prescribed date. As Laub notes, the December 2003 Notice stated that "If you choose to remain in the Class, you will be entitled to your share of any money awarded to the Class either through a settlement with the defendants...." The December 2003 Notice also specified, however, that "[i]n the event of a settlement, Lead Plaintiff will be required to obtain preliminary approval of such a settlement from the Court, including preliminary approval for a proposed plan of allocation for settlement proceeds.... The Court will only give final approval to a proposed settlement and plan of allocation if the Court finds them to be fair, adequate, and reasonable to the members of the Class." In the Citigroup Settlement Notice, mailed prior to the September 1, 2004 opt-out deadline, Class Members were informed that the Supplemental Plan, to be submitted to the Court "at a future time," would determine "how each portion of the Settlement proceeds shall be allocated" to the Class. Class Members were also advised on the first page of the Citigroup Settlement Notice that "[s]ome Class Members may recover more or less ... depending on, among ***349** other factors, when their shares and bonds were purchased or sold." None of these statements can be construed as a promise to Class Members that all claims would be treated as if equal in merit. Laub's objection must accordingly be rejected.[FN43]

FN43. At the Fairness Hearing, Laub's attorney intimated that the Lead Plaintiff had intentionally delayed disclosure of the Supplemental Plan. There is absolutely no basis for such an accusation. It was prudent and entirely reasonable to delay development of the Supplemental Plan until expert damages reports had been served, and indeed, until after the 2005 Settlements had been achieved.

Laub's attorney also argued that the allocation of ten percent of the normal recovery to Class Members who sold their securities prior to January 29, 2002 disadvantages Class Members who elected not to submit proofs of claim because they believed they would not recover, and that another notice period is therefore necessary. This argument has no merit, however, in light of the fact that the original deadline for filing a proof of claim was March 4, 2004, a date before the Supplemental Plan had been developed and distributed to Class Members and before the announcement in the Hearing Order that Class Members would have a second opportunity to submit proofs of claim. Any Class Member, regardless of the date on which she sold her securities, who wished to preserve her right to share in the eventual recovery should have filed a proof of claim before the March deadline; the second opportunity was essentially a windfall.

On September 15, 2005, Laub submitted an objection to the proposed Order approving the modified Supplemental Plan of Allocation. Laub argues that the modified Supplemental Plan was not supported by documents and affidavits showing its reasonableness and fairness to Class Members. Counsel for the Lead Plaintiff did attest to its fairness in a supplemental declaration accompanying Lead Plaintiff's reply brief, as well as at the Fairness Hearing. Laub also makes several arguments to the effect that no evidentiary basis exists for a finding that the Supplemental Plan is reasonable as modified. These arguments have already been addressed.

b. The Cerberus Objectors

[15] The Cerberus Objectors, who purchased more than $140 million of WorldCom securities during the Class period, have two objections to the Supplemental Plan. Both of these have been resolved by agreement with the Lead Plaintiff.

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First, the Cerberus Objectors contend that, in Paragraphs 18 and 19 of the Supplemental Plan, the methodology for determining Recognized Amounts for bonds purchased in the 2000 and 2001 Offerings overvalues the "aggregate value of consideration received" for the bonds in the WorldCom bankruptcy proceeding. The Supplemental Plan currently states the amount of consideration as $357 per $1000 face amount. The Cerberus Objectors argue that the amount of consideration is actually $255 per $1000 face amount for bonds exchanged for new common stock in accordance with WorldCom's Plan of Reorganization, as the $255 represents the corresponding market value of the common stock on the date the bonds were actually exchanged.

In WorldCom's Second Amended Joint Plan of Reorganization, approved by the bankruptcy court on October 21, 2003, WorldCom bondholders were given the choice of exchanging their notes for 14.28 shares of newly issued MCI common stock per $1000 face amount, new notes in a principal amount equal to $357 per $1000 face amount, or some combination of MCI common stock and new notes. Bondholders overwhelmingly opted for the notes, however, so the notes were oversubscribed. According to a September 13, 2005 submission by Lead Counsel, bondholders who requested notes in fact received only 46.85% of the notes that they sought; the remaining value of their distribution was in the form of MCI stock. Based on this ratio, the Lead Plaintiff proposes that the Supplemental Plan be altered to use a value of $302 per $1000 ***350** face amount of bonds to reflect the consideration received by bondholders in the WorldCom bankruptcy. Lead Plaintiff's proposal is fair and reasonable, and is approved.

Second, the Cerberus Objectors note that Paragraph 24 of the Supplemental Plan defines WorldCom Predecessor Bonds to include bonds issued by Intermedia, an entity acquired by WorldCom in September 2000, but does not provide a methodology for determining Recognized Amounts relating to purchases of Intermedia 13 1/2% Preferred Stock due 2009 ("Intermedia 13 1/2% Preferred Stock"). In response to this objection, the Lead Plaintiff notes that it did not originally have sufficient trading data for Intermedia 13 1/2% Preferred Stock but has since acquired more information. It has accordingly proposed a modification to the Supplemental Plan allowing Recognized Amounts to be calculated for purchases of this stock using the same methodology used in the Supplemental Plan to calculate Recognized Amounts for other forms of Intermedia preferred stock. Lead Plaintiff's proposal to allow Recognized Amounts to be calculated for the Intermedia 13 1/2% Stock is approved.[FN44]

FN44. The Cerberus Objectors dropped two of the four objections they originally filed. They argued that Paragraph 27.b. of the Supplemental Plan should be altered to reflect that the Net Market Loss (or Net Market Profit) of each claimant is to be determined by netting profits and losses only on securities purchased or acquired during the Class Period, rather than subsequent to the Class Period. At the Fairness Hearing, their counsel agreed that this alteration is unnecessary, as the Supplemental Plan, at Paragraphs 2 and 27, clearly indicates that Recognized Amounts are only calculated for purchases or acquisitions made during the Class Period.

The Cerberus Objectors also took issue with the fact that the Supplemental Plan does not provide a mechanism to dispute or appeal the Claims Administrator's determination of a claimant's Aggregate Recognized Amounts or Claim Form Amounts. As the Lead Plaintiff's reply brief explains, the Hearing Order prescribes a dispute resolution mechanism pursuant to which each Class Member who is determined to have a deficient or rejected claim will be sent a letter informing her of this determination and

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> will have thirty days from the date of the letter to supply documentation or an explanation to the Claims Administrator. If the Class Member does not respond, the Class Member's claim will be considered finally rejected. If the Class Member timely responds to the letter, Lead Counsel, through the Claims Administrator, will determine if the documentation or explanation has remedied the deficiency or rejection. If it has not, the claim will be deemed finally rejected at that time. All such finally rejected claims will be submitted to the Court when the Lead Plaintiff moves for an Order approving distribution of the settlement funds. Notice of any hearing on such a motion will be provided to all Class Members whose claims are disputed. In addition, Lead Plaintiff contemplates making two distributions of the settlement funds. The first distribution will be of approximately ninety percent of the overall funds, while ten percent will be held back to assure that sufficient funds remain in the event that a Class Member successfully objects to a distribution. At the Fairness Hearing, counsel for the Cerberus Objectors indicated that the procedures specified by the Lead Plaintiff were satisfactory.

c. Moulton

[16] Moulton contends that "intraclass conflicts" exist between purchasers of bonds in the 2000 and 2001 Offerings, who have Securities Act claims against the various defendants, and purchasers of other WorldCom securities. Since she characterizes her objection as one to the Plan of Allocation, she presumably does not intend to argue that conflicts of interest existed between these classes of securities holders in the prosecution of the action itself. Moulton's objection is entirely conclusory, and her attorney did not elaborate on it at the Fairness Hearing, but she appears to ***351** be objecting to the allocation of settlement funds between purchasers of bonds giving rise to Securities Act claims and purchasers of other securities on which Exchange Act claims are premised.

Moulton is correct that there is tension between the interests of Class Members with Securities Act and Exchange Act claims. With respect to the Underwriters' Settlements, however, it would be manifestly unfair to allocate those monies to purchasers of stock and pre-existing bonds with only Exchange Act claims, as the Underwriter Defendants faced only Securities Act claims arising from their participation in the 2000 and 2001 Offerings. The proceeds of the Directors', Andersen, Ebbers, and Sullivan Settlements are to be allocated in a 4:1 ratio of Exchange Act to Securities Act claims.[FN45] Although this ratio favors Class Members with Exchange Act claims, it is entirely appropriate given the very substantial recovery obtained for Class Members who purchased bonds in the 2000 and 2001 Offerings. The Class was represented by four named defendants, each with different stakes in the litigation. The Lead Plaintiff did not purchase bonds from the 2000 and 2001 Offerings, while the remaining three named defendants did do so. Their agreement that the 4:1 ratio is appropriate adequately addresses any concerns about the existence of a conflict. It is noteworthy that the Settlement Judges endorsed this ratio in their statement in support of the Andersen Settlement.

> FN45. This Opinion will not address the Plan of Allocation for the Citigroup Settlement, as the allocation of those funds was announced to the Class at the time of that settlement, and objections to the terms of the Citigroup Settlement that were not timely raised are now waived.

d. Norman

[17] Norman is the proposed class representative for a lawsuit brought by persons who participated in SSB's Guided Portfolio Management ("GPM") program (the "GPM Action"). The accounts in the GPM program were discretionary accounts, for which brokers rather than account hold-

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ers made the investment decisions. Norman alleges claims of breach of contract and breach of fiduciary duty, as well as a claim under the Investment Advisers Act of 1940, 15 U.S.C. § 80b–6, against SSB, one of the Citigroup Defendants. According to Norman, "[t]he core of [the GPM Action] complaint is that SSB invested its GPM customers' accounts based on research and ratings of securities SSB knew to be unreliable and provided by analysts who had a conflict of interest." The Norman action is pending before the Honorable Gerard E. Lynch. No class has been certified in the action. On June 9, 2004, finding that the complaint did not contain any allegation of fraud or misrepresentation, Judge Lynch denied a motion to dismiss the action that had argued that Norman's state law causes of action were preempted by Securities Litigation Uniform Standards Act (SLUSA). *Norman v. Salomon Smith Barney, Inc.,* 350 F.Supp.2d 382, 386 (S.D.N.Y.2004).

Despite the filing of his separate action, Norman did not opt out of the WorldCom class action. Norman objects to Paragraph 17 of the Supplemental Plan on the basis that it provides no recovery for GPM program members who sold securities before January 29, 2002. While he believes it may be appropriate to deny recovery to other Class Members who sold before that date, he contends that GPM program members should be treated differently. Although, as discussed above, Paragraph 17 of the Supplemental Plan is to be revised to provide Class Members who sold their WorldCom securities prior to January 29, 2002 with ten percent of the Recognized*352 Amounts for other losses sustained by Class Members, Norman's attorney indicated at the Fairness Hearing that Norman continued to object to the allocation insofar as it does not adequately compensate GPM program members. In addition, Norman asks for a set-aside of $50 million on behalf of all GPM program members who are Class Members to compensate them for what he estimates were their $500 million in trading losses. He argues that GPM program members deserve special treatment because of the uniqueness and strength of their claims.

The November 12, 2004 Opinion approving the Citigroup Settlement allowed Norman to renew a request for a set-aside when the Supplemental Plan was issued. *See WorldCom,* 2004 WL 2591402, at *13 n. 35. That Opinion also determined that, to the extent Norman's claims were based on the purchase of WorldCom securities, they were based on the "same underlying factual allegations against SSB that are at the heart of the [class action complaint]" and thus were properly barred by the claims release imposed pursuant to the Citigroup Settlement. *Id.* at *13. This Court's reasoning was recently confirmed in an opinion by Judge Lynch regarding Norman's objection to a virtually identical claims release in another securities litigation. *See In re Global Crossing Sec. Litig.,* No. 02 Civ. 910(GEL), 2005 WL 1668532, at *4 (S.D.N.Y. July 12, 2005) (concluding that, to the extent Norman's claims could be fairly characterized as arising out of or relating to a decision to invest in Global Crossing securities, their release was "entirely appropriate"). To the extent Norman's objection is a renewed attack on the Release, and the well-established principle that a release may bar causes of action other than those litigated in the class action, it is rejected.

Norman contends that the theory of damages applicable to the GPM Action is fundamentally different than the concept of loss causation applicable to the class action, and that the January 29, 2002 disclosure date on which the Supplemental Plan relies should thus not determine the distribution of settlement proceeds to GPM customers.[FN46] Norman is still unable to identify his theory of damages, however.[FN47] To the extent that Norman's claims are based on investments in securities issued by WorldCom, the damages calculation would certainly be based on a theory of loss due to the misrepresentations of WorldCom's financial condition and SSB's alleged complicity in that fraud. These factors explain the decline in the market price of WorldCom securities, a decline experienced by all securities holders regardless of where or how they

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held their securities. In this regard, the Supplemental Plan is as fair to GPM customers who sold their WorldCom securities prior to January 29, 2002 as it is to other Class Members who sold their securities prior to that date, because the loss causation analysis is the same. As explained with regard to the Laub objection, January 29, 2002 was the first date upon which the Lead Plaintiff could point to a partial corrective disclosure. The decline in the price of WorldCom securities prior to that date must therefore be attributed to factors other than the fraud.

FN46. Norman also notes that the GPM class action does not rest on the "fraud on the market" theory of causation. The "fraud on the market" theory applies to transaction causation, however, not loss causation. *See WorldCom,* 219 F.R.D. at 291.

FN47. Norman could not identify his theory of damages at the September 9 Fairness Hearing or at the Citigroup Settlement fairness hearing. *See WorldCom,* 2004 WL 2591402, at *12.

***353** As for Norman's request for a set-aside, it is completely lacking in merit. Norman provides no basis whatsoever for his damages figure on behalf of a class that has not even been certified. Moreover, he has provided no basis to find that the GPM claims are stronger than those prosecuted by the Class. Had that been his genuine belief, one would have expected someone seeking to represent a class of GPM account holders to opt out. Instead, he seeks to recover twice for losses associated with investments in WorldCom securities. It is telling that no other Class Member who purchased WorldCom securities through SSB is seeking special compensation. Because SSB's Jack Grubman was both the leading telecommunications analyst and cheerleader for WorldCom, SSB's recommendations were widely disseminated and can be fairly presumed to have affected the market for WorldCom securities and thus every investor in WorldCom. There is no principled basis to make a distinction in the amount of damages suffered based on the identity of a Class Member's broker. Norman's request for special treatment must accordingly be rejected.

4. Objection to the Proof of Claim Form

Thomason makes a narrow objection to the form of the Proof of Claim form. He notes that the Proof of Claim Form only has spaces for a Class Member to list direct purchases of WorldCom securities, and that there is no place to enter purchases of stock that were made for his benefit through an SSB Unit Investment Trust. Lead Counsel represents that such claims can be entered on the same form, with supporting documentation attached, and that the Claims Administrator will process such claims in the same manner as if the stock had been purchased directly by the Class Member. It represents that it has passed this information on to the few Class Members in Thomason's situation who have inquired. As such, Thomason's objection has been addressed.

Attorneys' Fees and Costs

When the Citigroup Settlement was approved in November 2004, Lead Counsel were awarded $141.5 million in attorneys' fees. Lead Counsel have applied for $194,600,000 in attorneys' fees for the 2005 Settlements, an amount which constitutes just under 5.5% of the total amount of the Underwriters', Directors', and Andersen Settlements.[FN48] Fees will be calculated separately for the Underwriters' Settlements and the Directors' and Andersen Settlements [FN49] so that no Class Member possessing solely Exchange Act claims (that is, claims arising from purchases of WorldCom securities other than those bonds issued in the 2000 and 2001 Offerings) will bear any part of the fee awarded on the basis of the Underwriters' Settlements. Broken down, the fee request is $187,720,000 for the Underwriters' Settlements, or approximately 5.5% of the $3,427,306,840 gained from those settlements, and $6,880,000 from the Directors' and Andersen Settlements, or approximately 5.5% of the $125,750,000 recovered in those settlements.

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The total lodestar calculation submitted by Lead Counsel totals $83,183,238.70 through June 30, 2005. ***354** When combined with the attorneys' fees awarded pursuant to the Citigroup Settlement, the amount sought is equivalent to a lodestar multiple of 4.0.[FN50]

> FN48. Lead Counsel obtained approval from the Lead Plaintiff, and from the Court on September 22, 2003, to employ a few other law firms to assist with document review and other discrete tasks under the supervision of Lead Counsel. This fee award will also compensate those assisting firms.

> FN49. Lead Counsel request no fees whatsoever for the Officers' Settlements, although those hours are used in the calculation of the total lodestar amount. Lead Counsel represents that, even if the time expended with respect to the Officers' Settlements was subtracted from the lodestar, the lodestar multiple would remain 4.0.

> FN50. Lead Counsel note that the Lead Counsel firms agreed to sustain their 2004 rates in 2005. If the firms had implemented a five percent fee increase, the lodestar multiple would be approximately 3.8. Moreover, fees are not requested for work that was performed by Lead Counsel after June 30, 2005, including filing papers in support of the settlements, plans of allocation, and supplemental plan; responses to objections; and the briefing of appeals.

In support of the application for attorneys' fees, Lead Counsel have provided an affidavit by Lebowitz[FN51] and a summary of time records, including hourly rates and number of hours worked, for all attorneys and paraprofessionals assigned to the case. The total number of hours worked was 277,862. Two firms, Barrack Rodos & Bacine ("Barrack Rodos") and Bernstein Litowitz Berger & Grossmann LLP ("Bernstein Litowitz"), accounted for 84,934 and 129,642 of these hours, respectively. The billing rates for Barrack Rodos, a firm based in Philadelphia, ranged from $350 to $580 per hour for partners, from $225 to $420 for associates, and from $90 to $175 for paralegals. The rates for Bernstein Litowitz, a New York City firm, ranged from $450 to $695 for partners, from $250 to $450 for associates, and from $155 to $185 for paralegals.[FN52]

> FN51. As previously noted, Lebowitz is General Counsel for the Comptroller of the State of New York.

> FN52. The Bernstein Litowitz summary reflects that one hour was worked by an associate billing at $500 an hour.

Despite full disclosure in the Class Notice that Lead Counsel would be requesting a fee not in excess of $195.4 million and payment of expenses in an amount not in excess of $12.5 million, no institutional investor has objected to this request, and many such investors are participating in the recovery achieved by the Class. Only one objection, that of Jane B. Selfe, remains to the attorneys' fees sought by Lead Counsel.[FN53] Selfe objects that 5.5% of such a large settlement fund is an unreasonable fee, citing *In re Domestic Air Transportation Antitrust Litigation,* 148 F.R.D. 297, 351 n. 76 (N.D.Ga.1993).

> FN53. An objection to attorneys' fees and expenses filed by Moulton was withdrawn by her counsel at the Fairness Hearing.

> It is unclear whether Selfe has standing to object to the application for attorneys' fees and expenses. The Lead Plaintiff represents that its records indicate that Selfe's only Class Period Acquisition of WorldCom Securities was through a stock split on December 31, 1999, a transaction that does not qualify as a true acquisition, and that Selfe did not file a proof of claim. Selfe submitted a reply stating that she did indeed "acquire"

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> WorldCom securities during this period, but she submits nothing to substantiate this claim. Selfe also notes that she filed a proof of claim, but that it was late "through oversight." In any event, this Opinion must consider the question whether the attorneys' fees sought are reasonable, and thus, the substance of Selfe's objection is squarely addressed.
>
> The Court is also in receipt of a letter from Gary L. Soderberg, who states, "I understand that there are many reasons for these [attorneys'] fees but this quantity appears prodigious." The substance of his concerns is likewise addressed in the discussion below.

[18][19] When attorneys create a common fund from which members of a class are compensated for a common injury, they are entitled to "a reasonable fee—set by the court—to be taken from the fund." *Goldberger v. Integrated Resources, Inc.*, 209 F.3d 43, 47 (2d Cir.2000) (citation omitted); *see also* 15 U.S.C. § 78u–4(a)(6) (In Exchange Act cases governed by the PSLRA, "[t]otal attorneys fees and expenses awarded by the court to counsel for ***355** the plaintiff class shall not exceed a reasonable percentage of the amount of any damages and prejudgment interest actually paid to the class."). Determination of "reasonableness" is within the discretion of the district court. *Goldberger,* 209 F.3d at 47. There are two methods by which the court may calculate reasonable attorneys' fees in a class action, the lodestar method and the percentage method. Applying either method, the court should consider the following factors, known as the *Goldberger* factors: (1) the time and labor expended by counsel; (2) the magnitude and complexities of the litigation; (3) the risk of the litigation; (4) the quality of representation; (5) the requested fee in relation to the settlement; and (6) public policy considerations. *Visa,* 396 F.3d at 121 (citing *Goldberger,* 209 F.3d at 50).

The lodestar method "calculates attorneys' fees by multiplying hours reasonably expended against a reasonable hourly rate." *Id.* at 123 n. 27. The court may determine that an enhancement of the lodestar is warranted "based on factors such as the riskiness of the litigation and the quality of attorneys." *Id.*; *see also Savoie v. Merchants Bank,* 166 F.3d 456, 460 (2d Cir.1999) (applying the lodestar steps).

[20] Under the percentage method, the fee award is simply "some percentage of the fund created for the benefit of the class." *Savoie,* 166 F.3d at 460. "The trend in this Circuit is toward the percentage method, which directly aligns the interests of the class and its counsel and provides a powerful incentive for the efficient prosecution and early resolution of litigation." *Visa,* 396 F.3d at 121 (citation omitted). This method has been found to be a solution to various problems inherent in the lodestar method, which "creates an unanticipated disincentive to early settlements, tempts lawyers to run up their hours, and compels district courts to engage in a gimlet-eyed review of line-item fee audits." *Id.* at 121. Because of the practical and policy advantages of the percentage method, as well as the PSLRA's express contemplation that the percentage method will be used to calculate attorneys' fees in securities fraud class actions, 15 U.S.C. § 78u–4(a)(6), this Opinion will apply the percentage method, with the lodestar used only as a cross-check of the reasonableness of the percentage of fees requested. *Cf. Visa,* 396 F.3d at 123. Where the lodestar fee is used as "a mere cross-check" to the percentage method of determining reasonable attorneys' fees, "the hours documented by counsel need not be exhaustively scrutinized by the district court." *Goldberger,* 209 F.3d at 50.

[21] Like the attorneys' fees awarded to Lead Counsel pursuant to the Citigroup Settlement, the fee request considered here accords with the retainer agreement negotiated in 2003 by the NYSCRF and Lead Counsel (the "Retainer Agreement") and has been submitted with the approval of the Lead Plaintiff. The Retainer Agreement was described in the December 11, 2003 notice to the class of the

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pendency of the class action, as well as in the notice of the proposed Citigroup Settlement mailed to Class Members in August 2004, and is posted on the Lead Counsel Website. The grid allows Lead Counsel to collect a higher fee for recoveries achieved in later stages of the litigation, but at the same time, provides for a lower percentage of recovery as the amount of recovery for the Class increases. The Retainer Agreement also adopted a lodestar ceiling for attorney's fees. For any recovery for the Class that exceeds $500 million, the attorney's fee is not to exceed the lesser of the grid amount or five times the lodestar. At the conclusion of the litigation, the NYSCRF may under certain circumstances adjust the fee so that it does not exceed four times the lodestar figure. The ***356** Retainer Agreement also imposes caps on certain expenses.

A district court is not required to adhere to a retainer agreement such as the one used to determine the fee amount requested here. *See Visa,* 396 F.3d at 123–24. Nonetheless, when class counsel in a securities lawsuit have negotiated an arm's-length agreement with a sophisticated lead plaintiff possessing a large stake in the litigation, and when that lead plaintiff endorses the application following close supervision of the litigation, the court should give the terms of that agreement great weight. *See In re Cendant Corp. Litig.*, 264 F.3d 201, 282 (3d Cir.2001) (concluding that fee agreements between class counsel and the lead plaintiff enjoy "a presumption of reasonableness" under the PSLRA); *WorldCom,* 2004 WL 2591402, at *20 (applying presumption of reasonableness where the Lead Plaintiff conscientiously supervised the work of Lead Counsel and endorsed the fee request). The establishment of criteria for the appointment of a lead plaintiff capable of exercising a significant supervisory role in the litigation, including management of the fees and costs, was an important innovation of the PSLRA. *See* Jill E. Fisch, *Lawyers on the Auction Block: Evaluating the Selection of Class Counsel by Auction,* 102 Colum. L.Rev. 650, 702–03 (2002) ("[T]he lead plaintiff provision [of the PSLRA] was designed to enable large, sophisticated investors to investigate, negotiate with, and monitor class counsel."); 15 U.S.C. § 78u–4(a)(3)(B)(1) (providing that the lead plaintiff shall be "the member ... of the purported plaintiff class that the court determines to be most capable of adequately representing the interests of class members"); *id.* § 78u–4(a)(3)(B)(iii)(bb) (listing, as one of three factors establishing a rebuttable presumption of "most adequate plaintiff" status, "the largest financial interest in the relief sought by the class").

The NYSCRF is the second largest public pension fund in the United States and lost over $300 million on WorldCom investments. *See WorldCom,* 219 F.R.D. at 275. It has been actively involved in overseeing every aspect of the litigation. Lebowitz attests that his office "carefully reviewed and analyzed" Lead Counsel's daily time and expense records and the hourly rates for each attorney and paraprofessional who worked in the case. The NYSCRF did not shy away from exercising its negotiating power to rein in attorneys' fees; as noted above, it refused to allow the Lead Counsel firms to raise their rates for 2005 for purposes of calculating the lodestar fee—"a significant concession," according to Lebowitz. Furthermore, the Retainer Agreement was not finalized until June 2003, after indictments had been filed against WorldCom officers and after a significant ruling had been issued on the motions to dismiss. *WorldCom,* 294 F.Supp.2d 392. The risks and rewards of the litigation were therefore clearer than they would have been at the inception of the lawsuit, further informing negotiations regarding the fee grid. All these facts weigh in favor of abiding by the Retainer Agreement.

The *Goldberger* factors similarly weigh in favor of approval of Lead Counsel's fee request. The fee request is well within the range of other awards courts have approved in mega-fund litigation.[FN54] *Visa* ***357** itself approved attorneys' fees that constituted 6.5% of $3.383 billion in compensatory re-

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lief recovered for the class. The lodestar multiple in that case was 3.5, but the court cited a district court's statement that multipliers of between 3 and 4.5 are common. *See Visa,* 396 F.3d at 123 (quoting *In re NASDAQ Market–Makers Antitrust Litigation,* 187 F.R.D. 465, 489 (S.D.N.Y.1998)). A number of other cases cited by Lead Counsel support the appropriateness of Lead Counsel's fee request on a percentage basis. *See, e.g., In re Lucent Techs., Inc. Sec. Litig.,* 327 F.Supp.2d 426, 445 (D.N.J.2004) (approving a fee constituting 17% of a $517 million common fund); *Shaw v. Toshiba Am. Info. Sys., Inc.,* 91 F.Supp.2d 942, 988 (E.D.Tex.2000) (approving a fee of 7% of a common fund valued at $2.1 billion); *NASDAQ,* 187 F.R.D. at 488–89 (approving a fee constituting 14%, or a 3.97 lodestar multiple, of a $1.027 billion common fund); *see also* cases cited *id.* at 487. *But see In re Cendant Corp. Litig.,* 243 F.Supp.2d 166, 172 (D.N.J.2003) (in "a simple case in terms of liability ... settled at an early stage, after little formal discovery," awarding only 1.7% of a $3.2 billion settlement (citation omitted)).[FN55]

FN54. It is noteworthy that William Lerach, who is now a named partner in the law firm Lerach Coughlin Stoia Geller Rudman Robbins LLP, actively solicited pension funds across the country to opt out of the WorldCom class action and file individual actions under a retainer agreement that provided a base fee of 12 or 13%, plus expenses, and a cap of 17%. *WorldCom,* 2003 WL 22701241, at *4. Those pension funds which accepted that solicitation run the risk of paying a hefty premium to their counsel over and above the attorneys' fees and expenses that will be paid by those who remained Class Members.

FN55. The case cited by objector Selfe, *In re Domestic Air Transportation Antitrust Litigation,* 148 F.R.D. 297, awarded attorneys' fees equivalent to 5.25% of a $305 million settlement fund. That case noted that, although fees of twenty to thirty percent are awarded in the typical common fund case, "fees in the range of 6–10% and even lower are common in [the] context [of megafund cases]." *Id.* at 351. The fee awards cited by the court in the accompanying footnote range from 3.5% for a $618 million settlement fund to 15% for a $171 million settlement. *Id.* at 351 n. 76. Nothing in that case's analysis commands a finding that Lead Counsel's fee request is unreasonable.

The magnitude and complexity of this litigation are well-recognized. The Lead Plaintiff asserted damages claims of over $10 billion for bondholders and scores of billions of dollars in losses to WorldCom stockholders. The disclosure of the fraud led to the largest bankruptcy in American history and spurred an extraordinary quantity of litigation, the centerpiece of which was this class action. Because there was so much at stake, the parties in the class action fought long and hard. The ferocity with which the parties fought to the eve of trial, and in one instance, through trial, are described in the many Opinions issued to resolve the parties' active motion practice. While the criminal and regulatory investigations were of enormous assistance to the Lead Plaintiff in its prosecution of this action, particularly in the description of the accounting manipulations, since those investigations concentrated on wrongdoing by WorldCom's insiders, they were of little assistance in the development of the Lead Plaintiff's claims against the Underwriter Defendants or even Andersen, which required the Lead Plaintiff to explain how Andersen's audits failed to comply with Generally Accepted Auditing Standards (GAAS).

The impressive extent and superior quality of Lead Counsel's efforts as of May 2004 were described in detail in the Opinion approving the Citigroup Settlement. *See WorldCom,* 2004 WL 2591402, at *17–*20. At the conclusion of this litigation, more than ever, it remains true that "the

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quality of representation that Lead Counsel has provided to the class has been superb." *WorldCom,* 2004 WL 2591402, at *20. The risks faced by the Class in obtaining further significant recovery in this litigation have already been described. Despite the existence of these risks, Lead ***358** Counsel obtained remarkable settlements for the Class while facing formidable opposing counsel from some of the best defense firms in the country. As Judge Sweet, one of the Settlement Judges in this litigation, aptly stated it in the *NASDAQ* case:

> The quality of opposing counsel is ... significant in considering the quality of services rendered by plaintiff's counsel, as measured by the result achieved.... The ability of Class Counsel to obtain record-breaking settlements in the face of a stubborn and well executed defense further evidences the excellent quality of petitioners' work.

NASDAQ, 187 F.R.D. at 488. Even with the absence of the Citigroup Defendants from the case, this litigation remained enormously complex, and much of the heavy lifting by Lead Counsel came after the Citigroup Settlement. In addition to completing fact discovery, preparing experts, undertaking discovery of the defendants' experts, and addressing a thicket of legal issues in opposition to the Underwriters', Andersen, and Roberts motions for summary judgment and the motions *in limine,* Lead Counsel faced the practical and tactical challenges of readying the cases against the Underwriter Defendants, Director Defendants, and Andersen for trial.[FN56] At trial against Andersen, the quality of Lead Counsel's representation remained first-rate. Lead Counsel and counsel for Andersen waged a vigorous courtroom battle, which included the submission of numerous letters to the Court and oral argument regarding evidentiary issues nearly every single day, while exhibiting impressive cordiality and professionalism toward each other and toward the Court.

> FN56. As noted above, the Underwriters' and Directors' Settlements occurred on the eve of trial, and the Andersen settlement at the close of the fourth week of trial.

The Lead Counsel firms also performed excellently on behalf of the Class in settlement negotiations. The Underwriters' Settlements were achieved after intensive negotiations with counsel for the individual Underwriter Defendants or small subsets of those defendants, and most settlements yielded funds exceeding the Citigroup Formula amount for Securities Act claims. To reach settlement agreements with the Director Defendants and the Officer Defendants, Lead Counsel and the Lead Plaintiff conducted a thorough examination of the financial status of each individual; a similar examination, performed in a flurry of activity over several short days near the end of the trial, made the Andersen Settlement possible. When negotiating the Ebbers Settlement, Lead Counsel negotiated not merely with Ebbers, but also with the U.S. Attorney's Office, MCI, and the WorldCom *ERISA Litigation* class plaintiffs' counsel, all entities with their own claims on Ebbers' resources, to construct an agreement that ultimately proved satisfactory to all concerned. Lead Counsel similarly worked with the U.S. Attorney's Office and ERISA counsel to achieve the Sullivan Settlement, and with the U.S. Attorney's Office to craft an agreement with insolvent defendants Myers and Yates. Again, Lead Counsel has not requested attorneys' fees in connection with the Ebbers, Sullivan, or Myers–Yates Settlements. The Citigroup Settlement Opinion mentioned the "cooperative spirit" that existed between Lead Counsel and Liaison Counsel for the Individual Actions. *See WorldCom,* 2004 WL 2591402, at *19. Lead Counsel have proven themselves adept at working with other counsel representing clients with varying, sometimes competing interests in the settlement context as well.

***359** Public policy also supports the approval of this fee request. The size of the recovery achieved for the class—which has been praised even by several objectors—could not have been achieved without the unwavering commitment of Lead Counsel to this litigation. Several of the lead

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attorneys for the Class essentially devoted years of their lives to this litigation, with the personal sacrifices that accompany such a commitment. If the Lead Plaintiff had been represented by less tenacious and competent counsel, it is by no means clear that it would have achieved the success it did here on behalf of the Class. In order to attract well-qualified plaintiffs' counsel who are able to take a case to trial, and who defendants understand are able and willing to do so, it is necessary to provide appropriate financial incentives. After all, this litigation was conducted on an entirely contingent fee basis, and Lead Counsel paid millions of dollars to fund the litigation. While some significant recovery in a case of this magnitude may seem a foregone conclusion now, the recovery achieved here was never certain. It is only the size of the Citigroup and Underwriters' Settlements that make this recovery so historic, and it is likely that less able plaintiffs' counsel would have achieved far less.

There is yet another public policy benefit to be acknowledged. In this case, the work performed by Lead Counsel also inures to the benefit of those who opted out of the Class. It was Lead Counsel who developed, led, and took the bulk of the discovery in the *Securities Litigation.* Under the terms of the Consolidation and Coordination Orders entered in the *Securities Litigation*, that discovery is available to plaintiffs' counsel in all Individual Actions. Moreover, the settlements that Lead Counsel and Lead Plaintiff achieved serve as benchmarks for recoveries in all of the Individual Actions.

Finally, the fact that an active and well-qualified Lead Plaintiff has approved this fee and that the Class has not objected to it are also appropriate to consider when judging the public policy of approving a fee award that in its aggregate gives Lead Counsel $336.1 million in fees based on a total lodestar of approximately $83.2 million. This endorsement may reflect their judgment about the integral role that competent plaintiffs' counsel play in insuring the integrity of U.S. securities markets and supplementing the enforcement work of the SEC in that regard.

Costs and Expenses

[22] Lead Counsel also seeks $10,736,948.25, plus interest, for reimbursement of expenses incurred since the Citigroup Settlement. Of this amount, $5,389,994.17 is for payment of expenses by Lead Counsel; $2,365,301.37 is owing from a litigation fund to which Lead Counsel and certain of the assisting firms had contributed; FN57 $11,063.54 is for payment of the Lead Plaintiff's expenses; FN58 and $2,970,589.17 is for payment to the Garden City Group, the Claims Administrator in the case, for the costs of mailing notices and processing claims for the class. In ***360** support of the application for reimbursement of expenses, the Lead Counsel firms have submitted, in addition to the Lebowitz Affidavit mentioned above, summaries of allowed expenses from September 1, 2004, to June 30, 2005 for each Lead Counsel firm, and at the Court's request, a summary of payments to experts and consultants.

FN57. The Citigroup Settlement had provided for the creation of a $5 million Litigation Fund out of the settlement proceeds to finance the continued prosecution of the class action against the remaining defendants, *see WorldCom,* 2004 WL 2591402, at *22, but that Litigation Fund was never funded.

FN58. Reimbursement of Lead Plaintiff's expenses is appropriate. *See* 15 U.S.C. § 78u–4(a)(4) ("Nothing in this paragraph shall be construed to limit the award of reasonable costs and expenses ... directly relating to the representation of the class to any representative party serving on behalf of a class.").

Reimbursement of the expenses sought by Lead Counsel is appropriate. *See LeBlanc–Sternberg v. Fletcher,* 143 F.3d 748, 763 (2d Cir.1998). Lebowitz attests that the Lead Plaintiff has audited the

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expenses. In fact, it disallowed more than $200,000 in submitted expenses incurred since the Citigroup Settlement. The Lead Plaintiff approves of Lead Counsel's submission. As no objection remains to the amount of costs sought by Lead Counsel, and the expenses do not appear facially unreasonable, the application for reimbursement of expenses is approved.

Conclusion

Lead Plaintiff's petition for approval of the 2005 Settlements is granted, with the three alterations to the Supplemental Plan, as noted above. Lead Counsel's application for attorneys' fees and expenses for the 2005 Settlements is also granted.

SO ORDERED:

S.D.N.Y.,2005.
In re WorldCom, Inc. Securities Litigation
388 F.Supp.2d 319

END OF DOCUMENT

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Case Name:
Gould v. BMO Nesbitt Burns Inc.

Between
Tim Gould and Archie Leach, Plaintiffs, and
BMO Nesbitt Burns Inc., Blackmont Capital Inc., Canaccord Capital Corporation, National Bank Financial Inc., Sprott Securities Inc., TD Securities Inc., BDO Seidman, LLP, FMF Capital Group Ltd., FMF Capital LLC, FMF Holdings, LLC, Michigan Fidelity Acceptance Corporation, PKF, LLC, Thomas Little, Atul Shah, Michael Hoffman, Edan King, Howard Morof, Robert Pilcowitz, Eric Slavens, and Lorie Weisberg, Defendants

[2007] O.J. No. 1095

45 C.P.C. (6th) 360

156 A.C.W.S. (3d) 25

2007 CarswellOnt 1720

Court File No. 49348 CP

Ontario Superior Court of Justice

M.C. Cullity J.

Heard: March 14, 2007
Judgment: March 23, 2007.

(56 paras.)

Civil procedure -- Settlements -- Approval -- Motion by the representative plaintiffs for approval of a settlement and counsel fees allowed -- The plaintiffs incurred losses on securities issued, marketed and sold by the defendants -- They claimed aggregate general and punitive damages of $135 million for negligence, negligent misrepresentation and breaches of the Competition Act -- The settlement provided for a fund of $28.6 million to be divided among class members -- The court certified the proceeding for the purpose of implementing the settlement, which was reasonable in its amount and

terms -- Fees were capped at $4.5 million given the speed settlement was reached.

Statutes, Regulations and Rules Cited:

Class Proceedings Act, s. 5(1), s. 5(1)(a), s. 5(1)(b), s. 5(1) (d), s. 5(1)(e), s. 32, s. 32(2), s. 32(4)(a), s. 33

Competition Act, s. 36, s. 52

Ontario Business Corporations Act, R.S.O. 1990, c. B.16,

Counsel:

Charles M. Wright, A. Dimitri Lascaris and H. Juroviesky - for the plaintiffs.

Ronald G. Slaght Q.C. and Jordan Goldblatt - for BMO Nesbitt Burns Inc., Thomas Little and Atul Shah.

Margaret Waddell - for FMF Capital Group Ltd., FMF Capital LLC, FMF Holdings, LLC, Michigan Fidelity Acceptance Corporation, PKF, LLC, Michael Hoffman, Eric Slavens, Lorie Weisberg, Edan King, Howard Morof, and Robert Pilcowitz

F. McLaughlin and Jeffrey Feiner - for TD Securities Inc.

Reena Goyal - for National Bank Financial Inc.

Gavin Smyth - for Sprott Securities Inc.

Timothy Banks - for BDO Seidman.

David Mitchell - for Canaccord Capital Corporation and Blackmont Capital Inc..

REASONS FOR DECISION

1 M.C. CULLITY J.:-- The plaintiffs' motions to approve the settlement of this class proceeding, and the fees of class counsel, were initially set down to be heard on January 25, 2007. On that date, after hearing the submissions of counsel, and of one of the putative class members who addressed the question of class counsel's fees, the hearing was adjourned to permit another member - Mr. Richard Byers - who had provided a written objection to the settlement to expand on his concerns. After further communications were received from him, the hearing resumed on February 23, 2007 and class counsel responded to his objections. In an endorsement released on

March 7, 2007, I declined to approve the settlement but provided counsel with an opportunity to file material, and make further submissions, on what I considered to be inadequacies in the record.

2 Additional affidavit material was then filed and addressed by counsel on March 14, 2007. At the conclusion of the hearing I indicated that I was satisfied that, in principle, the settlement should be approved. Subject to the comments I will make on particular provisions of the settlement agreement, there will be an order to this effect and an order certifying the proceeding for the purpose of implementing the settlement.

Background

3 The litigation concerns losses made by purchasers of income-participating securities ("Securities") issued by FMF Capital Group Ltd ("FMF Group"). FMF Group was incorporated under the *Ontario Business Corporations Act,* R.S.O. 1990, c. B.16 on October 20, 2004 for the purpose of an initial public offering ("IPO") of the Securities. Each of the Securities has two components: a common share, or equity component; and a subordinated note, or debt component. The prospectus stated that monthly distributions of dividends or interest were intended to be made. The value of the Securities, and the ability to declare dividends, and pay interest, on them was derived from subprime mortgage loans made by FMF Capital LLC ("FMF Capital") in the United States residential real estate market. As such loans are made to borrowers with a low credit rating, and may be made with relatively low margins, they are accompanied with a degree of risk that would not normally attach to residential mortgages. These risks were disclosed in the prospectus.

4 FMF Group has a 60 per cent indirect interest in FMF Capital. The remaining 40 per cent indirect interest is owned by Michigan Fidelity Acceptance Corporation (" MFAC") and PKF, LLC ("PKF"). PKF is allegedly controlled by the defendants, Edan King and Robert Pilcowitz, and 90 per cent of the equity of MFAC is owned by trusts for their families. Each of the above corporations - other than FMF Group - is incorporated in the United States.

5 The IPO of the Securities was made in Canada pursuant to a prospectus dated March 16, 2005. It closed on March 24, 2005 and the Securities were then listed, and traded, on the Toronto Stock Exchange ("TSX"). Dividends were declared, and interest paid, monthly, through October, 2005. On November 14, 2005, FMF Group announced that the declaration of dividends was suspended, and payments of interest deferred. The following day the listed price of the Securities on the TSX fell by 76.7 per cent. The price has continued to fall. At the close of trading on January 9, 2007, the Securities were trading at $ 0.17 compared with the offering price under the IPO of $10.00.

6 Since the initial hearing of these motions, the TSX has suspended trading of the Securities, and has informed FMF Group that they will be delisted on April 5, 2007. On March 9, 2007, FMF Group announced its decision to wind up the business and operations of FMF Capital as a result of the "continuing rapid and severe deterioration of the US nonprime mortgage industry and other factors affecting its overall nonprime mortgage business".

The litigation

7 The statement of claim in this action was issued in London, Ontario on January 25, 2006. A similar class proceeding (the "Michigan action") had been commenced in Michigan State Court on December 5, 2005. On March 21, 2006, a class proceeding was commenced in Quebec on behalf of residents of the Province who purchased Securities either in the IPO or, subsequently, over the TSX. Since that time the plaintiffs and their counsel in the three actions have attempted to co-ordinate their resources and efforts in the litigation, and the proposed settlement is intended to resolve and dispose of the issues in each of the proceedings.

8 Following amendments to the complaint filed in Michigan, the defendants in that action now include each of the defendants to this proceeding. In addition, the family trusts that own 90 per cent of MFAC are named as defendants in the Michigan proceedings. Subject to the general exclusion of residents of Quebec from the class in this proceeding, and their inclusion in the class in the Quebec action, the proposed class is defined in substantially the same manner in each of the three actions.

9 Although, strictly, I am concerned only with whether the action in Ontario should be certified, and the settlement of it approved, it was necessary to consider whether a proposed dismissal of the Michigan action would be in the interests of the putative class in this proceeding.

The parties

10 The plaintiffs purchased Securities under the IPO and, also, subsequently over the TSX before November 16, 2005. They seek to represent purchasers who would not be included in the class for which certification is sought in Quebec and who fall within each of the two categories ("Class I" and "Class II"). Of the 20 defendants, eleven consist of the corporations I have mentioned, a related holding company and certain directors and senior officers of them. These have been referred to by counsel as the "FMF Defendants". The remaining defendants consist of six underwriters, and an accounting firm, who were involved in the IPO, and a director and analyst of the lead underwriter, BMO Nesbitt Burns Inc.

The claims

11 The plaintiffs claim compensatory damages for negligence, negligent misrepresentation and breaches of sections 36 and 52 of the *Competition Act*. Punitive damages are also claimed. Expert evidence filed on behalf of the plaintiffs estimates the maximum aggregate, compensatory damages at approximately $135 million.

12 The misrepresentations consist of allegedly untrue statements in the prospectus for the IPO and, in particular, the omission of facts required to prevent other statements in the prospectus from being misleading. In addition to the prospectus misrepresentations, it is pleaded that certain of the defendants negligently made statements to, or withheld information from, the public that should be considered material to their decisions as prospective investors in the Securities. These allegations

are particularised in the pleading.

13 Underlying the claims with respect to material misrepresentations and non-disclosure is the general allegation that an extraordinary growth in FMF Capital's loan volume in the period preceding the IPO was accompanied by a degradation of its underwriting standards that led to repurchase demands by institutional purchases of the loans for which the corporation's loan loss reserves were, to the knowledge of defendants, inadequate.

The course of the proceedings

14 From the outset, the defendants indicated their intention to deny liability and to contest the claims made against them if the actions proceeded to trial. Motions to dismiss the proceedings in Michigan and to limit rights of discovery and the examination of witnesses there have been made. Apart from a successful motion by the defendants to change the venue of this action from London to Toronto, there have been no orders on motions in this proceeding to date. There is, however, a pending motion by the plaintiffs to stay this action until certification is denied, or the issues have been determined, in Michigan. The defendants have indicated their intention to oppose that motion on the ground that Ontario is the more convenient forum - the mirror image of part of their motion in the Michigan court to dismiss the action there.

15 Although Mr. Byers has characterised the motions in Michigan, and the pending motion here, as "legal manoeuvring", I am satisfied that they were much more than preliminary skirmishes. They highlight the existence of jurisdictional, procedural, practical and substantive legal issues that could impact significantly on the outcome of the litigation. Even if the likelihood of appeals from whatever disposition of the pending motions is made could be disregarded, I do not think there is any doubt that, if the litigation is to continue to a final judicial resolution, its complexity is such that it will very likely be protracted over a period of several years. It will be inordinately expensive to the parties and in terms of judicial resources. Moreover, at this stage - for the reasons I will give - there can be no guarantee of any satisfactory recovery for the members of the class. In short, this is pre-eminently a case in which the parties should be encouraged to reach a settlement that falls within a zone of reasonableness. The question is whether the proposed settlement is such.

The settlement

16 The settlement agreement was made between the plaintiffs and the defendants in each of the three actions with the exception of certain defendants in the Michigan proceedings. The latter are the spouses of Edan King and Robert Pilcowitz and the trustees of the trusts that own MFAC. The trusts are alleged to have received the greater part of the proceeds of the IPO and claims against them in respect of fraudulent conveyances and unjust enrichment are made in the Michigan proceedings. Although not parties to the settlement agreement, they are intended to be "third party beneficiaries" of it and to be entitled to all the rights it purports to confer on them - including releases of all claims that the class may have against them.

17 The agreement provides for a settlement fund consisting of (a) (US) $21 million to be provided by insurers of certain of the FMF Defendants; (b) (Can) $3,750,000 to be provided by the underwriters; and (c) (Can) $800,000 to be provided by the accounting firm involved in the IPO. The fund is to be distributed among the class in accordance with a Distribution Protocol after payment of class counsel's fees and certain expenses, including the expenses of giving notice to, and locating, class members, assisting them to make claims, and administering and distributing the balance of the fund to them. The fund ($28,625,504) has been deposited with class counsel and is earning interest of approximately $100,000 a month.

18 In consideration of those payments, all claims against the defendants - including the trusts - in the three actions are to be released without an admission of liability.

19 The Distribution Protocol is intended to permit the net settlement fund to be divided among the class members in a manner proportionate to the loss suffered by each of them with a discount factor applied to the amounts otherwise distributable to Class II members to reflect increased certification and substantive litigation risks affecting their claims.

20 Expert evidence was filed that estimated the loss per Security suffered by Class I members as falling within a range of 77 cent(s) to $7.74, and by Class II members from 46 cent(s) to $4.60. The mid-point within each range has been accepted for the purposes of the protocol.

21 Independent counsel were retained to negotiate the appropriate discount factor on behalf of the members of each of the classes. Their joint recommendation of a discount of 26 per cent is reflected in the protocol.

22 As well as the above considerations, which will require an individual determination in respect of each claimant, further adjustments are proposed to deal with a number of variables that will include: (a) whether members sold Securities prior to November 15, 2005; (b) whether they continued to own securities after that time; (c) whether they acquired Securities over the TSX as well as under the IPO; and (d) the total number of Securities purchased by class members whose valid claims are filed in a timely manner.

23 In view of the above, the Distribution Protocol is necessarily elaborate and complex and this created difficulties in summarising its contents and effect in the notices of the settlement approval hearing that were provided to purchasers of the Securities. The notices informed them of their ability to obtain further information from class counsel, or from counsel's website which contained the settlement documents including the protocol.

Analysis

24 The requirement that settlements of class proceedings must be approved by the court was enacted to ensure that the interests of the class members who will be bound by the settlement would be protected. In a case like this, where certification has not preceded the motion for settlement

approval, the concern is lessened by the right to opt out that will be provided to members who do not agree with the settlement after it has been approved. The concern, however, continues to exist because the right to opt out provides less than perfect protection for the interests of persons who are not before the court. The necessity for court approval is particularly important in cases where the factual and legal issues are complex and the task of assessing the litigation risks is difficult.

1. The governing principles

25 The principles that the court applies when considering approval of the settlement have been stated and discussed in numerous cases, including *Dabbs v. Sun Life Assurance Co of Canada* (1998), 40 O.R. (3d) 429 (G. D.), at page 444, affirmed (1998), 41 O.R. (3d) 97 (C.A.); *Parsons v. Canadian Red Cross Society*, [1999] O.J. No. 3572 (S.C.J.), at paras 77 - 80; *Fraser v. Falconbridge Ltd*, [2002] O.J. No. 2383 (S.C.J.), at paras 13 - 14; *Ford v. F. Hoffmann-La Roche Ltd*, [2005] O.J. No. 1118 (S.C. J.), at paras 110 - 118; and *Nunes v. Air Transat A.T. Inc.*, [2005] O.J. No. 2527 (S.C.J.)

26 As a settlement is necessarily a compromise of the competing rights asserted on behalf of the parties, it is necessary to consider the likelihood that the plaintiffs would be successful if the litigation continued and the future expense and likely duration of the proceeding, and to weigh these factors against the benefits that the settlement would provide. In deciding whether to grant, or withhold, approval, the court must consider whether the settlement is fair, reasonable and in the best interests of the class. It does not hold the parties to a standard of perfection. It is sufficient if the terms and effect of the settlement on the interests of the class fall within a zone of reasonableness.

27 Although the requirement of court approval is not a formality, and an exercise of judgment is required, the court will rarely, if ever, be in a position to weigh the benefits of the settlement against the litigation risks and likely outcome of the proceeding with the thoroughness and acuteness of experienced class counsel involved in the litigation. For that reason, a degree of deference is given to counsel's recommendation of the settlement if the court is satisfied that it was the result of arm's-length negotiations without collusion.

2. Conflicts of interest

28 As the Ontario Law Reform Commission recognised in chapter 20 of its *Report on Class Actions* (Ministry of the Attorney-General, 1982), an important threshold aspect of the court's consideration must be the adequacy of representation provided by the plaintiffs and their counsel and the potential conflicts between their respective interests and those of other class members. I have no concerns of this kind here. The proposed representative plaintiffs are by no means unsophisticated investors. Each of them purchased securities under the IPO and also on the secondary market and there is nothing in the record to suggest that they have interests that conflict with those of other putative class members under the settlement agreement, or otherwise.

29 Where, as here, counsel will also be seeking approval of an agreement for a contingency fee

expressed in terms of a percentage of the gross recovery in the action, there will be a concern to see that counsel have not succumbed to a temptation to prefer their own interests by recommending a speedy settlement that would provide them with rewards disproportionate to the work they have performed and the benefits for the class. At the same time, it must be noted that an early settlement of the proceedings can be very much in the interests of the class members.

30 The motion to approve the settlement in this case is not conditioned on the court's approval of the fee counsel are requesting. Although the time records they have filed indicate that the possibility of settlement was considered, and discussed, from virtually the inception of the proceedings, I do not find this to be in any way unusual, or inconsistent with an exercise of professional judgment in the light of the respective interests of the parties faced with potentially protracted litigation of this nature.

31 Having considered the settlement at some length, I see no basis for any concern that in recommending the settlement to their clients, counsel were acting inconsistently with their professional obligations to the representative plaintiffs and the class, or that they were improperly influenced by the existence of the contingency fee agreement. They are experienced in class proceedings and, from my examination of the material filed and having heard the submissions of class counsel, I am satisfied that the settlement was arrived at in arm's-length negotiations with the numerous defendants and their similarly experienced counsel. In these circumstances, I am satisfied that I should give considerable weight to their professional judgment when assessing the litigation risks and the other factors that have a significant bearing on the merits of the settlement.

3. Litigation risks

32 Although the decline in the value of the Securities was dramatic - even spectacular - and the claims asserted on behalf of the plaintiffs were by no means frivolous, I am, as I have indicated, satisfied that the proceedings would have been protracted and, from the viewpoint of the plaintiffs and the class, that the litigation risks were considerable. Apart from the issues affecting the appropriate forum, and differences between the substantive laws of Ontario and Michigan, there are also questions relating to the enforcement of foreign judgments and the prospects of recovery against certain defendants. Although important, and to varying degrees, difficult, these issues were, in counsel's judgment, increasingly overshadowed by fundamental factual considerations of causation underlined by a general and continuing decline in the subprime mortgage market in the United States - a matter that would bear on both the defences of the defendants on the facts, and the extent of damages if liability was ultimately established.

4. The settlement fund

33 In the retainer agreements executed by the plaintiffs in December, 2005, they acknowledged that counsel had advised that the amount of a reasonable settlement could be in a range of $10,000,000 to $50,000,000. By the time notice of the settlement approval has been given and class members' individual claims have been received and processed, it is estimated that the gross

settlement fund will amount to more than $29 million. When the benefits of having this amount - less fees, disbursements and expenses - available within a relatively short period are weighed against the litigation risks, I am not prepared to find that it, and the other provisions of the settlement agreement, fall outside the required zone of reasonableness. This includes the provisions of the Distribution Protocol which are based, in part, on the report of a qualified firm of consultants in economic damage quantification for complex litigation, on the recommendations of experienced counsel with respect to the Class II discount and, otherwise, on assumptions that I consider to be reasonable.

34 To the limited extent that guidance can be obtained from analyses of amounts recovered in securities cases in the United States, the settlement amount is not out of line.

5. Objections

35 Mr. Byers was the only prospective class member to file, or voice, objections to the settlement. He criticised it as a settlement of convenience that does not properly or fairly represent the best interests of the class members. I have referred above to his description of the motions in Michigan and the pending motions in Ontario as mere legal manoeuvring, and not meaningful progressive steps to advance the claims against the defendants. I am satisfied that this criticism reflects a misapprehension of the importance of those motions if, as he evidently wishes, the litigation were to continue. Among other things, success for the defendants would have created obstacles for any attempt to follow the proceeds of the IPO into the trusts that are defendants in the Michigan action. On this issue - and generally - I differ from Mr. Byers in my assessment of the benefits that are likely to be achieved for the class if the proceedings are to continue. I am satisfied that he has not appreciated fully the risks involved in prosecuting these proceedings to an eventual trial, or the length of time that would inevitably elapse - and the expense that would be incurred - before their final resolution.

36 Mr. Byers stated that he finds it incomprehensible that litigation of this magnitude could be settled so quickly. To the extent that this is intended to imply that plaintiff's counsel had not expended the time and effort required to investigate and assess the relative strengths and weaknesses of their case, I am satisfied from my review of the record - including the time sheets they provided - that the suggestion is unwarranted. This is not intended as a criticism of Mr. Byers' comments. His objections were helpful in focusing attention on a number of issues as well as the extent to which information about the settlement had been communicated to class members and the adequacy of the notice of the settlement approval hearing. As a consequence, further material was filed, further submissions were made by counsel, and the adjournment of the hearing provided members with a further opportunity to have access to materials filed on the motion. Any of the class members who share Mr. Byers' conviction that a claim could be advanced successfully against the underwriters, or other defendants, will have an opportunity to opt out of the proceedings and to pursue their separate claims in court, or otherwise. To that extent, they should not be prejudiced by this court's approval of the settlement.

37 The matters on which I considered the original material filed to be inadequate included the proposed dismissal of the Michigan action and the question whether this would be in the interests of the class in this proceeding. One of the concerns raised by Mr. Byers - and on which further material was filed and submissions made on March 14, 2007 - related to the effect of the dismissal of the Michigan action on the ability of class members to have recourse against the family trusts that are alleged to have received the greater part of the proceeds of the IPO. There was evidence, which I see no reason to reject, that a judgment of this court against the trusts might not be recognised and enforced in Michigan. While I was not entirely persuaded by the other evidence, or by counsel's submissions, on the substantive law of that jurisdiction that supposedly might withhold a restitutionary remedy against the trustees in the Michigan action, I am satisfied that any such remedy would necessarily be predicated on findings of liability there against the defendants to this proceeding. On that basis, and although the litigation risks in the Michigan action were not identical to those of this proceeding, I am satisfied that no material distinction should be drawn between the two actions for the purpose of this motion.

6. Appeals from decisions of the Claims Administrator

38 My only remaining concern about the proposed settlement is the absence of any provision for arbitration, in the event that claims are denied in full, or in part, by the Claims Administrator. This requires attention. The settlement is otherwise approved.

Certification

39 There will also be an order certifying the proceeding for the purposes of implementing the settlement. The requirements for certification in section 5(1) of the CPA are, in my judgment, satisfied. Causes of action for negligent misrepresentation and negligence have been pleaded against the defendants: section 5(1)(a); there are two classes, or subclasses, of purchasers of the Securities: section 5(1)(b); subject to my comments below, the claims of the members of the classes raise common issues: section 5(1)(c); a class proceeding is the preferable procedure for disposing of the claims: section 5(1)(d); and the representative plaintiffs will fairly and adequately represent the interests of the class and, for the purposes of certification, the settlement agreement may be considered to contain an acceptable litigation plan: section 5(1)(e).

40 The sole common issue proposed by class counsel was as follows:

> What claims to the Class 1 Members and the Class II members have against the Defendants arising from the Defendants' alleged acts, omissions, disclosures or non-disclosures relating either to the IPO, or subsequent alleged acts, omissions, disclosures or non-disclosures relating to the [Securities].

41 Given the purpose for which certification was requested, it is unnecessary to consider the extent to which the common issue would otherwise advance the proceeding but, in my judgment, it is too broadly stated. Insofar as it is to be understood as referring to valid claims, it would include

issues that could only be decided individually. Although, but for the settlement, it might be necessary to define the issues more elaborately, and to separate those arising from the claims of the two classes, or subclasses, I believe the following would be satisfactory for the present purposes:

> Did the Defendants, or any of them, breach duties of care owed to the Class 1 Members, or the Class II Members, by reason of the alleged acts, omissions, disclosures or non-disclosures relating to the IPO, or subsequent alleged acts, omissions, disclosures or non-disclosures relating to the Securities.

42 In the notice of settlement approval and certification, the opting out deadline referred to in the settlement agreement is to be extended from 30 days to 60 days after the short form approval notice is published. Any other matters concerning the terms and dissemination of notice can be discussed at a case conference.

Fees of class counsel

43 The representative plaintiffs moved for the court's approval of class counsel's fees in the amount of $6,000,000, plus disbursements in the amount of $289,416.49 and GST in the amount of $123,900.38 for a total of $6,413,316.87. These amounts would be payable out of the gross settlement fund in respect of the past, and future, professional services and disbursements of the six law firms retained on behalf of the plaintiffs in the proceedings in Ontario and Michigan. The firms were Siskinds LLP ("Siskinds") counsel for the plaintiffs in this action; Bernstein, Litowitz, Berger and Grossman, New York counsel retained to assist Siskinds in its initial investigation and analysis of the relevant law and facts; Juroviesky Ricci LLP, counsel for the plaintiffs in the Michigan action; Frank, Haron, Weiner and Navarro, Michigan counsel retained for the purpose of the Michigan action; and Strosberg Sutts LLP and Rochon Genova LLP, counsel retained by Siskinds for the purpose of the Class II discount.

44 The fee represents 24.66 per cent of the amount of the settlement fund notionally allocated to the Ontario action after 15 per cent of the fund has been attributed to the proposed settlement of the proceedings in Quebec. It is in line with the Siskinds retainer agreements with the representative plaintiffs that provided for a contingency fee of 25 per cent of any recovery by way of settlement, or judgment, in the action. Although the plaintiffs in the Michigan action had agreed to a fee of 33 per cent of the total value of the settlement, their counsel - the Juroviesky firm - have supported the motion for a global fee of $6,000,000. The fee is intended to cover the work performed in respect of the settlement motion and any further services that may be required in connection with the administration of the settlement by the Claims Administrator. I see no reason why the latter should be substantial or be permitted to have any significant impact on the size of the contingent fee.

45 Putting on one side for the moment the reasonableness of the amounts, I have no problem with the request to approve fees and disbursements in respect of the Michigan, as well as the Ontario, action. The settlement and the settlement fund are applicable to each of the actions and, although strictly, I may have jurisdiction under the CPA to deal only with the fees attributable to this

proceeding, I see no reason why I cannot, with the consent, and at the request, of the parties, deal with all the fees and disbursements in accordance with the practice and principles applied in this court.

46 Although there were separate proceedings in Ontario and Michigan, there was, in reality, one piece of litigation conducted on two fronts. In the circumstances, I am not prepared to find that this was unreasonable. Neither of the proceedings was frivolous and the advantages of one over the other would not have been apparent at the outset. Practical, as well as different legal, advantages and disadvantages for the parties attached to each and, as I have indicated earlier in these reasons, the pending motion to stay the proceedings here until the termination of the Michigan action might well have had an important, although at this stage necessarily unpredictable, bearing on the outcome of the litigation - if it had continued.

47 The representative plaintiffs filed substantially identical affidavits in which they referred to the fee provisions in the retainer agreements and expressed their support for applications to the court consistent with their terms. The affidavits were prepared by their counsel and there is no evidence that they obtained independent legal advice. They did not expressly state their belief that the fees requested by counsel are fair and reasonable from the viewpoint of the class but I am satisfied that this is to be inferred and that they were aware that, without court approval, the fee agreements would be unenforceable.

48 Section 32(2) of the CPA requires that fee agreements with representative plaintiffs are not enforceable without the consent of the court. The court must still be satisfied that their effect will not be unduly and unfairly detrimental to the interests of the class. Despite the agreement of the plaintiffs, the complexity of the issues involved in the litigation, and the quality of the services performed, I have had serious concerns about the size of the fee requested given, in particular, the relatively short period between the commencement of the proceedings and the negotiation of the settlement. Similar concerns were addressed at the initial hearing by one of the investors, Mr. David McDonald.

49 My concerns were enhanced when counsel attempted to persuade me that the fee of $6 million would represent a multiplier of less than three times the value of the time that will have been expended by the conclusion of the matter. As of January 17, 2007, the time sheets and dockets provided on behalf of the six law firms recorded time of more than 50 lawyers, paralegals and students for a total value of $1,776,430.20. As I have earlier indicated, the Michigan action was commenced on December 5, 2005 and this action on January 25, 2006. While I do not question that the docket entries record time actually spent, they fall far short of satisfying me that it was productive time, or time that might otherwise properly be charged to a client, or allowed for the purpose of determining a base fee pursuant to section 33 of the CPA. Many of the entries are repetitive, and inscrutably uninformative, and suggest, rather than exclude, the possibility of an amount of duplication and unnecessary work. The time sheets of the Juroviesky firm, in particular, are replete with general references to research and analysis, and time spent reviewing materials and

memoranda prepared by, or emails received from, other lawyers. Almost $40,000 of time is, for example, attributed to "Research & analysis re: FMF share price decline, service of process". Counsel's reliance on the docketed time appears explicable only on an assumption that every minute with a possible connection to the litigation could properly be charged to the clients and the class. On April 4, 2006 the Juroviesky firm reported time spent " Preparing FMF documents for meeting and cleaning the office". The time was not significant but its inclusion in the materials filed in support of the motion was indicative.

50 Between November 15, 2005 and early January 2006, when discussions to co-ordinate work with Siskinds commenced, the Juroviesky firm, with little previous experience in class action litigation, recorded time valued at almost $400,000. Much of this was spent on introductory research and analysis - work that was also performed by Siskinds. Time is included on the defendants' successful challenge to the venue chosen by Siskinds for the Ontario action and, from early October until the conclusion of the second hearing on February 23, 2007, the firms recorded time valued at more than $200,000 finalising the settlement and preparing for the approval motions, including the motion in respect of their fees. Overall, although I do not denigrate the high professional quality of the work performed, or the benefits achieved for the class, the time recorded is, in my judgment, significantly in excess of that which could properly be charged to a client in the absence of a contingency fee agreement.

51 The fees awarded to plaintiffs' counsel in class actions are often astronomical compared with those in other civil proceedings. They can provide an enormous, and understandable, incentive to lawyers to be over-generous in their allocation of their time and their resources. Inflated expectations of counsel can be reflected in inflated hourly rates as, for example, in the rate of $810 per hour reported by one of the senior counsel who performed supervisory work in the preparation of an opinion on the Class II discount. The hourly rates of other lawyers increased significantly during the proceeding but, overall, I do not consider them to be unreasonable.

52 The application of a multiplier to a base fee is just one method of computing a contingency fee under the provisions of the CPA. It may also be helpful in some circumstances in testing the reasonableness of a fee that is expressed as a percentage of recovery in an agreement between counsel and representative plaintiffs. Its utility is more limited in a case like this where the proceedings were settled in a relatively short time. In these circumstances, the speed with which a resolution of the issues was effected can itself be considered to be a significant benefit for the class. To the extent, however, that class counsel have relied on the multiplier method to justify their fee request, my review of the time records they have provided, and of the course of the proceedings, has satisfied me that a reasonable base fee for past and future professional services would not exceed $1,000,000.

53 While an agreement for a contingency fee of 25 per cent has been approved in this jurisdiction in other cases, it may well be excessive if, at the time the fee agreement was executed, there was a reasonable likelihood that a quick settlement would be obtained. Most class actions settle and I have

no doubt that, in accepting the retainer by the representative plaintiffs, Siskinds - the firm that took the lead in the co-ordinated litigation - hoped, and intended, to concentrate its efforts and resources in attempting to negotiate a settlement as quickly as possible. I have no doubt also that, from the outset, the firm was alive to the prospect that the defendants would not wish to be involved in lengthy cross-border proceedings in two jurisdictions and might well be interested in an early settlement. The firm's dockets suggest that the first settlement meeting occurred as early as February 16, 2006 - approximately three weeks after the statement of claim in the Ontario action was issued. The plaintiffs agreed to a settlement in principle with the FMF Defendants less than five months later.

54 I am satisfied that, when the retainer agreements with Messrs Gould and Leach were executed in December 2005, Siskinds was aware that there was a reasonable possibility that an early settlement would be reached. There is no evidence that they informed their clients of this, or of the possibility of having variable percentages in the retainer agreements to accommodate the possibility of an early settlement.

55 In determining whether the fee requested in this case is excessive, it is necessary to be careful not to rely on hindsight, or to penalize counsel for the quality of their work and the success they achieved in negotiating an early settlement. It is also necessary to recognize that, in December 2005, when they accepted the retainers from Messrs Gould and Leach that made their fees and disbursements contingent on success in the litigation, there was only a reasonable possibility, and no certainty, that the defendants would settle. The risks counsel assumed were not negligible. They are, nevertheless, very experienced in class action litigation and must be presumed to have been cognizant of the possibility of a speedy recovery, as well as the risks they were assuming.

56 I have not, in terms, been asked to approve the fee agreements in this motion. Counsel have, however, relied on sections 32 and 33 of the CPA as grounds for their motion for approval of the fees. In these circumstances, I have a discretion under section 32(4)(a) to determine the amount of an appropriate fee: see *Garland v. Enbridge Gas Distribution Inc.*, [2006] O.J. No. 4907 (S.C.J.), at para 23. I believe, also, that counsel have the burden of demonstrating that the contingency fee they request is fair and reasonable remuneration for the professional services they have rendered to their clients and the members of the class and may perform during the administration of the settlement. They have not satisfied me that global fees in excess of an amount of $4.5 million would be justified or, indeed, that the agreements that provided for a fee of 25 per cent of the gross recovery irrespective of the length of the proceedings should be approved in these circumstances. In my judgment, a global fee of $4,500,000 would represent fair and reasonable compensation for the work performed - and to be performed - the risks that were assumed, and the benefits that were obtained for the class. Accordingly, there will be an order approving fees of that amount, plus the disbursements claimed and GST as applicable.

M.C. CULLITY J.

cp/e/qlcct/qlpwb

Court File No. CV-13-481761

ONTARIO
SUPERIOR COURT OF JUSTICE

Cosimo Borrelli, in his capacity as trustee of the
SFC LITIGATION TRUST

Plaintiff

- and -

GEORGE HO, ALBERT IP, DAVID J. HORSLEY,
ALFRED C.T. HUNG, and SIMON YEUNG

Defendants

STATEMENT OF CLAIM

Notice of Action issued on May 31, 2013

1. The plaintiff, Cosimo Borrelli, claims in the capacity of a representative and/or trustee (the "**Trustee**") of the Sino-Forest Corporation ("**SFC**") Litigation Trust pursuant to a Litigation Trust Agreement dated January 30, 2013 (the "**Trust Agreement**") and pursuant to a plan of compromise and reorganization (the "**CCAA Plan**") and an Order of the Ontario Superior Court of Justice (Commercial List) (the "**CCAA Court**") dated December 10, 2012 (the "**CCAA Plan Sanction Order**"):

   a. damages in an amount to be specified prior to trial for losses suffered as a result of breach of contract, breach of duty (contractual, tortious, equitable, fiduciary, statutory, regulatory and/or other duties), misrepresentation, conspiracy, breach of trust, fraud, and/or duty of care and skill by, negligence by and/or unjust

enrichment of the Defendants, including as knowing recipients and/or knowing assistors or de facto directors, officers or agents;

b. punitive damages in the amount to be specified prior to trial;

c. an order for an accounting of profit and tracing of profits made by the defendants in connection with their relationship with SFC;

d. an order for restitution and/or such other equitable remedy for the breaches of duties and other tortious conduct referred to in subparagraph 1(a);

e. pre-judgment and post-judgment interest on a compound basis or alternatively in accordance with the Courts of Justice Act, R.S.O. 1990, c. C-34;

f. payment of applicable Harmonized Sales Tax on any sums awarded in favour of the plaintiff, including costs;

g. costs of this action on a substantial indemnity scale; and

h. such further and other relief as this Honourable Court deems just.

2. The claims asserted herein relate to the defendants' activities as directors and officers of SFC and its subsidiaries and are claims that belonged to and could have been advanced by SFC and its subsidiaries, prior to those claims being transferred pursuant to the CCAA Plan as described below. The claims asserted herein are not claims of the trustees in connection with the notes issued by SFC.

I. OVERVIEW

3. Until June 2011, SFC was one of Canada's most valuable forestry companies, and the

largest single forestry company throughout the People's Republic of China (the "**PRC**"). Ultimately, the company's market capitalization grew to $6 billion, based in large part on SFC's remarkable year-over-year growth in revenues. In less than six years, SFC's annual revenues increased from US$20.5 million to US$1.9 billion. Its asset base grew from roughly US$30 million to almost US$6 billion in that same timeframe.

4. SFC's remarkable story came to a dramatic conclusion in the summer of 2011. A short seller hedge fund, in concert with other similar hedge funds, published a report in June of 2011 that contained sensational allegations of fraud, corruption, and illegal activity at SFC. The report alleged, among other things, that SFC was a "multi-billion dollar ponzi scheme ... accompanied by substantial theft."

5. SFC, through the work of an independent committee (the "**IC**") and a dedicated board of directors, sought to investigate and if possible dispute the allegations made by the short sellers. At the same time, SFC was required to respond to investigations brought by the Ontario Securities Commission (the "**OSC**"), the Royal Canadian Mounted Police, and ultimately proceedings brought by the OSC.

6. SFC was unable to issue its third quarter 2011 financial statements because of the many questions that had been raised by the hedge funds' report, the IC, SFC's auditors, Ernst & Young ("**E&Y**"), the OSC, and others. In March 2012, SFC filed for protection under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (the "**CCAA**"). After fully canvassing the market, SFC determined that it was unable to find a buyer willing to purchase its assets for an amount equal to its outstanding debt. Pursuant to the CCAA Plan Sanction Order, SFC's assets were effectively transferred to its creditors, with roughly $6 billion in equity value having been wiped out.

7. George Ho, Albert Ip, Alfred C.T. Hung and Simon Yeung (the "**Overseas Management**") are responsible for the demise of SFC. Overseas Management was part of an inner circle of Hong Kong and China-based management who, through a combination of activities that ran the gamut ranging from sloppy record keeping to more general mismanagement, through to outright fraud and theft, caused SFC to materially overstate the value of SFC's revenues and assets and to conceal personal profits made in connection therewith. Among other things, Overseas Management:

(a) had operational and *de facto* control over allegedly arms-length purchasers of SFC's timber known as "authorized intermediaries" ("**AIs**") and the Suppliers of that timber ("**Suppliers**"), which control had not been disclosed to SFC, its auditors, or its directors;

(b) knew that certain of SFC's AIs and supplier counterparties were incapable of performing the obligations required of them by their contracts with SFC;

(c) withheld and/or hid information from SFC's auditors;

(d) prepared, certified and/or published false or materially misleading financial statements (including interim financial statements) and public disclosure documents of SFC and/or its subsidiaries (the "**Subsidiaries**");

(e) concealed their unlawful activities from SFC through the use of personal non-company e-mail accounts and by issuing instructions to hide certain transactions from SFC's accounting department in Hong Kong;

(f) forged SFC contracts to evade restrictions imposed by China's State Administration of Foreign Exchange ("**SAFE**") and/or to establish banking credit

that would not have otherwise been provided to SFC;

(g) entered into transactions that evidenced a circular flow of funds created for unknown or improper purposes;

(h) manipulated short term incentive program targets for SFC for the 2008 fiscal year, resulting in the payment of management bonuses beyond those properly due;

(i) entered into a number of transactions including transactions identified by the OSC that were suspicious if not outright fraudulent;

(j) failed to maintain SFC's records in a manner that would be expected of a publicly traded company, including by carrying out a practice of backdating contracts;

(k) caused moneys to be paid out by SFC and/or the Subsidiaries for no proper purpose; and

(l) prepared and/or published false information in connection with the debt or equity issues set out in Schedule 2 to the Notice of Action.

8. The plaintiff's claims against Overseas Management are for all losses and damages, equitable compensation and restitution necessary to compensate SFC for the losses caused in connection with or arising out of their acts or omissions in the direction and/or management of and/or dealings of SFC and/or its Subsidiaries.

9. In addition, the plaintiff claims against the defendant David Horlsey ("**Horsley**") for his role in contributing to the collapse of SFC. These claims, particularized below, flow from Horsley's acts and omissions as Chief Financial Officer of SFC.

II. THE PARTIES

10. The plaintiff, Cosimo Borrelli, is an individual resident in Hong Kong. Pursuant to the Trust Agreement, Mr. Borrelli was appointed as the Trustee of the SFC Litigation Trust.

11. Under the Trust Agreement and the CCAA Plan Sanction Order, the Litigation Trust Assets (as defined therein) of SFC, which included the Litigation Trust Claims (as defined therein), the Litigation Funding Amount (as defined therein), and any other assets acquired by the Litigation Trust on or after the effective date pursuant to the Trust Agreement or the CCAA Plan, were transferred to the SFC Litigation Trust.

12. The Litigation Trust Claims consist of any and all claims or causes of action which have been or may be asserted by or on behalf of (a) SFC against any and all third parties; or (b) the trustees (on behalf of the former noteholders in SFC) against any and all persons in connection with the notes issued by SFC, other than in either case (i) any claim, right or cause of action against any person that is released pursuant to Article 7 of the CCAA Plan; or (ii) any Excluded Litigation Trust Claim (as defined in the CCAA Plan).

13. Under the CCAA Plan Sanction Order, the CCAA Court ruled that there had been good and sufficient notice and service of the Plan Filing and Meeting Order and the Meeting Materials (as defined therein), which materials described the nature of the trust assets being transferred. The CCAA Plan Sanction Order further deemed effective the transfer, assignment and delivery of the Litigation Trust Claims, which effected by means of legal assignment the transfer of the litigation claims asserted herein.

14. All of the members of Overseas Management were de jure or de facto directors and/or officers of SFC. At all relevant times, SFC was a reporting issuer in the province of Ontario

whose shares traded on the Toronto Stock Exchange (the "**TSX**"). SFC was incorporated under the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44. At all relevant times, SFC's registered office was located in Mississauga Ontario, and its executive office was located in Hong Kong.

15. The defendant George Ho ("**Ho**") is an individual resident of Hong Kong. Prior to joining SFC, Ho obtained a degree in accounting from Simon Fraser University. From at least 2008 until his employment was terminated by SFC in 2012, Ho was the Vice President, Finance (China) of SFC. Along with all of the other Overseas Management, Ho was alleged by Staff of the Ontario Securities Commission (the "**OSC**") to have engaged in a complex fraudulent scheme to inflate the assets and revenue of SFC and was alleged to have made materially misleading statements in SFC's public disclosure record related to its primary business.

16. The defendant Albert Ip ("**Ip**") is an individual resident of Hong Kong. From 1997 to April 17, 2012, Ip was the Senior Vice President, Development and Operations North-east and South-west China of SFC. Ip received an Enforcement Notice from Staff of the OSC in 2012 in relation to his involvement in the alleged massive fraud at SFC. Ip resigned from SFC for health reasons on March 30, 2012.

17. The defendant Horsley is a Canadian citizen and resident of the Greater Toronto Area. Horsley was the Senior Vice President and Chief Financial Officer of SFC from October 2005 to April 2012. On April 17, 2012 Horsley resigned as the Chief Financial Officer but continued to be employed by the Company in its restructuring efforts. On September 27, 2012, SFC terminated Horsley's employment.

18. The defendant Alfred C.T. Hung ("**Hung**") is a resident of Hong Kong. Hung was the Vice President, Corporate Planning and Banking of SFC from at least 2004 to April 17, 2012. In

late August 2011, Hung was placed on administrative leave by SFC, and on April 17, 2012, his employment was terminated by SFC. Hung received an Enforcement Notice from Staff of the OSC in 2012 in relation to his involvement in the alleged massive fraud at SFC.

19. The defendant Simon Yeung ("**Yeung**") is a resident of Hong Kong. Yeung was the Vice President -- Operations within the Operations/Project Management Group of Sino-Panel (Asia) Inc., a subsidiary of SFC from at least June 30, 2006 to April 17, 2012. In late August 2011, Yeung was placed on administrative leave by SFC, and on April 17, 2012, his employment was terminated by SFC. Yeung received an Enforcement Notice from Staff of the OSC in 2012 in relation to his involvement in the alleged massive fraud at SFC.

III. OVERVIEW OF SINO-FOREST'S BUSINESS

A. General

20. SFC was an integrated forest plantation operator and forest products company, with assets predominantly in the PRC. Its stated principal businesses included the ownership and management of forest plantation trees, the sale of standing timber, wood logs and wood products and the complementary manufacturing of downstream engineered-wood products.

21. In addition, SFC held an indirect majority interest in the Greenheart Group, a Hong Kong listed investment holding company, which, together with its subsidiaries, owned certain rights and managed hardwood forest concessions in the Republic of Suriname and radiata pine plantation on freehold land in New Zealand.

22. As of March 30, 2011, a total of 137 entities made up the SFC group of companies: 67 PRC incorporated entities (with 12 branch companies), 58 BVI incorporated entities, 7 Hong Kong incorporated entities, 2 Canadian entities and 3 entities incorporated in other jurisdictions.

B. The Business Model

23. There are four types of rights associated with timber plantations in the PRC, namely (i) plantation land ownership, (ii) plantation land use rights, (iii) timber ownership, and (iv) timber use rights. All of these are separate rights and can be separately owned by different parties.

24. Generally, private enterprises cannot own plantation land in the PRC but may hold plantation land use rights for a specified duration (up to 70 years but typically 30 to 50 years), timber ownership and timber use rights. Foreign enterprises are not prohibited by law from acquiring timber ownership and timber use rights.

25. For its timber business in the PRC, SFC utilized two models, one involving BVI entities ("**BVIs**"), and the other involving subsidiaries incorporated in the PRC as wholly foreign owned enterprises ("**WFOEs**").

26. The BVI structure was the model primarily used by SFC for its forestry business in the PRC. By 2011, SFC had established 58 BVI companies. Not all of these BVIs were involved in the BVI model or standing timber business. Of the 58, there were 20 involved in the BVI standing timber business while the remaining BVIs were either holding companies or used in SFC's log trading business.

27. Overseas Management caused SFC to publicly state that the BVIs involved in the standing timber business acquired standing timber from "suppliers". The Suppliers were supposed to be third party aggregators who acquired the standing timber and, typically, land use rights from other Suppliers or from original timber owners. As non-PRC companies, the BVIs could not and did not acquire land use rights in the PRC, and instead only acquired the rights to timber in the PRC pursuant to the relevant standing timber purchase contracts.

28. The BVI model did not involve the BVIs concurrently acquiring the plantation land use rights or leases of the underlying plantation land with the purchase of standing timber, as the BVIs cannot legally acquire plantation use rights. However, the BVIs' supply contracts typically contained a right of first refusal for the BVIs to acquire, or nominate an affiliate to acquire, the plantation land use rights after the timber had been harvested.

29. The BVIs did not sell standing timber directly to customers. Instead, they conducted the sale of standing timber through AIs (which are also called "entrusted sales agents" in the BVI model) pursuant to "entrusted sales agreements". The AIs served as SFC's customers under the BVI model of its standing timber business.

30. The BVIs did not directly pay the Suppliers or receive payments from the AIs. Instead, the AIs were instructed by Overseas Management to make "set-off payments". Pursuant to the instructions of SFC, AIs were supposed to make payments directly or indirectly to SFC's Suppliers for amounts owed by the BVIs to those Suppliers. As a result, no cash actually flowed directly through the BVIs. SFC then received confirmations from the AIs and Suppliers confirming that payments had been made and received respectively.

31. The nature of the BVI model meant that SFC could not obtain cash from its BVI model operations or monetize its BVI model assets without engaging in a complicated and uncertain process.

32. The BVI model only made sense at all insofar as the AIs and Suppliers were arm's length third party purchasers or vendors. Absent that arm's length, the Board and SFC's auditors could have no assurance of the legitimacy of the BVI transactions, as opposed to simply being composed of circular paper transactions for the benefit of insiders.

33. The WFOE structure was created in or about 2004. Commencing in 2004, the PRC's Ministry of Commerce permitted foreign investors to invest in PRC-incorporated trading companies and to participate in most areas of the commodity distribution industry, including the purchase of standing timber and land use rights throughout the PRC. Prior to this time, WFOEs were prohibited from engaging in the commodity distribution industry.

34. Unlike BVIs, WFOEs could acquire land use rights or land leases as well as standing timber rights, and could have bank accounts in the PRC. Because of the WFOEs' direct presence in the PRC, they could more readily obtain financing from PRC banks to finance their operations. WFOEs could log the timber and sell both logs and standing timber to end customers, which means they did not need to use AIs. The WFOEs directly paid the Suppliers for the standing timber and directly received payment from end customers instead of utilizing the set-off arrangement used by SFC's BVI entities in the BVI model.

IV. SECRET CONTROL OVER AIs AND SUPPLIERS

35. Overseas Management fraudulently concealed their control and the control by other insiders at SFC over the Suppliers, AIs and other nominee companies, principally though not exclusively in the BVI side of SFC's business. Overseas Management established a collection of "nominee" or "peripheral" companies that were controlled by various "caretakers" who were employees of SFC or otherwise closely associated with the principals of SFC. By controlling the Suppliers, AIs, and peripheral companies, Overseas Management were carrying out transactions which either overstated the economic substance of the transactions, or which were entirely fictitious.

36. Moreover, these Suppliers, AIs and other nominee companies would have been considered to be "related parties" under generally accepted accounting principles ("**GAAP**") and

standards ("**GAAS**"). Related party transactions are considered to be not arm's length transactions that represent fair market value. The value of such transactions are susceptible to manipulation by insiders and therefore, under GAAP and GAAS, are not *per se* reliable for fair value determinations.

37. By falsely holding out these Suppliers, AIs, and other nominee companies as unrelated third party counterparties, Overseas Management exposed SFC to significant peril at the hands of regulators, shareholders, and other stakeholders. There was no legitimate business purpose either for carrying out transactions with such related parties, or for causing SFC to represent that such entities were unrelated third parties.

38. Overseas Management personally profited from their inside relationships with the related party Suppliers, AIs, and other nominee companies. The full particulars of the defendants' relationships with each of the related party Suppliers, AIs and peripheral companies, are known only to the defendants. Further particulars, including particulars of the secret profits made by Overseas Management in connection with such related party entities, will be provided prior to trial.

1. Kun'an

39. One of SFC's major Suppliers was Guangxi Hezhou City Kun'an Forestry Co., Ltd. ("**Kun'an**"). Kun'an was a PRC limited company that was established on January 20, 2009. Its registered office was located in Hezhou City, Guangxi, PRC. Over the years, SFC recorded and publicly disclosed that it had purchased hundreds of millions of dollars of timber assets from Kun'an. For example, in 2009, roughly 30% of all of SFC's plantation assets were purchased (by BVI entities) and leased (by Sino-Panel) from Kun'an.

40. Additionally, in March 2008 – nine months before the company even existed – Overseas Management caused SFC to record that Kun'an purchased $49 million worth of timber assets from SFC. Particulars of that transaction are described in the section entitled "Genga Fraud #2" below.

41. Contrary to Overseas Management representations to SFC, Kun'an was not an independent third party. The defendants Ip and Yeung helped to establish Kun'an. Its manager was Huang Ran, a former or perhaps current employee (the facts surrounding his employment are known only to Overseas Management) of SFC who was involved in numerous of the transactions referred to below.

42. By September 2009 – nine months after it was established and eighteen months after the company allegedly purchased $49 million of timber assets from SFC – the defendant Yeung urged Huang Ran to recruit "one or two clerks, tellers, or even merchandisers, to construct Kun'an to be a company with certain scale, instead of a one-person shell company." Another SFC employee, Qianhui Wu, responded using a personal address, agreeing with Yeung.

43. Undisclosed to SFC by Overseas Management was that they actually controlled Kun'an. Overseas Management developed a spreadsheet entitled "Companies held by managers and/or nominee shareholders overview", which listed more than 120 of SFC's "suppliers", AIs and other counterparties. Kun'an's registered shareholders were nominees only, nominated by Overseas Management to make it appear that Kun'an (and other suppliers) were independent third parties, when they were not. At all material times, Overseas Management, through the use of "caretakers", owned, managed, controlled and directed Kun'an.

2. Yuda Wood

44. Without limiting the generality of the foregoing, Overseas Management controlled Huaihua Yuda Wood Co. ("**Yuda Wood**"), which was allegedly SFC's largest supplier from 2007 to 2010. During that time period, SFC claimed to have paid Yuda Wood $650 million.

45. Unknown to SFC's board of directors or shareholders, in fact, Yuda Wood was registered and capitalized by Overseas Management, who also controlled bank accounts of Yuda Wood and key elements of its business. In or about July 1998, Overseas Management incorporated Sonic Jita Engineering Co. Ltd., the parent company of Yuda Wood. In or about 2006, the defendants Yeung and Ip assisted in the incorporation of Yuda Wood.

46. The defendant Ho had authority to supervise a Yuda bank account into which Sino-Panel deposited payments for timber assets allegedly purchased from Yuda Wood. At various times the defendants and other SFC personnel at their direction had access to Yuda's documents or chops.

47. Overseas Management controlled Yuda Wood through their relationship with Huang Ran, Yuda Wood's legal representative and SFC's former employee.

48. After Yuda Wood was identified and questioned by Muddy Waters in its report (described in the section entitled "Muddy Waters Report" below), Overseas Management and Huang Ran caused Yuda Wood to be deregistered. As quickly as Yuda Wood appeared and established a multi-hundred million dollar business, Yuda Wood disappeared entirely.

3. Dongkou

49. Dongkou Shuanglian Wood Company Limited ("**Dongkou**") was SFC's most significant AI, purportedly purchasing approximately $125 million in 2008, representing 14% of SFC's

revenue that year.

50. Undisclosed to the investing public or the Board of SFC was the fact that Overseas Management controlled Dongkou. Within 18 months of its incorporation in 2005, two SFC employees became the sole shareholders of Dongkou. Subsequently, the defendants controlled Dongkou through one of SFC's subsidiaries, Shaoyang Jiading Wood Products Co. Ltd. By 2007, at the direction of Ip and others, SFC employees drafted purchase contracts on Dongkou's behalf.

51. The fact that Dongkou was controlled by the inside management group of SFC meant that Dongkou was effectively a related party to SFC. By fraudulently holding Dongkou out as an independent third party and for causing SFC to treat Dongkou as a third party for accounting purposes, Overseas Management caused SFC's financial statements to be materially misstated.

4. Other Related Parties

52. As stated above, Overseas Management developed a "caretaker list", which set out a number of SFC's major Suppliers and AIs and their nominee shareholders. The full particulars of the related party status of all of SFC's Suppliers and AIs are known only to the defendants, and in all events further particulars will be provided prior to trial. Insofar as SFC recorded any transactions with parties that were in fact related parties at the direction of Overseas Management, such misrepresentations placed SFC in significant peril with securities regulators and all of its stakeholders. Such transactions undermined the accuracy of SFC's books and records and materially contributed to SFC's inability to issue audited financial results, as discussed below.

V. FRAUDULENT AND/OR QUESTIONABLE TRANSACTIONS

53. Overseas Management caused SFC and its subsidiaries to enter into a number of transactions (the "**Transactions**") that were fraudulent and/or devoid of any legitimate business purpose. Some of the Transactions were identified by the OSC as fraudulent transactions, and are *per se* unlawful beyond any related party aspect of them. All of the Transactions materially contributed to SFC's downfall.

54. In the alternative, if the Transactions were not outright fraudulent, they were sufficiently suspicious and devoid of legitimate business purpose that Overseas Management, as *de facto* officers of a public company, should have studiously avoided them. Entering into such transactions constituted a breach of the duty of care that Overseas Management owed to SFC both at common law and under the *CBCA*.

A. Absence of Evidence of Timber Asset Ownership

55. As a public company and a reporting issuer, SFC was expected to make complete and accurate disclosure about its assets. As the core management group at SFC, the defendants were responsible for internal and public reporting on operations, including SFC's acquisition of assets. At all material times, SFC had a reasonable expectation that assets Overseas Management purchased with company funds were accompanied with appropriate evidence of legal ownership. Such evidence of legal ownership was further required by GAAP and GAAS to be properly recorded as actual acquisitions by the company.

56. Overseas Management failed to obtain adequate supporting documentation and evidence of title for timber assets purchased and sold by SFC's BVI subsidiaries, which constituted most of SFC's timber assets and therefore the value of SFC. 80% by value of SFC's timber assets was

purportedly evidenced by purchase contracts entered into by the BVI subsidiaries ("**Purchase Contracts**"). The Purchase Contracts purported to have three attachments: plantation rights certificates ("**Certificates**") or other ownership documents; timber survey reports ("**Survey Reports**"); and farmer's authorization letters ("**Farmers' Authorizations**"). Additionally, Overseas Management purported to rely on PRC Forestry Bureau confirmations ("**Confirmations**") to evidence ownership.

57. Critical in any documents evidencing ownership is a sufficiently accurate description of what was being purchased. The Purchase Contracts and Confirmations did not sufficiently identify the trees or other timber assets purportedly purchased by SFC. It is not possible to identify approximately 80% of SFC's stated standing timber assets by reference to the Purchase Contracts and Confirmations.

58. The Confirmations were not legally recognized documents evidencing ownership or title of timber assets. The Confirmations were granted to Overseas Management as favours and were not intended by the Forestry Bureau to be disclosed to third parties and were not intended to be relied upon as legal evidence of title. Moreover, many of the Confirmations were in fact created by Overseas Management and employees working at their direction, and were backdated to suit Overseas Management's purposes.

59. The supporting documentation required to be attached to the Purchase Contracts were either insufficient or missing entirely. Without limiting the generality of the foregoing:

(a) none of the Purchase Contracts had any Farmers' Authorizations attached. Absent such authorizations, there was no evidence that title to timber was properly transferred to the "supplier" prior to the purported transfer to SFC; and

(b) the Survey Reports were conducted by a single firm who had a conflict of interest, Zhanjiang Southern Forestry Products Quality Supervision Co., Ltd. ("**Zhanjiang Southern**"). At all material times, Lu Qiding ("**Qiding**"), an SFC employee and a key member of its timber acquisition team, was a 10% shareholder of Zhanjiang Southern. At all material times, another 80% of the shares of Zhanjiang Southern were held by a former SFC employee. Drafts of these reports, which were held out to be drafted by an independent company, existed on computers of SFC employees who reported to Qiding and Overseas Management. These Survey Reports were relied upon by SFC's auditors, and Overseas Management intended for the auditors to rely on the Survey Reports.

60. The absence of sufficient legal evidence to demonstrate SFC's ownership of billions of dollars of timber assets was a material contributor to SFC's inability to obtain an audit opinion and to market the assets for sale to a third party in the Sales Process, defined and described below. The magnitude of this problem was aggravated by the serious questions raised about the independence of AIs and Suppliers and prior representations by Overseas Management, as described above.

B. Dacheng Frauds

61. The defendants committed a number of frauds through a series of transactions in 2008 involving Guangxi Dacheng Timber Co. Ltd. ("**Dacheng**"). Dacheng was ostensibly a "supplier" who sold timber assets to SFC at a price of RMB 47 million (approximately CAD $8 million). The purchase price was funneled through Dacheng's bank accounts and returned back to SFC's subsidiaries, shown to be revenue collected by those subsidiaries.

62. Further, Overseas Management caused SFC to record these timber assets "purchased"

from Dacheng twice in the books and for inflated amounts. In addition to recording these assets at the purchase price in the WFOE books, the defendants caused SFC to record these same assets at a value of RMB 205 million (approximately CAD $34 million) on the BVI books, notwithstanding that the BVI entities had nothing to do with the purchase of these assets and the assets had already been recorded on the WFOE subsidiaries' books.

63. Then, in 2009, the defendants caused the BVI entities to record a "sale" of these standing timber assets that the BVI entities did not actually purchase (and which had already been double counted on the books) for RMB 326 million – a one-year gain of RMB 121 million from the fictious numbers created on the BVI books, or RMB 279 million (approximately CAD $46 million) from the actual purchase price paid by the WFOE entities before the money was funneled back to SFC.

64. The Dacheng fraud gave the appearance that SFC was engaging in legitimate business activity, and in fact, highly lucrative activity through the purchase and sale of timber assets for a quick and virtually cost-free return on investment. The defendants caused SFC's own funds to be circulated within the SFC enterprise, giving the illusion not only of building an asset base, but also building revenues for the operating arms of SFC.

65. The Dacheng fraud was emblematic of the brazen frauds committed by Overseas Management, with multiple levels of fraud often occurring within a single transaction or series of transactions. The "proceeds" of the Dacheng transaction were then further employed in the purported acquisition of additional timber assets, resulting in a further compounding of the effects of the original fraud(s).

C. The "450,000 Fraud"

66. In 2009, the defendants secretly used a number of companies to create a fictitious purchase and subsequent sale of 450,000 cubic metres of timber assets (the "**450,000 Assets**"). Every aspect of this series of transactions was an abject fraud.

67. First, the defendants caused SFC, through three subsidiaries of Sino-Panel, to "purchase" the 450,000 Assets from Guangxi Hezhou City Yuangao Forestry Development Co. Ltd ("**Yuangao**") in or about October 2009. This "purchase" was recorded on SFC's books as being valued at RMB 183 million (CAD $31 million). But Yuangao was not, as was held out by Overseas Management, an independent third party, but rather, a company secretly controlled by Overseas Management through a former SFC employee, Huang Ran.

68. Only a few months later, SFC recorded a sale of the 450,000 Assets to three companies that were also held out by Overseas Management to be independent third party companies, Gaoyao City Xinqi Forestry Development Co., Ltd. ("**Xinqi**"), Guangxi Rongshui Meishan Wood Products Factory ("**Meishan**"), and Guangxi Pingle Haoseng Forestry Development Co., Ltd. ("**Haoseng**") But these companies were neither independent nor third parties. Instead, they were secretly controlled by the defendants, with Huang Ran again acting as Overseas Management's "caretaker".

69. In addition to the substratum of the 450,000 Asset transaction being completely fraudulent, Overseas Management compounded that fraud by creating a *gain* on the sale of the 450,000 Assets. In just a few short months, SFC had a gain of RMB 50 million on these assets – a 30% return over just two months. The RMB 233 million sale of standing timber was recorded in the books of SFC's WFOE subsidiaries and not its BVI subsidiaries that purportedly sold the assets.

70. Overseas Management then created a number of circular transactions designed to give the appearance of reality to the 450,000 Asset fraud. SFC made payments, purportedly to settle accounts payable, to various Suppliers (including Yuangao). Those Suppliers then funneled money to Xinqi, Meishan, and Hoaseng, who used money to "purchase" the assets back from SFC.

71. The net effect of the 450,000 Asset frauds was to overstate the revenues of SFC by at least $30 million, and to overstate the asset base of SFC by an amount that exceeded the value of the underlying assets, if any existed at all. The 450,000 Asset fraud had no economic substance and had no legitimate business purpose.

D. Gegma Fraud #1

72. In 2007, one of SFC's subsidiaries, Sino-Panel Gegma purchased certain land use rights and 105,750 Mu of standing timber from Gengma Dai and Wa Tribe Autonomous Region Forestry Co. ("**Gegma Forestry**") for a purchase price of RMB 102 million. This transaction was never recorded in the books and records of SFC or its subsidiaries.

73. Two months later, the defendants directed another of SFC's subsidiaries, Sino Panel Yunnan to purchase these same assets – including the 105,750 Mu of standing timber – from another party, Yuda Wood for a price of RMB 509.3 million – roughly five times the actual purchase price of the underlying assets as agreed four months earlier.

74. These assets – originally obtained for RMB 102 million but later papered up with a fictitious transaction with a related party – were then "sold" in 2010 for an alleged sales price of RMB 1.6 billion (approximately CAD $230 million).

75. The inflated price of the assets (RMB 509.3 million) was falsely recorded in SFC's public

disclosure documents and audited financial statements for three full fiscal years. And then after the purported sale, the defendants caused SFC to overstate its revenue by at least the differential of the real price to the artificially inflated price.

E. Gegma Fraud #2

76. In September 2007, SFC acquired certain standing timber located in the Yunnan Province (the "**Yunnan Plantation**") from Yuda Wood at a cost of $21.5 million. However, notwithstanding the public disclosure of this purchase in 2007, SFC did not actually acquire the Yunnan Plantation until September 2008.

77. Then, in 2008 and 2009, the defendants caused SFC to sell the Yunnan Plantation to Guangxi Hezhou City Kun'an Forestry Co., Ltd. ("**Kun'an**") for almost double the purchase price, $49 million. Certain of the transactions effective the sale were recorded as occurring in March 2008 – six months before the assets were actually acquired in the first place.

78. The Yunnan Plantation transaction, if not entirely fictitious, at the minimum resulted in inflating SFC's revenue by recording the sale of assets that it did not actually have, at least at the time of the sale if at all. Overseas Management personally debated who should be the "purchaser" of the Yunnan Plantation, originally contemplating Yuda Wood as being the purchaser. They instead decided on Kunan, which casts further doubt on the economic substance and/or reality of the transaction, as well as evidencing the control that Overseas Management held over both Suppliers that were purportedly arms length entities.

VI. OTHER MATTERS

A. Revenue Recognition

79. As an audited public company, SFC was required to accurately disclose the quantum of

revenue earned in the quarter in which it was actually earned. For the purchase and sale of standing timber, revenue is recognized in the quarter in which all of the following have occurred: (a) the Purchase Contract is entered into which establishes a fixed and determinable price: (b) collection is reasonably assured; and (c) the significant risks and rewards of ownership have been transferred to the customer.

80. For the BVI subsidiaries, an individual employee at SFC would create contracts in the quarter or quarters *after* the revenue was recognized through a mail merge function in a word processor. There is no evidence that these contracts were even sent to the counterparties with which SFC was ostensibly entering into the transactions, and in some cases, the contracts were created after payments under the contracts had allegedly been made.

81. At the minimum, this practice of creating contracts in quarters after the revenue was recognized was inconsistent with public disclosure made by SFC regarding its revenue recognition policies. Finally, this practice created substantial risk of inaccuracies and put into further question the legitimacy of the claim that SFC's AIs and Suppliers were independent third parties.

82. This practice of creating contracts in the quarter or quarters after the transactions actually occurred was known not only to Overseas Management, but also to Horsley. As CFO, it was Horsley's responsibility to ensure that SFC's financial statements accurately reflected the substance of the transactions being carried out by SFC. Notwithstanding his obligations to SFC, and SFC's continuous disclosure obligations, Horsley took no steps whatsoever to correct SFC's disclosure with respect to revenue recognition, even after he had learned that it had been materially misstated. To the contrary, in 2008, Horsley wrote to the OSC in response to continuous disclosure inquiries, and falsely stated that revenue was recognized by SFC when the

relevant sales agreement was signed.

B. Engineered Bonus to Horsley

83. As part of his compensation package for 2008, Horsley had a "bonus objectives achievement assessment" whereby SFC would pay Horsley a bonus if SFC brought 12 million cubic metres of fiber to market. An initial draft of SFC's year-end MD&A showed that for fiscal year 2008, SFC only sold a total of 11.1 million cubic metres of fiber to market. The consequence of missing this objective was a cumulative loss to applicable SFC management of $1.8 million.

84. After discussing the matter further with other SFC executives, within two days SFC had "discovered" another 1.2 million cubic metres of sales, and within four days, SFC realized that, in fact, SFC had sold 12.8 million cubic metres of fiber. This all occurred almost three months after year-end, and had the direct and intended consequence of having SFC meet its bonus objective; with Horsley and others being paid the bonus that Horsley originally feared would be met using the actual data from the company. This grossing up practice did not occur on any other year, demonstrating the unusual step taken in 2008.

VII. THE DEMISE OF SINO-FOREST

A. Muddy Waters Report and the IC Investigation

85. On June 2, 2011, a short seller of SFC, Carson Block and his "research" company, Muddy Waters LLC ("**Muddy Waters**"), released an incendiary report (the "**Muddy Waters Report**"). The Muddy Waters Report alleged that SFC committed several frauds and described SFC as a "multi-billion dollar ponzi scheme ... accompanied by substantial theft."

86. Among other things, the Muddy Waters Report alleged that SFC does not hold the full

amount of timber assets that it reports, that the timber assets actually held by SFC have been overstated, and that SFC overstated its revenue. In addition, the Muddy Waters Report alleged that SFC has engaged in unreported related-party transactions. In particular, both the Muddy Waters Report and two subsequent reports released by Muddy Waters alleged that Huaihua City Yuda Wood Limited ("**Yuda Wood**"), SFC's largest supplier of standing timber between 2007 and 2010, was secretly controlled by SFC insiders.

87. The same day that the Muddy Waters Report was released, SFC's board of directors appointed the IC to investigate the allegations made in the Muddy Waters Report. The IC, in turn, retained independent legal and financial advisors in Canada, Hong Kong and the PRC, to investigate the matters.

88. The scope of the IC's review was significant, reflecting the wide range of allegations contained in the Muddy Waters Report. The IC and its advisors worked to compile and analyze the vast amount of data required for their comprehensive review of SFC's operations and business, the relationships between SFC and other entities, and SFC's ownership of assets.

B. Regulatory Investigations

89. The Muddy Waters Report and the investigations arising therefrom had a ripple effect in causing substantial damage to SFC. As part of the fallout from the Muddy Waters Report, (i) SFC was sued in multiple class action proceedings across Canada and in the U.S., and (ii) SFC was the subject of an OSC investigation and was named in an OSC statement of allegations.

90. SFC attempted to cooperate with the OSC investigation. SFC made extensive production of documents including documents sourced from jurisdictions outside of the OSC's power to compel production. SFC also facilitated interviews by the OSC with SFC personnel. In

circumstances where OSC staff sought to examine SFC personnel resident in the PRC, SFC arranged to bring individuals to Hong Kong to be examined.

91. Subsequent to August 26, 2011, the IC's advisors identified additional documents that raised issues meriting comment and explanation from SFC's management. Also, SFC's external counsel, in response to requests from the OSC, also identified documents of a similar nature. Further documents meriting comment and explanation were identified by E&Y and in interviews conducted by OSC staff.

C. Efforts to Obtain an Audit Opinion

92. As SFC reached the November 15, 2011 deadline to release its 2011 third quarter financial statements (the "**Q3 Results**"), the Audit Committee recommended and the Board agreed that SFC should defer the release of the Q3 Results until certain issues could be resolved to the satisfaction of the Board and SFC's auditor. The issues included (i) determining the nature and scope of the relationships between SFC and certain of its AIs and Suppliers, as discussed in the Second Interim Report of the IC, and (ii) the satisfactory explanation and resolution of issues raised by certain documents identified by the IC's advisors, SFC's counsel, SFC's external auditors, and/or by OSC staff.

93. SFC's failure to file the Q3 Results and provide a copy of the Q3 Results to the trustee and to its noteholders under its senior and convertible note indentures on or before November 15, 2011 constituted a default under those note indentures. Pursuant to the indentures, an event of default would have occurred if SFC failed to cure that breach within 30 days in the case of the senior notes, and 60 days in the case of the convertible notes, after having received written notice of such default from the relevant indenture trustee or the holders of 25% or more in aggregate principal amount of a given series of notes.

94. On December 12, 2011, SFC issued a press release announcing that it would not be able to release the Q3 Results within the 30-day period originally indicated. SFC further announced in that press release that, in the circumstances, there was no assurance that it would be able to release the Q3 Results, or, if able, as to when such release would occur. The press release also explained the circumstances that caused SFC to be unable to release the Q3 Results also could impact SFC's historic financial statements and SFC's ability to obtain an audit for its 2011 fiscal year.

95. To issue an audit opinion, E&Y stated that SFC would be required to address a number of outstanding audit issues. These issues had never been imposed as preconditions to E&Y's audit engagements in previous years. The new issues identified by E&Y required SFC to provide satisfactory responses to questions arising in relation to, among other things,:

(a) SFC's relationship with Yuda Wood;

(b) the verification of certain issues surrounding SFC's relationships with AIs and Suppliers, including E&Y's ability to attend meetings with certain AIs and Suppliers;

(c) the completion of an asset verification exercise accompanied by the engagement of Stewart Murray and Indufor;

(d) a "proof of concept" exercise through which confirmations of the technology, methodology and reporting framework could be invoked for the wider area verification of the SFC estate;

(e) provision of legal opinions related to structure and tree title, among other things;

(f) chain of BVI timber title, including access to source documents;

(g) SFC's plan to remove funds from the PRC, including the provision of legal opinions as necessary;

(h) International Financial Reporting Standards reconciliation; and

(i) sales analysis of all BVI plantation sales by supplier to customers.

96. It was not possible for SFC to address these issues within an acceptable time period. Consequently, absent a resolution with the noteholders, the indenture trustees would have been in a position to enforce their legal rights as early as April 30, 2012.

D. Defaults Under the Bonds

97. SFC's failure to make the US$9.775 million interest payment on the 2016 convertible notes when due on December 15, 2011 constituted a default under that indenture. Under the terms of that indenture, SFC had 30 days to cure its default and make the required interest payment in order to prevent an event of default from occurring, which could have resulted in the acceleration and enforcement of the approximately US$1.8 billion in notes which have been issued by SFC and guaranteed by many of its subsidiaries outside of the PRC.

98. On December 18, 2011, SFC announced that it had received written notices of default dated December 16, 2011, in respect of its senior notes due 2014 and its senior notes due 2017. The notices, which were sent by the trustees under the senior note indentures, referenced SFC's previously-disclosed failure to release the Q3 Results on a timely basis. SFC reiterated in the December 18, 2011 press release that it did not expect to be able to file the Q3 Results and cure the default within the 30 day cure period.

99. In response to the receipt of the notices of default, among other considerations, on December 16, 2011, the Board established a Special Restructuring Committee of the Board comprised exclusively of directors independent of management of SFC, for the purpose of supervising, analyzing and managing strategic options available to SFC.

E. The Support Agreement and SFC Filed for CCAA Protection

100. Following extensive negotiations between SFC and its noteholders, the parties agreed on the framework for a consensual resolution of SFC's defaults and the restructuring of its business, and entered into a Support Agreement on March 30, 2012.

101. The Support Agreement requires SFC to pursue a plan of compromise on the terms set out in the Support Agreement in order to implement the agreed-upon restructuring transaction (the "**Restructuring Transaction**") and to simultaneously undertake a sales process (the "**Sales Process**") as an alternative to the Restructuring Transaction. As such, on March 30, 2012, SFC applied for protection from its creditors under the CCAA and the CCAA Court made an Initial Order granting a CCAA stay of proceedings against SFC and certain of its subsidiaries and appointing FTI Consulting Canada Inc. as the Monitor in the CCAA proceedings. The CCAA Court also granted an order approving the Sales Process and authorizing and directing SFC, the Monitor and Houlihan Lokey to do all things reasonably necessary to perform each of their obligations thereunder.

102. On April 13, 2012, the Court made an order extending the stay of proceedings contained in the Initial Order to June 1, 2012 and on May 31, 2012, the Court further extended the stay period to September 28, 2012.

F. The Sales Process

103. The Sales Process was intended to provide a "market test" by which third parties could propose to acquire SFC's business operations through a CCAA Plan as an alternative to the restructuring transaction provided pursuant to the Plan currently being pursued by SFC.

104. Following the bid deadline set out in the Sales Process, SFC, Houlihan Lokey and the Monitor determined that none of the letters of intent constituted a Qualified Letter of Intent as that term was defined in the Sale Process Order, which required amongst other things, cash consideration in an amount equal to 85% of the aggregate principal amount of the notes, plus all accrued and unpaid interest on the notes.

105. Even when cleansed of all of the Class Action and related Third Party Defendant indemnification claims, the Sales Process demonstrated that the realizable market value of SFC's business is less than the $1.8 billion that SFC owed its noteholders.

106. The difference between the value of SFC's assets as recorded in its financial statements and as publicly disclosed, and the reality of the Sales Process, was attributable to two factors, both of which were direct and foreseeable consequences of the defendants' conduct. First, as a company in distress and in insolvency proceedings, SFC by definition would not have realized fair value for its assets. Second, and more importantly, notwithstanding the thorough canvassing of the market and the openness of SFC to potential bidders through a comprehensive dataroom, bidders were unable to get sufficient comfort about the legitimacy or accuracy of SFC's financial statements and the value of SFC's assets.

G. The CCAA Plan and Plan Sanction Order

107. Given that the Sale Process was not successful, SFC developed a Plan with its creditors

that contemplated a new company and a further subsidiary ("Newco" and "Newco II", respectively) would be incorporated and SFC would transfer substantially all of its assets to Newco in compromise and satisfaction of all claims made against it. The result was that Newco would own, directly or indirectly, all of SFC's Subsidiaries and SFC's interest in Greenheart and its subsidiaries as well as any intercompany debts owed by the Subsidiaries to SFC. Pursuant to the Plan, the shares of Newco will be distributed to the Affected Creditors. Newco will immediately transfer the acquired assets to Newco II.

108. As the value of the assets was less than amounts owed to SFC's secured creditors, there was no residual equity value remaining for existing SFC shareholders. Accordingly, the Plan contemplated the extinguishment of all existing equity of SFC in return for no consideration at all.

109. A creditor meeting was held on December 3, 2012 at which an overwhelming majority of SFC's affected creditors approved the Plan. The Plan was sanctioned by Justice Morawetz on December 10, 2012. One set of shareholders sought leave to appeal the Plan Sanction Order, but leave to appeal was denied by the Court of Appeal on June 26, 2013.

VIII. LIABILITY TO SFC

110. Overseas Management is liable to SFC for breaching their duties as officers of SFC. At all relevant times, Overseas Management were either actual or ostensible officers of SFC, each of whom authorized, permitted or acquiesced in the wrongful conduct described above.

111. Under section 122 of the *CBCA*, each of the defendants owed a duty of care to SFC to (a) act honestly and in good faith with a view to the best interests of the corporation, and (b) to exercise the care, diligence and skill that a reasonably prudent person would exercise in

comparable circumstances. By reason of the facts described above, the defendants breached this duty of care and failed to act in a manner that was required of officers of a publicly traded company.

112. Overseas Management further breached section 241 of the *CBCA*, by carrying on the business or affairs of SFC in a manner that was oppressive or unfairly prejudicial or that unfairly disregarded the interests of all of SFC's securityholders and creditors. Such securityholders and creditors had a reasonable expectation that Overseas Management would carry out the affairs of SFC in a manner that was lawful and that would not have preferred the interests of insiders as described above.

113. By reason of the facts described above, the defendants breached express and implied terms of their employment agreements with SFC and its subsidiaries. Among other things, the defendants were required to conduct themselves and the operations of SFC in a manner that was lawful. The defendants were further required to comply with SFC Codes of Conduct, which the defendants breached by virtue of the facts described above.

114. The defendants further owed SFC fiduciary duties, as a result of the positions of trust and confidence held by the defendants. SFC was vulnerable to the unilateral exercise of discretion and power by the defendants. By reason of the facts described above, the defendants breached their fiduciary duties to SFC.

115. Overseas Management conspired with each other to overstate the value of SFC's revenue and assets and to cause SFC to release financial statements that were untrue. In certain instances, as described above, the predominant purpose of such conspiracy was for the defendants, or certain of them, to obtain pecuniary benefits. In other cases, the predominant purpose is unknown as a result of the clandestine nature of the conspiracy and the particular

opaqueness created by the overseas operations, the use of "shell" companies, nominee shareholders, among other things, but in all instances the predominant purpose was not to advance the legitimate business interests of SFC and its stakeholders. Overseas Management took steps in furtherance of the conspiracy as described above.

116. By virtue of the facts set out above, Overseas Management are liable to SFC for negligent and/or fraudulent misrepresentation. SFC relied on the representations described above to its detriment, and the damages SFC suffered in furtherance of such reliance was reasonably foreseeable and proximate.

117. By virtue of the facts set out above, the defendants have been unjustly enriched by their wrongful acts and omissions. SFC suffered a corresponding deprivation by reason of the wrongful acts of the defendants. There was no juristic reason for the resulting enrichment to the defendants. The plaintiff is entitled to a constructive trust with respect to such enrichment.

118. Overseas Management are alternatively liable to SFC as knowing recipients of trust moneys and/or knowing assistors of breaches of trust and fiduciary duty by others, for the reasons set out above. At all material times, Overseas Management, whether or not they personally owed fiduciary duties or trust obligations to SFC, knew that others in senior management had such trust and fiduciary obligations, and Overseas Management willfully assisted in the breach of such trust and fiduciary obligations, including through the handling and receipt of SFC moneys that had been impressed with a trust.

IX. DAMAGES

119. By virtue of the facts set out above, SFC has suffered damages. Such damages were reasonably foreseeable by the defendants, and proximate to the wrongful acts described above.

120. Overseas Management are jointly and severally liable for the acts relating to Overseas Management described above.

121. SFC has taken all reasonable steps to mitigate its damages.

122. The particulars of such damages are not yet fixed and will be provided prior to trial.

123. By virtue of the conduct described above, an award of punitive or exemplary damages is appropriate. The defendants' conduct was high handed and demonstrated reckless and wanton disregard for SFC and its stakeholders. Overseas Management's activities were particularly egregious and warranting punitive or exemplary damages.

124. In addition to the general, punitive and exemplary damages described above, by reason of the facts described above, the defendants have conducted themselves in a manner that disentitles them to retain the compensation that they received directly and indirectly from SFC, whether in the form of salary, bonuses, options, or otherwise. In light of all of the circumstances, SFC received no value for the services provided by the defendants in connection with their employment contracts, and such compensation should be returned to SFC.

X. STATUTORY REFERENCES

125. The plaintiff pleads and relies upon rules 17.02 (g), (h) and (o) of the *Rules of Civil Procedure*, R.R.O. 1990, Reg. 194, for service of this Notice of Action on the defendants outside of Ontario because it relates to torts committed in Ontario and the damage was sustained in Ontario arising from tort, breach of contract, breach of fiduciary duty or breach of confidence, wherever committed, and is against persons outside Ontario who are a necessary or proper party to a proceeding properly brought against another person served in Ontario (Horsley). Further,

the actions are asserted by the Trustee pursuant to the CCAA Court and the Plan, both of which were made in Ontario.

126. The plaintiff pleads and relies upon sections 122 and 241 of the *CBCA*.

XI. VENUE

127. The plaintiff proposes that this action be tried at the City of Toronto.

Dated: July 2, 2013

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439

SFC LITIGATION TRUST
Plaintiff

- and -

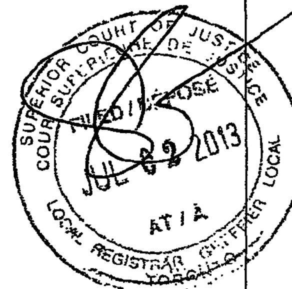
GEORGE HO et al.
Defendants

Court File No. CV-13-481761

ONTARIO
SUPERIOR COURT OF JUSTICE

Proceeding commenced at Toronto

STATEMENT OF CLAIM



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SINO-FOREST LITIGATION TRUST AGREEMENT

TABLE OF CONTENTS

Page

ARTICLE 1 ESTABLISHMENT OF THE LITIGATION TRUST **2**

1.1 Settling the Litigation Trust and Funding Expenses of the Litigation Trust 2
1.2 Establishment of Litigation Trust and Appointment of the Litigation Trustee 2
1.3 Transfer of Assets and Rights to the Litigation Trustee 3
1.4 Title to Litigation Trust Assets 5
1.5 Nature and Purpose of the Litigation Trust 5
1.6 Incorporation of Plan 7

ARTICLE 2 LITIGATION TRUST INTERESTS **7**

2.1 Allocation of Litigation Trust Interests 7
2.2 Interests Beneficial Only 7
2.3 Evidence of Beneficial Interests 7
2.4 Securities Law Registration 8
2.5 No Transfers 8
2.6 Absolute Owners 8

ARTICLE 3 THE LITIGATION TRUSTEE **9**

3.1 Litigation Trust Proceeds 9
3.2 Collection of Litigation Trust Proceeds 9
3.3 Payment of Litigation Trust Expenses 9
3.4 Distributions 9
3.5 Tenure, Removal, and Replacement of the Litigation Trustee 10
3.6 Acceptance of Appointment by Successor Trustee 11
3.7 Regular Meetings of the Litigation Trustee and the Litigation Trust Board 11
3.8 Special Meetings of the Litigation Trustee and the Litigation Trust Board 12
3.9 Notice of, and Waiver of Notice for Litigation Trustee and Litigation Trust Board Meeting 12
3.10 Manner of Acting 12
3.11 Role of the Litigation Trustee 12
3.12 Authority of Litigation Trustee 13
3.13 Limitation of Litigation Trustee's Authority 15
3.14 Books and Records 16
3.15 Inquiries into Trustee's Authority 16
3.16 Compliance with Laws 16
3.17 Compensation of the Litigation Trustee 16
3.18 Reliance by Litigation Trustee 16
3.19 Investment and Safekeeping of Litigation Trust Assets 17
3.20 Standard of Care; Exculpation 17

ARTICLE 4 LITIGATION TRUST BOARD **17**

4.1 Litigation Trust Board 17
4.2 Authority of the Litigation Trust Board 18
4.3 Regular Meetings of the Litigation Trust Board 18

4.4 Special Meetings of the Litigation Trust Board 18
4.5 Manner of Acting 18
4.6 Litigation Trust Board's Action Without a Meeting 19
4.7 Notice of, and Waiver of Notice for Litigation Trust Board Meetings 19
4.8 Telephonic Communications 20
4.9 Tenure, Removal and Replacement of the Members of the Litigation Trust Board .20
4.10 Compensation of the Litigation Trust Board 21
4.11 Standard of Care; Exculpation 21

ARTICLE 5 TAX MATTERS 22

5.1 U.S. Federal Income Tax Treatment of the Litigation Trust 22
5.2 Allocations of Litigation Trust Taxable Income For U.S. Federal Income Tax Purposes 23
5.3 Canadian Tax Treatment of Distributions by Litigation Trustee 24

ARTICLE 6 DISTRIBUTIONS 24

6.1 Distributions; Withholding 24
6.2 Manner of Payment or Distribution 25
6.3 Cash Distributions 25

ARTICLE 7 INDEMNIFICATION 25

7.1 Indemnification of Litigation Trustee and the Litigation Trust Board 25

ARTICLE 8 REPORTING OBLIGATIONS OF LITIGATION TRUSTEE 26

8.1 Reports 26

ARTICLE 9 TERM; TERMINATION OF THE LITIGATION TRUST 26

9.1 Term; Termination of the Litigation Trust 26
9.2 Continuance of Trust for Winding Up 27

ARTICLE 10 AMENDMENT AND WAIVER 27

10.1 Amendment and Waiver 27

ARTICLE 11 MISCELLANEOUS PROVISIONS 28

11.1 Intention of Parties to Establish the Litigation Trust 28
11.2 Laws as to Construction 28
11.3 Jurisdiction 28
11.4 Severability 28
11.5 Notices 29
11.6 Fiscal Year 30
11.7 Construction; Usage 30
11.8 Counterparts; Facsimile; PDF 31
11.9 Confidentiality 31
11.10 Entire Agreement 32
11.11 No Bond 32
11.12 Effectiveness 32
11.13 Successor and Assigns 32
11.14 No Execution 32
11.15 Irrevocability 33

THIS LITIGATION TRUST AGREEMENT (this "**Agreement**"), dated as of the Effective Date, is entered into by and among:

1. Sino-Forest Corporation ("**SFC**"); and

2. Cosimo Borrelli, as trustee of the Litigation Trust (the "**Litigation Trustee**").

PRELIMINARY STATEMENT

On March 30, 2012 (the "**Filing Date**"), SFC commenced reorganization proceedings under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (the "**CCAA**") (Case No. CV-12-9667-CL) before the Ontario Superior Court of Justice (the "**CCAA Court**").

On December 3, 2012, SFC filed that certain Plan of Compromise and Reorganization dated December 3, 2012 pursuant to the provisions of the CCAA and the *Companies Business Corporations Act* (together with any supplement to such Plan and the exhibits and schedules thereto, as the same may be amended, modified or supplemented from time to time in accordance with the terms thereof, the "**Plan**").

On December 12, 2012, the CCAA Court entered the Plan Sanction Order approving the Plan, which contemplates the creation of this Litigation Trust, which is hereby created pursuant to this Agreement and in accordance with the laws of Ontario in order to effectuate certain provisions of the Plan and the Plan Sanction Order and, in accordance therewith and herewith, the Litigation Trustee will hold the Litigation Trust Claims and the other Litigation Trust Assets for the benefit of the Litigation Trust Beneficiaries, all as defined herein or in the Plan.

In this Agreement, "**Litigation Trust Claims**" means any and all claims, actions, causes of action, demands, counterclaims, suits, rights, entitlements, litigation, arbitration, proceeding, hearing, complaint, debt, obligation, sums of money, accounts, covenants, damages, judgments, orders, including for injunctive relief or specific performance and compliance orders, expenses, executions, Encumbrances and other recoveries of whatever nature that any Person may be entitled to assert in law, equity or otherwise, whether known or unknown, foreseen or unforeseen, reduced to judgment or not reduced to judgment, liquidated or unliquidated, contingent or non-contingent, matured or unmatured, disputed or undisputed, secured or unsecured, assertable directly, indirectly or derivatively, existing or hereafter arising and whether pertaining to events occurring before, on or after the Filing Date (the "**Causes of Action**") which have been or may be asserted by or on behalf of (a) SFC against any and all third parties; or (b) the Trustees (on behalf of the Noteholders) against any and all Persons in connection with the Notes issued by SFC, which claims are transferred to and vested in the Litigation Trustee pursuant to the Plan, the Plan Sanction Order and this Agreement; provided, however, that in no event shall Litigation Trust Claims include any (i) claim, right or cause of action against any Person that is released pursuant to Article 7 of the Plan or (ii) Excluded Litigation Trust Claim. For greater certainty: (x) the claims being advanced or that are subsequently advanced in the Class Actions are not being transferred to the Litigation Trust; and (y) the claims transferred to the Litigation Trust shall not be advanced in the Class Actions.

In this Agreement, "**Litigation Trust Assets**" means the Litigation Trust Claims, the Litigation Funding Amount, and any other assets acquired by the Litigation Trust on or after the Effective Date pursuant to this Agreement or the Plan.

The Litigation Trust is established for the sole purpose of liquidating and distributing the Litigation Trust Assets pursuant to the Plan and this Agreement with no objective to continue or engage in the conduct of a trade or business.

The Litigation Trust is established for (i) the benefit of the Affected Creditors with Proven Claims and the Noteholder Class Action Claimants entitled to receive Litigation Trust Interests under the Plan (individually, a "**Litigation Trust Beneficiary**" and collectively, the "**Litigation Trust Beneficiaries**") and (ii) the pursuit of all Litigation Trust Claims.

The Litigation Trustee is duly appointed pursuant to the Plan, the Plan Sanction Order and Section 1.2(b) of this Agreement.

Unless the context otherwise requires, capitalized terms used in this Agreement and not otherwise defined herein shall have the meanings ascribed to them in the Plan. Schedule A to this Agreement sets forth an index of terms that are defined in this Agreement.

AGREEMENT

NOW, THEREFORE, in consideration of the promises and the mutual covenants and agreements contained herein and in the Plan, SFC and the Litigation Trustee intending to be legally bound, agree as follows:

ARTICLE 1
ESTABLISHMENT OF THE LITIGATION TRUST

1.1 Settling the Litigation Trust and Funding Expenses of the Litigation Trust

SFC hereby settles the Litigation Trust with the sum of twenty ($20.00) Canadian dollars (serial number: BIR6584805) (the "**Settlement Funds**"), the receipt of which is hereby acknowledged by the Litigation Trustee, and loans the Litigation Funding Amount to the Litigation Trustee, by way of the form of promissory note appended hereto at Schedule B, which is executed as of the date of this Agreement, to finance the operations of the Litigation Trust. The Litigation Trust Claims Transferors (as defined below) have no other funding obligations with respect to the Litigation Trust.

1.2 Establishment of Litigation Trust and Appointment of the Litigation Trustee

(a) Pursuant to the Plan, the Plan Sanction Order and this Agreement, the Litigation Trust is hereby established on the date and at the time set out in section 6.4 of the Plan, and shall be known as the "**SFC Litigation Trust**" on behalf of and for the benefit of the Litigation Trust Beneficiaries.

(b) The Litigation Trustee hereby accepts its appointment as trustee of the Litigation Trust as of the Plan Implementation Date (the "**Effective Date**") and agrees to accept and hold the Settlement Funds and the Litigation Trust Assets in trust for

the Litigation Trust Beneficiaries, subject to the terms of this Agreement. The Litigation Trustee (and each successor trustee thereto serving from time to time hereunder) shall have all the rights, powers and duties set forth herein and pursuant to applicable law for accomplishing the purposes of the Litigation Trust.

1.3 Transfer of Assets and Rights to the Litigation Trustee

(a) Subject to section 1.3(b), on the Effective Date, pursuant to the Plan and the Plan Sanction Order, each of the Litigation Trust Claims shall be deemed to be irrevocably transferred, assigned and delivered to the Litigation Trustee, including (i) all rights, title and interests in and to the Litigation Trust Claims (and with respect to the Trustees, all of the rights, title and interests of the Noteholders in and to the Litigation Trust Claims on behalf of the Noteholders), free and clear of any and all liens, claims (other than claims in the nature of setoff or recoupment), encumbrances or interests of any kind in such property of any other Person, and (ii) all respective rights, title and interests in and to any lawyer-client privilege, work product privilege or other privilege or immunity attaching to any documents or communications (whether written or oral) associated with the Litigation Trust Claims (collectively, the "**Privileges**") (and with respect to the Trustees, all of the rights, title and interests of the Noteholders in and to the Privileges on behalf of the Noteholders), all of which shall, and shall be deemed to, vest in the Litigation Trustee for the benefit of the Litigation Trust Beneficiaries. In no event shall any part of the Litigation Trust Claims revert to or be distributed to SFC or the Noteholders (or any representative thereof (including the Trustees). None of the foregoing transfers to the Litigation Trustee shall constitute a merger or consolidation of the respective Litigation Trust Claims, each of which shall retain its separateness following the transfer for all purposes relevant to the prosecution thereof. The Litigation Trustee's receipt of the Privileges shall be without waiver in recognition of the joint and/or successor interest in prosecuting claims on behalf of the Litigation Trust Claims Transferors.

(b) At any time prior to the Effective Date, SFC and the Initial Consenting Noteholders may agree to exclude one or more Causes of Action from the Litigation Trust Claims and/or to specify that any Causes of Action against a specified Person will not constitute Litigation Trust Claims ("**Excluded Litigation Trust Claims**"), in which case, any such Causes of Action shall not be transferred to the Litigation Trust on the Effective Date. Any such Excluded Litigation Trust Claims shall be fully, finally, irrevocably and forever compromised, released, discharged, cancelled and barred on the Plan Implementation Date in accordance with Article 7 of the Plan.

(c) Pursuant to and consistent with the provisions of the Plan, all Causes of Action against the Underwriters by (i) SFC or (ii) the Trustees (on behalf of the Noteholders) shall be deemed to be Excluded Litigation Trust Claims that are fully, finally, irrevocably and forever compromised, released, discharged, cancelled and barred on the Plan Implementation Date in accordance with Article 7 of the Plan, provided that, unless otherwise agreed by SFC and the Initial Consenting Noteholders prior to the Plan Implementation Date in accordance with

section 4.12(a) of the Plan, any such Causes of Action for fraud or criminal conduct shall not constitute Excluded Litigation Trust Claims and shall be transferred to the Litigation Trust in accordance with section 6.4(o) of the Plan.

(d) Subject to Section 1.3(e), after the Effective Date, SFC shall (i) deliver or cause to be delivered to the Litigation Trustee, documents reasonably requested and related to the Litigation Trust Claims (including those maintained in electronic format), whether held by SFC or its employees, agents, advisors, counsel, accountants, or other professionals and (ii) provide reasonable access to such employees, agents, advisors, counsel, accountants or other professionals with knowledge of matters relevant to the Litigation Trust Claims. Where original documents are required, SFC will make reasonable efforts to make such original documents available. For the avoidance of doubt, the rights of the Litigation Trustee pursuant to this Section 1.3(d) shall include the right to demand or compel the production of copies of any such documents or information from any party, committee or person who may have produced such documents for or on behalf of SFC or any committee appointed by SFC or its board of directors.

(e) Any documents or information delivered by SFC to the Litigation Trustee pursuant to Section 1.3(d): (i) shall be used strictly for the purposes of advancing the Litigation Trust Claims and for no other purpose, (ii) shall not, except as may be required by law, be used for any purpose in relation to any regulatory proceedings involving the Named Directors and Officers, and (iii) shall be subject to the continuation of any privilege attaching to such documents, including but not limited to lawyer-client privilege, litigation privilege, and common interest privilege, which privileges the Litigation Trustee agrees to maintain and uphold.

(f) Where documents, information and/or access is requested of third party agents, advisors, lawyers, accountants or other professionals (“**Third Party Disclosers**”), the Litigation Trustee shall pay such reasonable fees and costs of such Third Party Disclosers as are necessary for them to comply with the requests of the Litigation Trustee.

(g) SFC hereby agrees at any time and from time to time on and after the Effective Date, (i) at the reasonable request of the Litigation Trustee, to execute and/or deliver any instruments, documents, books, and records (including those maintained in electronic format and original documents as may be needed), (ii) to take, or cause to be taken, all such further actions as the Litigation Trustee may reasonably request in order to evidence or effectuate the transfer of the Litigation Trust Claims and the Privileges to the Litigation Trustee contemplated hereby and by the Plan and to otherwise carry out the intent of the parties hereunder, and (iii) to cooperate with the Litigation Trustee in the prosecution of Litigation Trust Claims to the extent reasonable.

(h) The Litigation Trustee agrees that it will accommodate reasonable requests by Named Directors and Officers (and their agents, advisors, lawyers, accountants or other professionals) to access, at their expense, copies or originals of any documents obtained by the Litigation Trustee pursuant to the terms of this

Agreement, for the purposes of defending any civil, regulatory or other proceedings involving the Named Directors and Officers or in connection with their financial affairs.

1.4 Title to Litigation Trust Assets

(a) Upon the transfer of the Litigation Trust Claims to the Litigation Trust pursuant to the Plan, the Plan Sanction Order and this Agreement, SFC and any other holders of the Litigation Trust Claims (the "**Litigation Trust Claims Transferors**") shall have no interest in or with respect to the Litigation Trust Assets, and the Litigation Trustee, on behalf of the Litigation Trust Beneficiaries, shall succeed to all of the Litigation Trust Claims Transferors' rights, title and interests in and to the Litigation Trust Claims.

(b) Notwithstanding anything in the Plan or in this Agreement to the contrary, the transfer of the Litigation Trust Claims to the Litigation Trustee does not diminish, and fully preserves, any defences or privileges a defendant would have if such Litigation Trust Claims had been retained by the Litigation Trust Claims Transferors.

(c) To the extent that any Litigation Trust Assets cannot be transferred to the Litigation Trustee because of a restriction on transferability under applicable non-bankruptcy law, such Litigation Trust Assets shall be deemed to have been retained by the applicable Litigation Trust Claims Transferors, and the Litigation Trustee shall be deemed to have been designated as the exclusive representative of such Litigation Trust Claims Transferors to enforce and pursue such Litigation Trust Assets on behalf of such Litigation Trust Claims Transferors, and all proceeds, income and recoveries on account of any such Litigation Trust Assets shall be assets of the Litigation Trust and paid over thereto immediately upon receipt by the Litigation Trust Claims Transferors, or any other Person. Notwithstanding the foregoing, but subject to Section 3.4 and Article 6 of this Agreement, all net proceeds, income, and recoveries of or on account of such Litigation Trust Assets shall be transferred to the Litigation Trust to be distributed to the holders of the Litigation Trust Interests consistent with the terms of this Agreement.

1.5 Nature and Purpose of the Litigation Trust

(a) Purpose. The Litigation Trust is organized and established as a trust pursuant to which the Litigation Trustee, subject to the terms and conditions contained herein, is to (i) hold the assets of the Litigation Trust and (ii) oversee the efficient prosecution of the Litigation Trust Claims, on the terms and conditions set forth herein.

(b) Actions of the Litigation Trustee. Subject to the terms of this Agreement, the Litigation Trustee shall, in consultation with the Litigation Trust Board and subject to the exercise of their collective reasonable business judgment, and with the consent of the Litigation Trust Board where required under the terms of this

Agreement, in an efficient and responsible manner prosecute the Litigation Trust Claims and preserve and endeavour to enhance the value of the Litigation Trust Assets. The efficient and responsible prosecution of the Litigation Trust Claims may be accomplished either through the prosecution, compromise and settlement, abandonment, dismissal or other disposition of any or all claims, rights or causes of action, or otherwise, as determined by the Litigation Trustee and the Litigation Trustee Board in accordance with the terms of this Agreement and the exercise of their collective reasonable best judgement. The Litigation Trustee shall, subject to the terms of this Agreement, have the absolute right to pursue, settle and compromise or not pursue any and all Litigation Trust Claims as it determines is in the best interests of the Litigation Trust Beneficiaries and consistent with the purposes of the Litigation Trust, and the Litigation Trustee shall have no liability for the outcome of any such decision except for any damages caused by gross negligence, bad faith, wilful misconduct or knowing violation of law.

(c) Limitation on Actions Against Named Directors and Officers. From and after the Plan Implementation Date, to the extent that the Litigation Trust Claims include rights of action against a Named Director or Officer, (a) the Litigation Trustee may only commence or prosecute an action for a Non-Released D&O Claim against a Named Director or Officer if the Litigation Trustee has first obtained (i) the consent of the Monitor or (ii) leave of the Court on notice to the applicable Directors and Officers, SFC, the Monitor, the Initial Consenting Noteholders and any applicable insurers; and (b) in connection with any action brought or prosecuted by the Litigation Trustee against a Named Director or Officer asserting a Section 5.1(2) D&O Claim or a Conspiracy Claim, the Litigation Trustee shall, as against the Named Directors and Officers, in relation to such claims, be irrevocably limited to recovery solely from the proceeds of the Insurance Policies paid or payable on behalf of SFC or its Directors or Officers, and shall have no right to, and shall not, directly or indirectly, make any claim or seek any recoveries from any of the Named Directors and Officers other than enforcing the Litigation Trustee's rights to be paid from the proceeds of an Insurance Policy by the applicable insurer(s).

(d) Relationship. This Agreement is intended to create a trust and a trust relationship and to be governed and construed in all respects as a trust. The Litigation Trust is not intended to be, and shall not be deemed to be or treated as, a general partnership, limited partnership, joint venture, corporation, joint stock company or association, nor shall the Litigation Trustee, or the Litigation Trust Board (or any of its members or *ex officio* members), or the Litigation Trust Beneficiaries, or any of them, for any purpose be, or be deemed to be or treated in any way whatsoever to be, liable or responsible hereunder as partners or joint venturers. The relationship of the Litigation Trust Beneficiaries, on the one hand, to the Litigation Trustee and the Litigation Trust Board, on the other, shall not be deemed a principal or agency relationship, and their rights shall be limited to those conferred upon them by this Agreement.

(e) No Waiver of Claims. Subject to the terms of this Agreement, the Litigation Trustee may enforce all rights to commence and pursue, as appropriate, any and

all Litigation Trust Claims after the Effective Date. The Litigation Trustee shall have, retain, reserve, and be entitled to assert all such Litigation Trust Claims, rights of setoff, and other legal or equitable defences which the Litigation Trust Claims Transferors had on the Effective Date fully as if the Litigation Trust Claims had not been transferred to the Litigation Trustee in accordance with the Plan, the Plan Sanction Order and this Agreement, and all of the Litigation Trust Claims Transferors' legal and equitable rights may be asserted after the Effective Date. Nothing in this Agreement shall be construed in a manner that is inconsistent with the Plan, the Plan Sanction Order or any other orders made by the CCAA Court.

1.6 Incorporation of Plan

The Plan and the Plan Sanction Order are each hereby incorporated into this Agreement and made a part hereof by this reference; provided, however, to the extent that there is conflict between the provisions of this Agreement, the provisions of the Plan, and/or the Plan Sanction Order, each such document shall have controlling effect in the following rank order: (1) the Plan; (2) the Plan Sanction Order; and (3) this Agreement.

ARTICLE 2
LITIGATION TRUST INTERESTS

2.1 Allocation of Litigation Trust Interests

The Litigation Trust Interests shall be allocated pursuant to the Plan.

2.2 Interests Beneficial Only

The ownership of a Litigation Trust Interest shall not entitle any holder of Litigation Trust Interests to any title in or to the assets of the Litigation Trust as such (which title shall be vested in the Litigation Trustee) or to any right to call for a partition or division of the assets of the Litigation Trust or to require an accounting.

2.3 Evidence of Beneficial Interests

The entitlements of the holders of Litigation Trust Interests (and the beneficial interests therein) are as established pursuant to the Plan and the Plan Sanction Order and will not be represented by any certificates, securities, receipts or in any other form or manner whatsoever, except as may be maintained on the books and records of the Litigation Trust by the Litigation Trustee or the Registrar. The death, incapacity or bankruptcy of any Litigation Trust Beneficiary during the term of the Litigation Trust shall not (i) operate to terminate the Litigation Trust, (ii) entitle the representatives or creditors of the deceased party to an accounting, (iii) entitle the representatives or creditors of the deceased party to take any action in the CCAA Court or elsewhere for the distribution of the Litigation Trust Assets or for a partition thereof or (iv) otherwise affect the rights and obligations of any of the Litigation Trust Beneficiaries hereunder.

2.4 Securities Law Registration

It is intended that the Litigation Trust Interests shall not constitute "securities." To the extent the Litigation Trust Interests are deemed to be "securities," the issuance of Litigation Trust Interests to Litigation Trust Beneficiaries hereunder or under the Plan (and any redistribution of any of the foregoing pursuant to the Plan or otherwise) shall be exempt from the prospectus and registration requirements of any applicable provincial laws pursuant to section 2.11 of National Instrument 45-106 – Prospectus and Registration Exemptions. If the Litigation Trustee determines, with the advice of counsel, that the Litigation Trust is required to comply with registration and/or reporting requirements of any applicable securities laws, then the Litigation Trustee shall, after consultation with the Litigation Trust Board, take any and all actions to comply with such registration and reporting requirements, if any, to the extent required by applicable law. Notwithstanding the foregoing, nothing herein shall be deemed to preclude the Litigation Trust Board and the Litigation Trustee from amending this Agreement to make such changes as are deemed necessary or appropriate by the Litigation Trustee, with the advice of counsel, to ensure that the Litigation Trust is not subject to any such registration and/or reporting requirements.

2.5 No Transfers

(a) No transfer, sale assignment, distribution, exchange, pledge, hypothecation, mortgage or other disposition (each, a "**Transfer**") of a Litigation Trust Interest may be effected or made; provided, that, Transfers of a Litigation Trust Interest may be made by operation of law or by will or the laws of descent and distribution.

(b) The Litigation Trustee may appoint a registrar, which may be the Litigation Trustee (the "**Registrar**"), for the purpose of recording entitlement to the Litigation Trust Interests as provided for in this Agreement. The Registrar, if other than the Litigation Trustee, may be such other institution acceptable to the Litigation Trust Board. For its services hereunder, the Registrar, unless it is the Litigation Trustee, shall be entitled to receive reasonable compensation from the Litigation Trust as approved by the Litigation Trust Board, as an expense of the Litigation Trust.

(c) The Litigation Trustee may cause to be kept at the office of the Registrar, or at such other place or places as shall be designated by the Litigation Trustee from time to time, a registry of the holders of Litigation Trust Interests (the "**Trust Register**") which shall be maintained on a strictly confidential basis by the Registrar. The identity and extent of the Litigation Trust Interests of any Litigation Trust Beneficiary shall not be disclosed to any third party (other than the Litigation Trustee, the Litigation Trust Board and the Registrar, each of them shall maintain any such information in strict confidence), without the prior written consent of such Litigation Trust Beneficiary in each case.

2.6 Absolute Owners

The Litigation Trustee may deem and treat the holder of a Litigation Trust Interest (of record in the Trust Register or otherwise) as the absolute owner of such Litigation Trust Interests for the

purpose of receiving distributions and payment thereon or on account thereof and for all other purposes whatsoever and the Litigation Trustee shall not be charged with having received notice of any claim or demand to such Litigation Trust Interests or the interest therein of any other Person.

ARTICLE 3
THE LITIGATION TRUSTEE

3.1 Litigation Trust Proceeds

Any and all proceeds, income and/or recoveries obtained on account of or from the Litigation Trust Assets shall be added to the assets of the Litigation Trust (the "**Litigation Trust Proceeds**", which, for greater certainty, shall not include the Litigation Funding Amount), held as a part thereof and dealt with in accordance with the terms of this Agreement.

3.2 Collection of Litigation Trust Proceeds

The Litigation Trustee shall collect all Litigation Trust Proceeds and title therein shall be vested in the Litigation Trustee, in trust for the benefit of the Litigation Trust Beneficiaries, to be dealt with in accordance with the terms of this Agreement.

3.3 Payment of Litigation Trust Expenses

Subject to Section 3.12 of this Agreement and the obligations of the Litigation Trustee under Section 3.4 of this Agreement, the Litigation Trustee shall maintain the Litigation Funding Amount and expend the Litigation Funding Amount, together with any other amounts received as litigation funding amounts in accordance with Section 3.12(s), (i) as is reasonably necessary to pay reasonable and necessary administrative expenses (including but not limited to, the reasonable costs and expenses of the Litigation Trustee (including reasonable fees, costs, and expenses of professionals retained thereby) and the compensation and the reasonable costs and expenses of the members of the Litigation Trust Board as contemplated by Section 4.10 hereof (including the fees of professionals retained by such members as contemplated by Sections 4.2 hereof), any taxes imposed on the Litigation Trust or in respect of the Litigation Trust Assets or reasonable fees and expenses in connection with, arising out of, or related to, the Litigation Trust Assets and litigations associated therewith), (ii) to pay the costs and expenses of the valuations of the Litigation Trust Assets incurred by the Litigation Trust Board and/or the Litigation Trustee in accordance with Section 5.1(c) of this Agreement, (iii) to pay or reimburse amounts in accordance with Article 7 hereof and (iv) to satisfy other liabilities incurred or assumed by the Litigation Trust (or to which the assets of the Litigation Trust are otherwise subject) in accordance with this Agreement.

3.4 Distributions

The Litigation Trustee shall make distributions of Litigation Trust Proceeds in accordance with the provisions of Article 6 of this Agreement.

3.5 Tenure, Removal, and Replacement of the Litigation Trustee

(a) Each Litigation Trustee will serve until the earliest of (i) the completion of all the Litigation Trustee's duties, responsibilities and obligations under this Agreement, (ii) the Litigation Trustee's resignation and the appointment of a successor pursuant to Section 3.5(b) of this Agreement, (iii) the Litigation Trustee's removal pursuant to Section 3.5(c) of this Agreement, (iv) the Litigation Trustee's death (if applicable) and (v) the termination of the Litigation Trust in accordance with this Agreement.

(b) The Litigation Trustee may resign by giving not less than 90 days' prior written notice to the Litigation Trust Board. Such resignation will become effective on the later to occur of: (i) the day specified in such written notice and (ii) the appointment of a successor trustee as provided herein and the acceptance by such successor trustee of such appointment in accordance with Section 3.6 of this Agreement. If a successor trustee is not appointed or does not accept its appointment within 90 days following delivery of notice of resignation, the Litigation Trustee may file a motion with the CCAA Court, upon notice and hearing, for the appointment of a successor trustee.

(c) The Litigation Trustee may be removed for any reason by majority vote of the members of the Litigation Trust Board.

(d) In the event of a vacancy in the position of the Litigation Trustee (whether by removal, resignation, or death, if applicable), the vacancy will be filled by the appointment of a successor trustee by (i) majority vote of the members of the Litigation Trust Board, and by the acceptance of the Litigation Trust by the successor trustee in accordance with Section 3.6 of this Agreement or (ii) an order of the CCAA Court after an opportunity for a hearing (provided, however, that only the Litigation Trust Board shall have standing to seek such an order (and the Litigation Trust Board shall only seek such an order upon a majority vote of the members of the Litigation Trust Board, except as provided in Section 3.5(b) of this Agreement)). If a successor trustee is appointed as provided in clause (i) or (ii) of the preceding sentence, and such appointment is accepted by the successor trustee in accordance with Section 3.6 of this Agreement, the Litigation Trust Board shall provide notice of such appointment to the holders of the Litigation Trust Interests, which notice will include the name, address, and telephone number of the successor trustee provided, however, that the provision of such notice shall not be a condition precedent to the vesting in the successor Litigation Trustee of all the estates, properties, rights, powers, trusts, and duties of its predecessor.

(e) Immediately upon the appointment of any successor trustee, all rights, powers, duties, authority, and privileges of the predecessor Litigation Trustee hereunder will be vested in and undertaken by the successor trustee without any further act and the successor trustee will not be liable personally for any act or omission of the predecessor Litigation Trustee. A successor trustee shall have all the rights, privileges, powers, and duties of its predecessor under this Agreement.

(f) Upon the appointment of a successor trustee, the predecessor Litigation Trustee (or the duly appointed legal representative of a deceased Litigation Trustee) shall, if applicable, when requested in writing by the successor trustee or the CCAA Court, execute and deliver an instrument or instruments conveying and transferring to such successor trustee upon the trusts herein expressed all the estates, properties, rights, powers and trusts of such predecessor Litigation Trustee, and shall duly assign, transfer, and deliver to such successor trustee all property and money held hereunder, and all other assets, documents, instruments, records and other writings relating to the Litigation Trust, the Litigation Trust Assets, the Litigation Trust Proceeds, the Litigation Funding Amount, and the Litigation Trust Interests, then in its possession and held hereunder, and shall execute and deliver such documents, instruments and other writings as may be requested by the successor trustee or the CCAA Court to effect the termination of such predecessor Litigation Trustee's capacity under the Litigation Trust, this Agreement and the Plan and otherwise assist and cooperate, without cost or expense to the predecessor Litigation Trustee, in effectuating the assumption of its obligations and functions by the successor trustee.

(g) During any period in which there is a vacancy in the position of Litigation Trustee, the Litigation Trust Board shall appoint one of its members to serve as interim Litigation Trustee (the "**Interim Trustee**"). The Interim Trustee shall be subject to all the terms and conditions applicable to a Litigation Trustee hereunder. Such Interim Trustee shall not be limited in any manner from exercising any rights or powers as a member of the Litigation Trust Board merely by its appointment as Interim Trustee.

(h) The death, resignation or removal of the Litigation Trustee shall not terminate the Litigation Trust or revoke any existing agency created pursuant to this Agreement or invalidate any action theretofore taken by the Litigation Trustee.

3.6 Acceptance of Appointment by Successor Trustee

Any successor trustee appointed hereunder shall execute an instrument accepting such appointment and assuming all of the obligations of the predecessor Litigation Trustee hereunder and accepting the terms of this Agreement and agreeing that the provisions of this Agreement shall be binding upon and inure to the benefit of the successor trustee and all of its heirs, and legal and personal representatives, successors and assigns, and thereupon the successor trustee shall, without any further act, become vested with all the estates, properties, rights, powers, trusts, and duties of its predecessor Litigation Trustee in the Litigation Trust hereunder with like effect as if originally named herein.

3.7 Regular Meetings of the Litigation Trustee and the Litigation Trust Board

Meetings of the Litigation Trustee, on one hand, and the Litigation Trust Board, on the other, are to be held with such frequency and in such manner and at such place as the Litigation Trust Board may determine in its sole discretion, but in no event shall such meetings be held less frequently than one time during each quarter of each calendar year.

3.8 Special Meetings of the Litigation Trustee and the Litigation Trust Board

Special meetings of the Litigation Trustee on the one hand, and the Litigation Trust Board, on the other, may be held whenever, wherever and however called for either by the Litigation Trustee or at least two members of the Litigation Trust Board.

3.9 Notice of, and Waiver of Notice for Litigation Trustee and Litigation Trust Board Meeting

Notice of the time and place (but not necessarily the purpose or all of the purposes) of any regular or special meeting of the Litigation Trust Board and the Litigation Trustee will be given to the Litigation Trustee and the members of the Litigation Trust Board in person or by telephone, or via mail, electronic mail, or facsimile transmission. Notice to the Litigation Trustee and the members of the Litigation Trust Board of any such meeting will be deemed given sufficiently in advance when (i) if given by mail, the same is deposited in the mail at least ten calendar days before the meeting date, with postage thereon prepaid, (ii) if given by electronic mail or facsimile transmission, the same is transmitted at least one Business Day prior to the convening of the meeting, or (iii) if personally delivered (including by overnight courier) or given by telephone, the same is handed, or the substance thereof is communicated over the telephone, to the Litigation Trustee and the members of the Litigation Trust Board or to an adult member of his/her office staff or household, at least one Business Day prior to the convening of the meeting. The Litigation Trustee and any member of the Litigation Trust Board may waive notice of any meeting of the Litigation Trust Board and any adjournment thereof at any time before, during, or after it is held, subject to applicable law. Except as provided in the next sentence below, the waiver must be in writing, signed by the Litigation Trustee or the applicable member or members of the Litigation Trust Board entitled to the notice, and filed with the minutes or records of the Litigation Trust. The attendance of the Litigation Trustee or a member of the Litigation Trust Board at a meeting (whether in person or by telephone or videoconference) shall constitute a waiver of notice of such meeting, except when the person attends a meeting for the express purpose of objecting, at the beginning of the meeting, to the transaction of any business because the meeting is not lawfully called or convened.

3.10 Manner of Acting

The Litigation Trustee or any member of the Litigation Trust Board may participate in a regular or special meeting by, or conduct the meeting through the use of, conference telephone, or similar communications equipment by means of which all persons participating in the meeting may hear each other, in which case any required notice of such meeting may generally describe the arrangements (rather than or in addition to the place) for the holding thereof. The Litigation Trustee or any member of the Litigation Trust Board participating in a meeting by this means is deemed to be present in person at the meeting.

3.11 Role of the Litigation Trustee

In furtherance of and consistent with the purpose of the Litigation Trust, the Litigation Trustee, subject to the terms and conditions of this Agreement, shall have the power to (i) prosecute, compromise and settle, abandon, dismiss or otherwise dispose of for the benefit of the Litigation Trust Beneficiaries all Litigation Trust Claims transferred to the Litigation Trust (whether such

suits are brought in the name of the Litigation Trust, the Litigation Trustee or otherwise), and (ii) otherwise perform the functions and take the actions provided for or permitted in this Agreement. In all circumstances, the Litigation Trustee shall act in the best interests of the Litigation Trust Beneficiaries and in furtherance of the purpose of the Litigation Trust.

3.12 Authority of Litigation Trustee

Subject to any limitations set forth in this Agreement (including, without limitation, Article 4 hereof and Section 3.4 of this Agreement) or in the Plan, but in addition to the other powers and authorities granted to the Litigation Trustee and set forth in this Agreement, the Litigation Trustee shall have the following powers and authorities:

(a) to hold legal title to any and all rights of the holders of Litigation Trust Interests in or arising from the Litigation Trust Assets, including collecting, receiving any and all money and other property belonging to the Litigation Trust (including any Litigation Trust Proceeds) and, in consultation with the Litigation Trust Board, the right, on behalf of the Litigation Trust Beneficiaries, to vote any claim or interest relating to a Litigation Trust Claim in any proceeding and to receive any distribution thereon;

(b) in consultation with, and subject to the approval of the Litigation Trust Board where required under the terms of this Agreement, to perform the duties, exercise the powers, and assert the rights of a trustee, including commencing, prosecuting or settling causes of action, enforcing contracts or asserting claims, defences, offsets and privileges;

(c) in consultation with the Litigation Trust Board, to protect and enforce the rights to the Litigation Trust Claims by any method deemed appropriate including by judicial proceedings or pursuant to any applicable bankruptcy, insolvency, moratorium or similar law and general principles of equity;

(d) in consultation with and subject to the approval of the Litigation Trust Board, to obtain reasonable insurance coverage with respect to the liabilities and obligations of the Litigation Trustee and the Litigation Trust Board under this Agreement (in the form of any errors and omissions policy or otherwise);

(e) in consultation with the Litigation Trust Board, to obtain insurance coverage with respect to real and personal property that may become assets of the Litigation Trust, if any;

(f) in consultation with and subject to the approval of the Litigation Trust Board, to retain and pay such counsel and other professionals, including any professionals previously retained by the ad hoc committee of Initial Consenting Noteholders or SFC, as the Litigation Trustee shall select to assist the Litigation Trustee in its duties, on such terms as the Litigation Trustee and the Litigation Trust Board deem reasonable and appropriate, without CCAA Court approval; and subject to the approval of the Litigation Trust Board, the Litigation Trustee may commit the Litigation Trust to and shall pay such counsel and other professionals reasonable

compensation for services rendered (including on an hourly, contingency, or modified contingency basis) and reasonable and documented out-of-pocket expenses incurred;

(g) in consultation with and subject to the approval of the Litigation Trust Board, to retain and pay an accounting firm to perform such reviews and/or audits of the financial books and records of the Litigation Trust as may be required by applicable laws (including, if applicable, securities laws) and/or this Agreement, and to prepare and file any tax returns, informational returns or periodic and current reports for the Litigation Trust as required by applicable laws (including, if applicable, securities laws) and/or by this Agreement; subject to the approval of the Litigation Trust Board, the Litigation Trustee may commit the Litigation Trust to and shall pay such accounting firm reasonable compensation for services rendered and reasonable and documented out-of-pocket expenses incurred;

(h) in consultation with and subject to the approval of the Litigation Trust Board, to retain, enter into fee arrangements with and pay such third parties to assist the Litigation Trustee in carrying out its powers, authorities and duties under this Agreement; subject to the approval of the Litigation Trust Board, the Litigation Trustee may commit the Litigation Trust to and shall pay all such Persons reasonable compensation for services rendered and reasonable and documented out-of-pocket expenses incurred, as well as commit the Litigation Trust to indemnify any such Persons in connection with the performance of services (provided that such indemnity shall not cover any losses, costs, damages, expenses or liabilities that result from the gross negligence, bad faith, wilful misconduct or knowing violation of law by such Persons);

(i) in consultation with and subject to the approval of the Litigation Trust Board, to waive any privilege (including the Privileges) or any defence on behalf of the Litigation Trust or, with respect to the Litigation Trust Claims;

(j) in consultation with and subject to the approval of the Litigation Trust Board, to investigate, analyze, compromise, adjust, arbitrate, mediate, sue on or defend, pursue; prosecute, abandon, dismiss, exercise rights, powers, and privileges with respect to, or otherwise deal with and settle, in accordance with the terms set forth herein, all causes of action in favour of or against the Litigation Trust;

(k) at any time from and after the Effective Date, and subject to the approval of the Litigation Trust Board and the prior consent of the Initial Consenting Noteholders, to seek and obtain an order from any court of competent jurisdiction, including an Order of the Court in the CCAA or otherwise, that gives effect to any releases of any Litigation Trust Claims agreed to by the Litigation Trustee in accordance with this Agreement, including a release that fully, finally, irrevocably and forever compromises, releases, discharges, cancels and bars the applicable Litigation Trust Claims as if they were Excluded Litigation Trust Claims released in accordance with Article 7 of the Plan;

(l) in consultation with and subject to the approval of the Litigation Trust Board, and solely with respect to Litigation Trust Claims, to avoid and recover transfers of SFC's property as may be permitted by applicable law;

(m) to invest any moneys held as part of the Litigation Trust in accordance with the terms of Section 3.19 of this Agreement;

(n) in consultation with the Litigation Trust Board, to request any appropriate tax determination with respect to the Litigation Trust;

(o) subject to applicable securities and other laws, if any, to establish and maintain a website for the purpose of providing notice of Litigation Trust activities in lieu of sending written notice to the holders of the Litigation Trust Interests and other such Persons entitled thereto, subject to providing notice of such website to such holders and other Persons;

(p) in consultation with the Litigation Trust Board, to seek the examination of any Person, subject to the provisions of any applicable laws or rules;

(q) to make distributions in accordance with Article 6 of this Agreement;

(r) to take or refrain from taking any and all other actions that the Litigation Trustee, upon consultation with the Litigation Trust Board, reasonably deems necessary or convenient for the continuation, protection and maximization of the Litigation Trust Claims or to carry out the purposes hereof; provided, however, that the Litigation Trustee shall not be required to consult with or obtain approval of the Litigation Trust Board to the extent such actions are purely administrative in nature; and

(s) in consultation with and subject to the approval of the Litigation Trust Board, to incur or receive on any terms that the Litigation Trustee and the Litigation Trust Board may approve, any further amounts to be used as a "Litigation Funding Amount" pursuant to the terms of this Agreement.

3.13 Limitation of Litigation Trustee's Authority

(a) Notwithstanding anything herein to the contrary, the Litigation Trustee shall not (i) be authorized to engage in any trade or business or (ii) take any such actions as would be inconsistent with the purposes of this Agreement, the preservation of the assets of the Litigation Trust and the best interests of the Litigation Trust Beneficiaries.

(b) The Litigation Trust shall not hold 50% or more of the stock (in either vote or value) of any Person that is treated as a corporation for federal income tax purposes, nor be the sole member of a limited liability company, nor have any interest in a Person that is treated as a partnership for federal income tax purposes, unless such stock, membership interest, or partnership interest was obtained involuntarily or as a matter of practical economic necessity in order to preserve the value of the Litigation Trust Assets.

3.14 Books and Records

(a) The Litigation Trustee shall maintain books and records relating to the Litigation Trust Assets and the Litigation Trust Proceeds and the payment of expenses of, liabilities of, and claims against or assumed by, the Litigation Trust in such detail and for such period of time as may be necessary to enable it to make full and proper accounting in respect thereof. Such books and records shall be maintained on a modified cash or other comprehensive basis of accounting necessary to facilitate compliance with the tax reporting and securities law requirements, if any, of the Litigation Trust as well as the reporting requirements set forth in Article 8 and elsewhere in this Agreement. Nothing in this Agreement requires the Litigation Trustee to file any accounting or seek approval of any court with respect to the administration of the Litigation Trust, or as a condition for managing any payment or distribution out of the assets of the Litigation Trust.

(b) Holders of the Litigation Trust Interests and their duly authorized representatives shall have the right, upon reasonable prior written notice to the Litigation Trustee, and in accordance with the reasonable regulations prescribed by the Litigation Trustee, to inspect and, at the sole expense of such holder seeking the same, make copies of the books and records relating to the Litigation Trust on any Business Day and as often as may be reasonably be desired, in each case for a purpose reasonably related to such holder's Litigation Trust Interests and subject to any confidentiality restrictions set forth herein or as the Litigation Trustee or the Litigation Trust Board may deem appropriate.

3.15 Inquiries into Trustee's Authority

Except as otherwise set forth in this Agreement or the Plan, no Person dealing with the Litigation Trust shall be obligated to inquire into the authority of the Litigation Trustee in connection with the protection, conservation or disposition of the Litigation Trust Claims.

3.16 Compliance with Laws

Any and all distributions of assets of the Litigation Trust shall be in compliance with applicable laws, including applicable provincial securities laws.

3.17 Compensation of the Litigation Trustee

Notwithstanding anything to the contrary contained herein, the Litigation Trustee shall be compensated for its services, and reimbursed for its expenses, in accordance with, and pursuant to the terms of, a separate agreement to be negotiated and executed by the Litigation Trust Board, which agreement shall not be subject to any third-party notice or approval.

3.18 Reliance by Litigation Trustee

Except as otherwise provided herein:

(a) the Litigation Trustee may rely on, and shall be protected in acting upon, any resolution, certificate, statement, instrument, opinion, report, notice, request,

consent, order or other paper or document reasonably believed by the Litigation Trustee to be genuine and to have been signed or presented by the proper party or parties; and

(b) Persons dealing with the Litigation Trustee shall look only to the assets of the Litigation Trust to satisfy any liability incurred by the Litigation Trustee to such Person in carrying out the terms of this Agreement, and neither the Litigation Trustee nor any member of the Litigation Trust Board shall have any personal obligation to satisfy any such liability.

3.19 Investment and Safekeeping of Litigation Trust Assets

Subject to Section 3.4 of this Agreement, the Litigation Trustee shall invest all Litigation Trust Assets (other than Litigation Trust Claims), all Litigation Trust Proceeds, the Litigation Funding Amount and all income earned by the Litigation Trust (pending distribution in accordance with Article 6 of this Agreement) only in cash and government securities, and the Litigation Trustee may retain any Litigation Trust Proceeds received that are not cash only for so long as may be required for the prompt and orderly liquidation of such assets into cash.

3.20 Standard of Care; Exculpation

Neither the Litigation Trustee nor any of its duly designated agents or representatives or professionals shall be liable for any act or omission taken or omitted to be taken by the Litigation Trustee in good faith, other than (i) acts or omissions resulting from the Litigation Trustee's or any such agent's, representative's or professional's gross negligence, bad faith, wilful misconduct or knowing violation of law or (ii) acts or omissions from which the Litigation Trustee or any such agent, representative or professional derived an improper personal benefit. The Litigation Trustee may, in connection with the performance of its functions, and in its sole and absolute discretion, consult with its counsel, accountants, financial advisors and agents, and shall not be liable for any act taken, omitted to be taken, or suffered to be done in accordance with advice or opinions rendered by such Persons. Notwithstanding such authority, the Litigation Trustee shall be under no obligation to consult with its counsel, accountants, financial advisors or agents, and its good faith determination not to do so shall not result in the imposition of liability on the Litigation Trustee, unless such determination is based on gross negligence, bad faith, wilful misconduct or knowing violation of law. No amendment, modification or repeal of this Section 3.20 shall adversely affect any right or protection of the Litigation Trustee or any of its agents, representatives or professionals that exists at the time of such amendment, modification or repeal.

ARTICLE 4
LITIGATION TRUST BOARD

4.1 Litigation Trust Board

A litigation trust board (the "**Litigation Trust Board**") shall initially consist of three Persons selected to serve in such capacity prior to the Effective Date by the Initial Consenting Noteholders, as listed on Schedule C hereto. No holder of Litigation Trust Interests (except to

the extent such holder is a member of the Litigation Trust Board) shall have any consultation or approval rights whatsoever in respect of management and operation of the Litigation Trust.

4.2 Authority of the Litigation Trust Board

The Litigation Trust Board shall have the authority and responsibility to oversee, review, and guide the activities and performance of the Litigation Trustee and shall have the authority to remove the Litigation Trustee in accordance with Section 3.5(c) of this Agreement. The Litigation Trustee shall consult with and provide information to the Litigation Trust Board in accordance with and pursuant to the terms of this Agreement and the Plan. The Litigation Trust Board shall have the authority to select and engage such Persons, and select and engage such professional advisors, including any professional previously retained by the Initial Consenting Noteholders or SFC, in accordance with the terms of this Agreement, as the Litigation Trust Board deems necessary and desirable to assist the Litigation Trust Board in fulfilling its obligations under this Agreement. The Litigation Trustee shall pay the reasonable fees of such Persons and firms (including on an hourly, contingency, or modified contingency basis) and reimburse such Persons for their reasonable and documented out-of-pocket costs and expenses consistent with the terms of this Agreement.

4.3 Regular Meetings of the Litigation Trust Board

Meetings of the Litigation Trust Board are to be held with such frequency and in such manner and at such place and time as the members of the Litigation Trust Board may determine in their reasonable discretion, but in no event shall such meetings be held less frequently than one time during each quarter of each calendar year.

4.4 Special Meetings of the Litigation Trust Board

Special meetings of the Litigation Trust Board may be held whenever, wherever and however called for by the Litigation Trust Board or any two members of the Litigation Trust Board.

4.5 Manner of Acting

(a) A majority of the total number of members of the Litigation Trust Board then in office shall constitute a quorum for the transaction of business at any meeting of the Litigation Trust Board (whether at a meeting with or without the Litigation Trustee); provided, however, that all decisions or approvals or other actions of the Litigation Trust Board shall require the affirmative vote of a majority of all of the members of the Litigation Trust Board, and such an affirmative vote obtained as to any particular matter, decision, approval or other action at a meeting at which a quorum is present shall be the act of the Litigation Trust Board, except as otherwise required by law or as provided in this Agreement.

(b) Voting may, if approved by the majority of all of the members of the Litigation Trust Board, be conducted by electronic mail or individual communications by each member of the Litigation Trust Board.

(c) Any member of the Litigation Trust Board who is present and entitled to vote at a meeting of the Litigation Trust Board (including any meeting of the Litigation

Trustee and the Litigation Trust Board) when action is taken is deemed to have assented to the action taken, subject to the requisite vote of the Litigation Trust Board unless: (i) such member of the Litigation Trust Board objects at the beginning of the meeting (or promptly upon his/her arrival) to holding it or transacting business at the meeting; or (ii) his/her dissent or abstention from the action taken is entered in the minutes of the meeting; or (iii) he/she delivers written notice (including by electronic or facsimile transmission) of his/her dissent or abstention to the Litigation Trust Board before its adjournment. The right of dissent or abstention is not available to any member of the Litigation Trust Board who votes in favour of the action taken.

(d) Prior to the taking of a vote on any matter or issue or the taking of any action with respect to any matter or issue, each member of the Litigation Trust Board shall report to the Litigation Trust Board any conflict of interest such member has or may have with respect to the matter or issue at hand and fully disclose the nature of such conflict or potential conflict (including disclosing any and all financial or other pecuniary interests that such member might have with respect to or in connection with such matter or issue, other than solely as a holder of a Litigation Trust Interest). A member who has or who may have a conflict of interest shall be deemed to be a "conflicted member" who shall not be entitled to vote or take part in any action with respect to such matter or issue (provided, however, such member shall be counted for purposes of determining the existence of a quorum); the vote or action with respect to such matter or issue shall be undertaken only by members of the Litigation Trust Board who are not "conflicted members" and, notwithstanding anything contained herein to the contrary, the affirmative vote of only a majority of the members of the Litigation Trust Board who are not "conflicted members" shall be required to approve of such matter or issue and the same shall be the act of the Litigation Trust Board.

4.6 Litigation Trust Board's Action Without a Meeting

Any action required or permitted to be taken by the Litigation Trust Board at a meeting of the Litigation Trust Board may be taken without a meeting if the action is taken by unanimous written consent of the Litigation Trust Board as evidenced by one or more written (including by way of email) consents describing the action taken, signed by all members of the Litigation Trust Board and recorded in the minutes or other transcript of proceedings of the Litigation Trust Board.

4.7 Notice of, and Waiver of Notice for Litigation Trust Board Meetings

Notice of the time and place (but not necessarily the purpose or all of the purposes) of any regular or special meeting of the Litigation Trust Board will be given to the members of the Litigation Trust Board in person or by telephone, or via mail, electronic mail, or facsimile transmission. Notice to the members of the Litigation Trust Board of any such special meeting will be deemed given sufficiently in advance when (i) if given by mail, the same is deposited in the mail at least ten calendar days before the meeting date, with postage thereon prepaid, (ii) if given by electronic mail or facsimile transmission, the same is transmitted at least one Business Day prior to the convening of the meeting, or (iii) if personally delivered (including by overnight

courier) or given by telephone, the same is handed, or the substance thereof is communicated over the telephone to the members of the Litigation Trust Board or to an adult member of his/her office staff or household, at least one Business Day prior to the convening of the meeting. Any member of the Litigation Trust Board may waive notice of any meeting and any adjournment thereof at any time before, during, or after it is held, subject to applicable law. Except as provided in the next sentence below, the waiver must be in writing, signed by the applicable member or members of the Litigation Trust Board entitled to the notice. The attendance of a member of the Litigation Trust Board at a meeting (whether in person or by telephone or videoconference) shall constitute a waiver of notice of such meeting, except when the person attends a meeting for the express purpose of objecting, at the beginning of the meeting, to the transaction of any business because the meeting is not lawfully called or convened.

4.8 Telephonic Communications

Any member of the Litigation Trust Board may participate in a regular or special meeting of the Litigation Trust Board by, or conduct the meeting through the use of, conference telephone, or similar communications equipment by means of which all persons participating in the meeting may hear each other, in which case any required notice of such meeting may generally describe the arrangements (rather than or in addition to the place) for the holding thereof. Any member of the Litigation Trust Board participating in a meeting by this means is deemed to be present in person at the meeting.

4.9 Tenure, Removal and Replacement of the Members of the Litigation Trust Board

The authority of the members of the Litigation Trust Board will be effective as of the Effective Date and will remain and continue in full force and effect until the Litigation Trust is terminated in accordance with Section 8.1 hereof. The service of the members of the Litigation Trust Board will be subject to the following:

(a) The members of the Litigation Trust Board will serve until death or resignation pursuant to Section 4.9(b) of this Agreement, or removal pursuant to Section 4.9(c) of this Agreement.

(b) A member of the Litigation Trust Board may resign at any time by providing a written notice of resignation to the remaining members of the Litigation Trust Board. Such resignation will be effective upon the date received by the Litigation Trust Board or such later date specified in the written notice.

(c) A member of the Litigation Trust Board may be removed by the majority vote of the other members of the Litigation Trust Board, written resolution of which shall be delivered to the removed Litigation Trust Board member; provided, however, that such removal may only be made for Cause. For purposes of this Section 4.9(c), "**Cause**" shall be defined as: (i) such Litigation Trust Board member's theft or embezzlement or attempted theft or embezzlement of money or tangible or intangible assets or property; (ii) such Litigation Trust Board member's violation of any law (whether foreign or domestic), which results in an indictable offence or similar judicial proceeding; (iii) such Litigation Trust Board member's gross negligence, bad faith, wilful misconduct or knowing violation of law, in the

performance of his or her duties as a member of the Litigation Trust Board; or (iv) such Litigation Trust Board member's failure to perform any of his or her other material duties under this Agreement (including the regular attendance at meetings of the Litigation Trust Board and of the Litigation Trustee and the Litigation Trust Board); provided, however, that such Litigation Trust Board member shall have been given a reasonable period to cure any alleged Cause under clauses (iii) (other than bad faith, wilful misconduct or knowing violation of law) and (iv).

(d) In the event of a vacancy on the Litigation Trust Board (whether by removal, death or resignation), the remaining members of the Litigation Trust Board shall appoint a new member to fill such position. In the event that there are no members of the Litigation Trust Board selected or appointed in accordance with the preceding sentence, appointments to fill such vacancies that would have been made in accordance with the preceding sentence shall be made by the Litigation Trustee, following consultation with the Monitor (if available in such capacity). Upon any such appointment of a successor member of the Litigation Trust Board, the Litigation Trustee shall provide the holders of the Litigation Trust Interests with notice of the name of the new member of the Litigation Trust Board, provided, however, that the provision of such notice shall not be a condition precedent to the rights and power of the new member of the Litigation Trust Board to act in such capacity.

(e) Immediately upon the appointment of any successor member of the Litigation Trust Board all rights, powers, duties, authority, and privileges of the predecessor member of the Litigation Trust Board hereunder will be vested in and undertaken by the successor member of the Litigation Trust Board without any further act; and the successor member of the Litigation Trust Board will not be liable personally for any act or omission of the predecessor member of the Litigation Trust Board.

4.10 Compensation of the Litigation Trust Board

Each member of the Litigation Trust Board shall be paid an annual amount as compensation for his or her services hereunder as a member of the Litigation Trust Board, which amount shall be determined by the Board of Newco (as defined in the Plan) from time to time. In addition, each member of the Litigation Trust Board shall be entitled to be reimbursed from the Litigation Trust for his or her reasonable and documented out-of-pocket expenses incurred in connection with the performance of his or her duties hereunder by the Litigation Trust upon demand for payment thereof.

4.11 Standard of Care; Exculpation

None of the Litigation Trust Board, its respective members, designees, professionals, or duly designated agents, counsel or representatives, shall be liable for the act or omission of any other member, designee, professional, agent, or representative of the Litigation Trust Board, nor shall any member of the Litigation Trust Board be liable for any act or omission taken or omitted to be taken by the Litigation Trust Board in good faith, other than for (i) acts or omissions resulting

from the Litigation Trust Board's or any such member's, designee's, professional's, agent's or representative's gross negligence, bad faith, wilful misconduct or knowing violation of law or (ii) acts or omissions from which the Litigation Trust Board or such member, designee, professional, agent or representative derived an improper personal benefit. The Litigation Trust Board may, in connection with the performance of its functions, and in its sole and absolute discretion, consult with the Litigation Trust Board's counsel, accountants, financial advisors and agents, and shall not be liable for any act taken, omitted to be taken, or suffered to be done in good faith in accordance with advice or opinions rendered by such Persons. Notwithstanding such authority, none of the Litigation Trust Board or any of its members shall be under any obligation to consult with the Litigation Trust Board's counsel, accountants, financial advisors or agents, and their good faith determination not to do so shall not result in the imposition of liability on the Litigation Trust Board or, as applicable, any of its members, designees, professionals, agents or representatives, unless such determination is based on gross negligence, bad faith, wilful misconduct or knowing violation of law. No amendment modification or repeal of this Section 4.11 shall adversely affect any right or protection of the Litigation Trust Board, its members, designees, professional agents or representatives that exists at the time of such amendment, modification or repeal.

ARTICLE 5
TAX MATTERS

5.1 U.S. Federal Income Tax Treatment of the Litigation Trust

(a) For all U.S. federal income tax purposes, all parties (including SFC and the other Litigation Trust Claims Transferors, the Litigation Trustee, the Litigation Trust Board and the Litigation Trust Beneficiaries) shall treat the transfer of the Litigation Trust Assets to the Litigation Trustee for the benefit of the Litigation Trust Beneficiaries as (a) a transfer of the Litigation Trust Assets directly to those Litigation Trust Beneficiaries receiving Litigation Trust Interests (other than to the extent allocable to Unresolved Claims), followed by (b) the transfer by such Litigation Trust Beneficiaries to the Litigation Trustee of the Litigation Trust Assets in exchange for the Litigation Trust Interests (and in respect of the Litigation Trust Assets allocable to the Unresolved Claims, as a transfer to the Unresolved Claims Reserve by the Litigation Trust Claim Transferors). Accordingly, those Litigation Trust Beneficiaries receiving Litigation Trust Interests shall be treated for U.S. federal income tax purposes as the grantors and owners of their respective shares of the Litigation Trust Assets. The foregoing treatment also shall apply, to the extent permitted by applicable law, for U.S. state and local income tax purposes.

(b) Subject to definitive guidance from the I.R.S. or a court of competent jurisdiction to the contrary, the Litigation Trustee shall file returns for the Litigation Trust as a grantor trust pursuant to Treasury Regulation section 1.671-4(a) and in accordance with this Article 5. The Litigation Trustee shall also annually send to each holder of a Litigation Trust Interest a separate statement setting forth such holder's share of items of income, gain, loss, deduction, or credit and will instruct all such holders and parties to report such items on their federal income tax returns. The Litigation Trustee also shall file (or cause to be filed) any other

statements, returns or disclosures relating to the Litigation Trust that are required by any governmental unit.

(c) The Litigation Trust Board shall inform, in writing, the Litigation Trustee of the fair market value of the Litigation Trust Assets transferred to the Litigation Trust based on the good faith determination of the Litigation Trust Board, and the Litigation Trustee shall apprise, in writing, the Litigation Trust Beneficiaries of such valuation. In such circumstances, the valuation shall be used consistently by all parties (including SFC and the other Litigation Trust Claim Transferors, the Litigation Trustee, the Litigation Trust Board and the Litigation Trust Beneficiaries) for all federal income tax purposes, as applicable. As applicable or necessary, the Litigation Trustee shall make such valuation prepared by the Litigation Trust Board available from time to time, to the extent relevant or reasonably necessary, and such valuation shall be used consistently by all parties (including SFC and the other Litigation Trust Claim Transferors, the Litigation Trustee, the Litigation Trust Board and the Litigation Trust Beneficiaries) for all federal income tax purposes. In connection with the preparation of any such valuation, the Litigation Trust Board shall be entitled to retain such professionals and advisors as the Litigation Trust Board shall determine to be appropriate or necessary, and the Litigation Trust Board shall take such other actions in connection therewith as it determines to be appropriate or necessary in connection therewith. The Litigation Trust shall bear all of the reasonable costs and expenses incurred in connection with determining such value, including the fees and expenses of any Persons retained by the Litigation Trust Board in connection therewith.

(d) If applicable, the Litigation Trustee may request an expedited determination of taxes of the Litigation Trust for all returns filed for, or on behalf of, the Litigation Trust for all taxable periods through the dissolution of the Litigation Trust.

(e) The Litigation Trustee shall be responsible for payments, out of the Litigation Trust Assets and Litigation Trust Proceeds, of any taxes imposed on the Litigation Trust or the Litigation Trust Assets.

(f) The Litigation Trustee may require any of the Litigation Trust Beneficiaries to furnish to the Litigation Trustee its Employer or Taxpayer Identification Number and the Litigation Trustee may condition any distribution or payment to any of them upon receipt of such identification number.

5.2 Allocations of Litigation Trust Taxable Income For U.S. Federal Income Tax Purposes

Allocations of Litigation Trust taxable income among the holders of the Litigation Trust Interests shall be determined by reference to the manner in which an amount of cash equal to such taxable income would be distributed (without regard to any restrictions on distributions described herein) if, immediately prior to such deemed distribution, the Litigation Trust had distributed all of its other assets (valued at their tax book value) to the holders of the Litigation Trust Interests, in each case up to the tax book value of the assets treated as contributed by such holders, adjusted

for prior taxable income and loss and taking into account all prior and concurrent distributions from the Litigation Trust (including all distributions held in escrow pending the resolution of Unresolved Claims). Similarly, taxable loss of the Litigation Trust shall be allocated by reference to the manner in which an economic loss would be borne immediately after a liquidating distribution of the remaining Litigation Trust Assets. The tax book value of the Litigation Trust Assets for this purpose shall equal their fair market value on the Effective Date (or otherwise, as applicable) as determined under Section 5.1(c) above, adjusted in either case in accordance with tax accounting principles prescribed by the Internal Revenue Code, and applicable tax regulations, and other applicable administrative and judicial authorities and pronouncements.

5.3 Canadian Tax Treatment of Distributions by Litigation Trustee

Amounts distributed by the Litigation Trustee shall be treated as distributions of income or capital for Canadian federal income tax purposes, as determined by the Litigation Trustee. The Litigation Trustee shall be entitled to file any election for tax purposes which it considers desirable or appropriate. The Litigation Trustee may create a legally enforceable right of Litigation Trust Beneficiaries in respect of any particular distribution to enforce payment of that distribution on or before December 31 of the relevant taxation year of the Litigation Trust.

ARTICLE 6
DISTRIBUTIONS

6.1 Distributions; Withholding

Subject to Section 3.4 of this Agreement, the Litigation Trustee shall distribute, in accordance with this Article 6, to the holders of the Litigation Trust Interests the Litigation Trust Proceeds (including, without limitation, all net cash income plus all net cash proceeds from the liquidation of Litigation Trust Assets (including as cash, for this purpose, all cash equivalents), but excluding, for greater certainty, the Litigation Funding Amount or any remaining portion thereof); provided, however, that the Litigation Trustee may retain and not distribute to holders of the Litigation Trust Interests such amounts as determined by the Litigation Trust Board (i) as are reasonably necessary to meet contingent liabilities of the Litigation Trust during liquidation and (ii) to pay reasonable and necessary administrative expenses incurred in connection with liquidation and any taxes imposed on the Litigation Trust or in respect of the Litigation Trust Assets, and provided further that prior to any distribution of Litigation Trust Proceeds to the holders of the Litigation Trust Interests, the Litigation Trustee shall first pay to Newco an amount in cash equivalent to the Litigation Funding Amount (together with any other amounts that may have been advanced by Newco as Litigation Funding Amounts). All distributions and/or payments to be made to the holders of the Litigation Trust Interests pursuant to this Agreement shall be made to the holders of the Litigation Trust Interests pro rata based on the amount of Litigation Trust Interests held by a holder compared with the aggregate amount of the Litigation Trust Interests outstanding, subject, in each case, to the terms of the Plan and this Agreement. The Litigation Trustee may withhold from amounts distributable to any Person any and all amounts, determined in the Litigation Trustee's reasonable sole discretion, to be required by any law, regulation, rule, ruling, directive or other governmental requirement.

6.2 Manner of Payment or Distribution

All distributions to be made by the Litigation Trustee hereunder to the holders of the Litigation Trust Interests shall be made to a disbursing agent acceptable to the Litigation Trust Board for further distribution to the holders of the Litigation Trust Interests and shall be payable to the holders of Litigation Trust Interests of record as of the 20th day prior to the date scheduled for the distribution, unless such day is not a Business Day, then such day shall be the following Business Day. If the distribution shall be in cash, the Litigation Trustee shall distribute such cash by wire, check, or such other method as the Litigation Trustee deems appropriate under the circumstances.

6.3 Cash Distributions

No cash distributions shall be required to be made to any holders of a Litigation Trust Interest in an amount less than $100.00. Any funds so withheld and not distributed shall be held in reserve and distributed in subsequent distributions. Notwithstanding the foregoing, all cash shall be distributed in the final distribution of the Litigation Trust.

ARTICLE 7
INDEMNIFICATION

7.1 Indemnification of Litigation Trustee and the Litigation Trust Board

(a) To the fullest extent permitted by law, the Litigation Trust, to the extent of its assets legally available for that purpose, shall indemnify and hold harmless the Litigation Trustee, each of the members of the Litigation Trust Board and each of their respective directors, members, shareholders, partners, officers, agents, employees, counsel and other professionals (collectively, the "**Indemnified Persons**") from and against any and all losses, costs, damages, reasonable and documented out-of-pocket expenses (including reasonable fees and expenses of counsel and other advisors and any court costs incurred by any Indemnified Person) or liability by reason of anything any Indemnified Person did, does, or refrains from doing for the business or affairs of the Litigation Trust, except to the extent that the loss, cost, damage, expense or liability resulted (i) from the Indemnified Person's gross negligence, bad faith, wilful misconduct or knowing violation of law or (ii) from an act or omission from which the Indemnified Person derived an improper personal benefit. To the extent reasonable, the Litigation Trust shall pay in advance or reimburse reasonable and documented out-of-pocket expenses (including advancing reasonable costs of defence) incurred by the Indemnified Person who is or is threatened to be named or made a defendant or a respondent in a proceeding concerning the business and affairs of the Litigation Trust. The indemnification provided under this Section 7.1 shall survive the death, dissolution, resignation or removal, as may be applicable, of the Litigation Trustee, the Litigation Trust Board, any Litigation Trust Board member and/or any other Indemnified Person, and shall enure to the benefit of the Litigation Trustee's, each Litigation Trust Board member's and each other Indemnified Person's heirs, successors and assigns.

(b) Any Indemnified Person may waive the benefits of indemnification under this Section 7.1, but only by an instrument in writing executed by such Indemnified Person.

(c) The rights to indemnification under this Section 7.1 are not exclusive of other rights which any Indemnified Person may otherwise have at law or in equity, including without limitation common law rights to indemnification or contribution. Nothing in this Section 7.1 will affect the rights or obligations of any Person (or the limitations on those rights or obligations) under this Agreement, or any other agreement or instrument to which that Person is a party.

ARTICLE 8
REPORTING OBLIGATIONS OF LITIGATION TRUSTEE

8.1 Reports

(a) The Litigation Trustee shall prepare such reports as the Litigation Trust Board shall request from time to time, which reports may be marked privileged and confidential at the discretion of the Litigation Trust Board or the Litigation Trustee, and shall distribute such reports to the Litigation Trust Board and, if directed by the Litigation Trust Board, to all holders of the Litigation Trust Interests as provided in this Article 8. For the avoidance of doubt, the holders of the Litigation Trust Interests shall not be entitled to any report, financial or otherwise, unless determined by the Litigation Trust Board in its sole discretion.

(b) Without limiting the foregoing, the Litigation Trustee shall timely (i) prepare, file and distribute such statements, reports, tax returns and forms, and submissions as may be necessary to cause the Litigation Trust and the Litigation Trustee to be in compliance with all applicable laws (including any quarterly and annual reports to the extent required by applicable law or in order to gain an exemption from compliance with applicable law) and (ii) prepare and file with the CCAA Court such reports and submissions as may be required by the CCAA Court.

(c) The Litigation Trustee may post any report required to be provided under this Section 8.1 on a web site maintained by the Litigation Trustee in lieu of actual notice, subject to also filing such reports with the CCAA Court when required to do so.

ARTICLE 9
TERM; TERMINATION OF THE LITIGATION TRUST

9.1 Term; Termination of the Litigation Trust

(a) The Litigation Trust shall commence on the date hereof and terminate no later than the fifth anniversary of the Effective Date; provided, however, that, on or prior to the date that is 90 days prior to such termination, the Litigation Trust Board may extend the term of the Litigation Trust if it is necessary to the efficient and proper administration of the Litigation Trust Assets in accordance with the

purposes and terms of this Agreement. Notwithstanding the foregoing, multiple extensions can be obtained so long as each extension is obtained not less than 90 days prior to the expiration of each extended term; and provided, further, that neither this Agreement nor the continued existence of the Litigation Trust shall prevent SFC from terminating the CCAA Proceeding.

(b) The Litigation Trust may be terminated earlier than its scheduled termination if: (i) the Litigation Trustee has administered all Litigation Trust Assets and performed all other duties required by this Agreement and the Litigation Trust; or (ii) if the Litigation Trustee, in consultation with and subject to the approval of the Litigation Trust Board, determines that it is not in the best interests of the Litigation Trust Beneficiaries to continue pursuing the Litigation Trust Claims. Upon termination of the Litigation Trust pursuant to subsection (ii) hereof, any and all remaining portion of the Litigation Funding Amount shall be paid to Newco in cash by wire, check, or such other method as agreed to by the Litigation Trustee and Newco.

9.2 Continuance of Trust for Winding Up

After the termination of the Litigation Trust and for the purpose of liquidating and winding up the affairs of the Litigation Trust, the Litigation Trustee shall continue to act as such until its duties have been fully performed. Prior to the final distribution of all of the remaining assets of the Litigation Trust and upon approval of the Litigation Trust Board, the Litigation Trustee shall be entitled to reserve from such assets any and all amounts required to provide for its own reasonable costs and expenses, in accordance with Section 3.17, until such time as the winding up of the Litigation Trust is completed. Upon termination of the Litigation Trust, the Litigation Trustee shall retain for a period of two years the books, records and other documents and files that have been delivered to or created by the Litigation Trustee. At the Litigation Trustee's discretion, all of such records and documents may, but need not, be destroyed at any time after two years from the completion and winding up of the affairs of the Litigation Trust. Except as otherwise specifically provided herein, upon the termination of the Litigation Trust, the Litigation Trustee shall have no further duties or obligations hereunder.

ARTICLE 10
AMENDMENT AND WAIVER

10.1 Amendment and Waiver

The Litigation Trustee, with the prior approval of the majority of the members of the Litigation Trust Board, may amend, supplement or waive any provision of, this Agreement, without notice to or the consent of the holders of the Litigation Trust Interests or the approval of the CCAA Court to (or on behalf or for the account of) any of the holders of the Litigation Trust Interests: (i) to cure any ambiguity, omission, defect or inconsistency in this Agreement; (ii) to comply with any requirements in connection with the tax status of the Litigation Trust; (iii) to comply with any requirements in connection with maintaining that the Litigation Trust is not subject to registration or reporting requirements; (iv) to make the Litigation Trust a reporting entity and, in such event, to comply with any requirements in connection with satisfying any applicable registration or reporting requirements; (v) to evidence and provide for the acceptance of

appointment hereunder by a successor trustee in accordance with the terms of this Agreement; and (vi) to achieve any other purpose that is not inconsistent with the purpose and intention of this Agreement; provided, that, no such amendment, supplement or waiver shall adversely affect the payments and/or distributions to be made under this Agreement.

ARTICLE 11
MISCELLANEOUS PROVISIONS

11.1 Intention of Parties to Establish the Litigation Trust

This Agreement is intended to create a liquidating trust for U.S. federal income tax purposes and, to the extent provided by law, shall be governed and construed in all respects as such a trust and any ambiguity herein shall be construed consistent herewith and, if necessary, this Agreement may be amended in accordance with Section 10.1 to comply with such federal income tax laws, which amendments may apply retroactively.

11.2 Laws as to Construction

This Agreement shall be governed by and construed in accordance with the laws of the Province of Ontario and the federals laws of Canada applicable therein, without regard to whether any conflicts of law would require the application of the law of another jurisdiction.

11.3 Jurisdiction

Without limiting any Person's right to appeal any order of the CCAA Court with regard to any matter, (i) the CCAA Court shall retain exclusive jurisdiction to enforce the terms of this Agreement and to decide any claims or disputes which may arise or result from, or be connected with, this Agreement, any breach or default hereunder, or the transactions contemplated hereby, and (ii) any and all actions related to the foregoing shall be filed and maintained only in the CCAA Court, and the parties, including the holders of the Litigation Trust Interests, and holders of Claims, hereby consent to and submit to the jurisdiction and venue of the CCAA Court.

11.4 Severability

If any provision of this Agreement or the application thereof to any Person or circumstance shall be finally determined by a court of competent jurisdiction to be invalid or unenforceable to any extent, the remainder of this Agreement, or the application of such provision to Persons or circumstances other than those as to which it is held invalid or unenforceable, shall not be affected thereby, and such provision of this Agreement shall be valid and enforced to the fullest extent permitted by law.

11.5 Notices

All notices, requests or other communications to the parties hereto shall be in writing and shall be sufficiently given only if (i) delivered in person; (ii) sent by electronic mail or facsimile communication (as evidenced by a confirmed fax transmission report); (iii) sent by registered or certified mail, return receipt requested; or (iv) sent by commercial delivery service or courier. Until a change of address is communicated, as provided below, all notices, requests and other communications shall be sent to the parties at the following addresses or facsimile numbers:

If to the Litigation Trustee:

Cosimo Borrelli
c/o Borrelli Walsh
Level 17, Tower 1, Admiralty Centre
18 Harcourt Road
Hong Kong
Telephone: 852.3761.3800
Facsimile: 852.3761.3889
Email: cb@borrelliwalsh.com

If to the Litigation Trust Board Members:

Paul Brough
c/o Blue Willow Limited
11th Floor, Waga Commercial Centre
99 Wellington Street
Central, Hong Kong
Telephone: 852.9109.6469
Facsimile: 852.2319.1001
Email: paulbrough@bluewillowhk.com

And to:

Eugene Davis
5 Canoe Brook Dr.
Livingston, NJ
07039-6121, USA
Telephone: 1.973.464.9333
Facsimile: 1.973.535.1843
Email: genedavis@pirinateconsulting.com

And to:

Barry Field
140 The Street,
Rushmere St Andrew, Ipwswich
IP5 1 DH, UK
Telephone: 44. 14.7348.4437
Email: barry.field2@gmail.com

(with a copy to)

Hogan Lovells LLP
11th Floor, One Pacific Place
88 Queensway
Hong Kong
Telephone: 852.2840.5002
Facsimile: 852.2219.0222
Email: neil.mcdonald@hoganlovells.com
Attn: Neil McDonald

All notices shall be effective and shall be deemed delivered (i) if by personal delivery, delivery service or courier, on the date of delivery; (ii) if by electronic mail or facsimile communication, on the date of receipt or confirmed transmission of the communication; and (iii) if by mail, on the date of receipt. Any Person from time to time may change his, her or its address, facsimile number, or other information for the purpose of notices to that Person by giving notice specifying such change to the Litigation Trustee and the Persons who are at the time of such notice members of the Litigation Trust Board.

11.6 Fiscal Year

The fiscal year of the Litigation Trust will begin on the first day of January and end on the last day of December of each calendar year.

11.7 Construction; Usage

(a) Interpretation. In this Agreement, unless a clear contrary intention appears:

(i) the singular number includes the plural number and vice versa;

(ii) reference to any Person includes such Person's successors and assigns but, if applicable, only if such successors and assigns are not prohibited by this Agreement, and reference to a Person in a particular capacity excludes such Person in any other capacity or individually;

(iii) reference to any gender includes each other gender;

(iv) reference to any agreement, document or instrument means such agreement, document or instrument as amended or modified and in effect from time to time in accordance with the terms thereof;

(v) reference to any applicable law means such applicable law as amended, modified, codified, replaced or re-enacted, in whole or in part, and in effect from time to time, including rules and regulations promulgated thereunder, and reference to any section or other provision of any applicable law means that provision of such applicable law from time to time in effect and constituting the substantive amendment, modification, codification, replacement or re-enactment of such section or other provision;

(vi) "hereunder," "hereof," "hereto," and words of similar import shall be deemed references to this Agreement as a whole and not to any particular Article, Section or other provision hereof;

(vii) reference to Articles, Sections, Schedules or Exhibits herein shall be deemed to be references to the Articles, Sections, Schedules and Exhibits to this Agreement unless otherwise specified;

(viii) "including" means including without limiting the generality of any description preceding such term; and

(ix) references to documents, instruments or agreements shall be deemed to refer as well to all addenda, exhibits, schedules or amendments thereto.

(b) Legal Representation of the Parties. This Agreement was negotiated by the parties and beneficiaries hereto with the benefit of legal representation and any rule of construction or interpretation otherwise requiring this Agreement to be construed or interpreted against any party hereto shall not apply to any construction or interpretation hereof.

(c) Headings. The headings contained in this Agreement are for the convenience of reference only, shall not be deemed to be a part of this Agreement and shall not be referred to in connection with the construction or interpretation of this Agreement.

11.8 Counterparts; Facsimile; PDF

This Agreement may be executed in any number of counterparts, each of which shall be deemed an original and all of which shall constitute one and the same instrument. Any facsimile or portable document format copies hereof or signature hereon shall, for all purposes, be deemed originals.

11.9 Confidentiality

The Litigation Trustee and each successor trustee and each member of the Litigation Trust Board and each successor member of the Litigation Trust Board (each a "**Covered Person**") shall, during the period that they serve in such capacity under this Agreement and following either the termination of this Agreement or such individual's removal, incapacity, or resignation hereunder, hold strictly confidential and not use for personal gain any material, non-public information of or pertaining to any Person to which any of the assets of the Litigation Trust relates or of which it has become aware in its capacity (the "**Information**"), including without limitation, the identity of any Holder of Litigation Trust Interests and the extent of their holdings thereof, except to the extent disclosure of any such information is required by applicable law, order, regulation or legal process. In the event that any Covered Person is requested or required (by oral questions, interrogatories, requests for information or documents, subpoena, civil investigation, demand or similar legal process) to disclose any Information, such Covered Person shall notify the Litigation Trust Board reasonably promptly (unless prohibited by law) so that the Litigation Trust Board may seek an appropriate protective order or other appropriate remedy or, in its discretion, waive compliance with the terms of this Section 11.9 (and if the Litigation Trust

Board seeks such an order, the relevant Covered Person will provide cooperation as the Litigation Trust Board shall reasonably request). In the event that no such protective order or other remedy is obtained, or that the Litigation Trust Board waives compliance with the terms of this Section 11.9 and that any Covered Person is nonetheless legally compelled to disclose the Information, the Covered Person will furnish only that portion of the Information, which the Covered Person, advised by counsel, is legally required and will give the Litigation Trust Board written notice (unless prohibited by law) of the Information to be disclosed as far in advance as practicable and exercise all reasonable efforts to obtain reliable assurance that confidential treatment will be accorded the Information.

11.10 Entire Agreement

This Agreement (including the Recitals), the Plan, and the Plan Sanction Order constitute the entire agreement by and among the parties hereto and there are no representations, warranties, covenants or obligations except as set forth herein or therein. This Agreement, the Plan and the Plan Sanction Order supersede all prior and contemporaneous agreements, understandings, negotiations, discussions, written or oral, of the parties hereto, relating to any transaction contemplated hereunder. Except as otherwise specifically provided herein, in the Plan or in the Plan Sanction Order, nothing in this Agreement is intended or shall be construed to confer upon or to give any Entity or Person other than the parties hereto and their respective heirs, administrators, executors, permitted successors, or permitted assigns any right to remedies under or by reason of this Agreement, except that (i) the Persons identified in Article 7 hereof are intended third party beneficiaries of Article 7 hereof and shall be entitled to enforce the provisions thereof as if they were parties hereto and (ii) the members (and former members) of the Litigation Trust Board are intended third party beneficiaries of Article 4 hereof and shall be entitled to enforce the provisions thereof as if they were parties hereto.

11.11 No Bond

Notwithstanding any state or federal law to the contrary, the Litigation Trustee (including any successor trustee) shall be exempt from giving any bond or other security in any jurisdiction.

11.12 Effectiveness

This Agreement shall become effective on the Effective Date.

11.13 Successor and Assigns

This Agreement shall inure to the benefit of the parties hereto and the intended third party beneficiaries identified in Section 11.10 hereof (to the extent specified therein), and shall be binding upon the parties hereto, and each of their respective successors and assigns to the extent permitted by this Agreement and applicable law.

11.14 No Execution

All funds in the Litigation Trust shall be deemed in *custodia legis* until such times as the funds have actually been paid to or for the benefit of a holder of a Litigation Trust Interest, and no holder of a Litigation Trust Interest or any other Person can execute upon, garnish or attach the assets of the Litigation Trust in any manner or compel payment from the Litigation Trust except

by an order of the CCAA Court. Distributions from the Litigation Trust will be governed solely by the Plan and this Agreement.

11.15 Irrevocability

The Litigation Trust is irrevocable, but is subject to amendment and waiver as provided for in this Agreement.

[SIGNATURE PAGE FOLLOWS]

IN WITNESS WHEREOF, the parties hereto have either executed and acknowledged this Agreement, or caused it to be executed and acknowledged on their behalf by their duly authorized officers all as of the date first above written.

SINO-FOREST CORPORATION:

By: ______________________________
Name:
Title:

LITIGATION TRUSTEE:

____
Name: Cosimo Borrelli, solely in his capacity as the Litigation Trustee and not in his personal capacity

6148079

SCHEDULE A

Index of Defined Terms

Term	Location
Agreement	Introduction
Cause	Section 4.9(c)
Causes of Action	Preliminary Statement
CCAA	Preliminary Statement
CCAA Court	Preliminary Statement
Covered Person	Section 11.9
Effective Date	Section 1.2(b)
Excluded Litigation Trust Claims	Section 1.3(b)
Filing Date	Preliminary Statement
Indemnified Persons	Section 7.1(a)
Information	Section 11.9
Interim Trustee	Section 3.5(g)
Litigation Trust Assets	Preliminary Statement
Litigation Trust Beneficiary	Preliminary Statement
Litigation Trust Board	Section 4.1
Litigation Trust Claims	Preliminary Statement
Litigation Trust Claims Transferors	Section 1.4(a)
Litigation Trust Proceeds	Section 3.1
Litigation Trustee	Introduction
Plan	Preliminary Statement
Privileges	Section 1.3(a)
Registrar	Section 2.5(b)
Settlement Funds	Section 1.1
SFC	Introduction
SFC Litigation Trust	Section 1.2(a)
Third Party Disclosers	Section 1.3(f)
Transfer	Section 2.5(a)
Trust Register	Section 2.5(c)

SCHEDULE B

Form of Promissory Note for Litigation Trust Funding Amount

SCHEDULE C

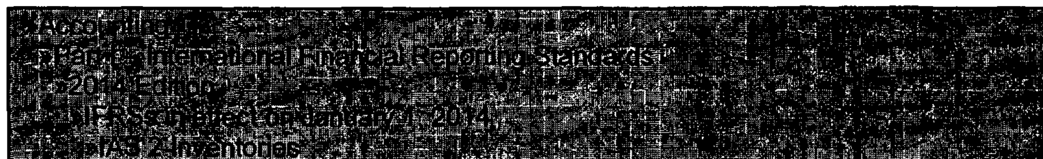
Initial Members of the Litigation Trust Board

Paul Brough

Gene Davis

Barry Field

News knotia.ca



INTERNATIONAL ACCOUNTING STANDARD 2 inventories

CONTENTS — Paragraph

CONTENTS	Paragraph
OBJECTIVE	**1**
SCOPE	**2**
DEFINITIONS	**6**
MEASUREMENT OF INVENTORIES	**9**
Cost of inventories	**10**
Costs of purchase	11
Costs of conversion	12
Other costs	15
Cost of inventories of a service provider	19
Cost of agricultural produce harvested from biological assets	20
Techniques for the measurement of cost	21
Cost formulas	**23**
Net realisable value	**28**
RECOGNITION AS AN EXPENSE	**34**
DISCLOSURE	**36**
EFFECTIVE DATE	**40**
WITHDRAWAL OF OTHER PRONOUNCEMENTS	**41**

Objective

1 The objective of this Standard is to prescribe the accounting treatment for inventories. A primary issue in accounting for inventories is the amount of cost to be recognised as an asset and carried forward until the related revenues are recognised. This Standard provides guidance on the determination of cost and its subsequent recognition as an expense, including any write-down to net realisable value. It also provides guidance on the cost formulas that are used to assign costs to inventories.

Scope

2 **This Standard applies to all inventories, except:**

(a) **work in progress arising under construction contracts, including directly related service contracts (see IAS 11 *Construction Contracts*);**

(b) **financial instruments (see IAS 32 *Financial Instruments: Presentation* and IAS 39 *Financial Instruments: Recognition and Measurement*); and**

(c) **biological assets related to agricultural activity and agricultural produce at the point of harvest (see IAS 41 *Agriculture*).**

3 **This Standard does not apply to the measurement of inventories held by:**

(a) **producers of agricultural and forest products, agricultural produce after harvest, and minerals and mineral products, to the extent that they are measured at net realisable value in accordance with well-established practices in those industries. When such inventories are measured at net realisable value, changes in that value are recognised in profit or loss in the period of the change.**

(b) **commodity broker-traders who measure their inventories at fair value less costs to sell. When such inventories are measured at fair value less costs to sell, changes in fair value less costs to sell are recognised in profit or loss in the period of the change.**

4 The inventories referred to in paragraph 3(a) are measured at net realisable value at certain stages of production. This occurs, for example, when agricultural crops have been harvested or minerals have been extracted and sale is assured under a forward contract or a government guarantee, or when an active market exists and there is a negligible risk of failure to sell. These inventories are excluded from only the measurement requirements of this Standard.

5 Broker-traders are those who buy or sell commodities for others or on their own account. The inventories referred to in paragraph 3(b) are principally acquired with the purpose of selling in the near future and generating a profit from fluctuations in price or broker-traders' margin. When these inventories are measured at fair value less costs to sell, they are excluded from only the measurement requirements of this Standard.

Definitions

6 **The following terms are used in this Standard with the meanings specified:**

***Inventories* are assets:**

(a) **held for sale in the ordinary course of business;**

(b) **in the process of production for such sale; or**

(c) **in the form of materials or supplies to be consumed in the production process or in the rendering of services.**

***Net realisable value* is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.**

***Fair value* is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. (See IFRS 13 *Fair Value Measurement*.)**

7 Net realisable value refers to the net amount that an entity expects to realise from the sale of inventory in the ordinary course of business. Fair value reflects the price at which an orderly transaction to sell the same inventory in the principal (or most advantageous) market for that inventory would take place between market participants at the measurement date. The former is an entity-specific value; the latter is not. Net realisable value for inventories may not equal fair value less costs to sell.

8 Inventories encompass goods purchased and held for resale including, for example, merchandise purchased by a retailer and held for resale, or land and other property held for resale. Inventories also encompass finished goods produced, or work in

progress being produced, by the entity and include materials and supplies awaiting use in the production process. In the case of a service provider, inventories include the costs of the service, as described in paragraph 19, for which the entity has not yet recognised the related revenue (see IAS 18 *Revenue*).

Measurement of inventories

9 **Inventories shall be measured at the lower of cost and net realisable value.**

Cost of inventories

10 **The cost of inventories shall comprise all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.**

Costs of purchase

11 The costs of purchase of inventories comprise the purchase price, import duties and other taxes (other than those subsequently recoverable by the entity from the taxing authorities), and transport, handling and other costs directly attributable to the acquisition of finished goods, materials and services. Trade discounts, rebates and other similar items are deducted in determining the costs of purchase.

Costs of conversion

12 The costs of conversion of inventories include costs directly related to the units of production, such as direct labour. They also include a systematic allocation of fixed and variable production overheads that are incurred in converting materials into finished goods. Fixed production overheads are those indirect costs of production that remain relatively constant regardless of the volume of production, such as depreciation and maintenance of factory buildings and equipment, and the cost of factory management and administration. Variable production overheads are those indirect costs of production that vary directly, or nearly directly, with the volume of production, such as indirect materials and indirect labour.

13 The allocation of fixed production overheads to the costs of conversion is based on the normal capacity of the production facilities. Normal capacity is the production expected to be achieved on average over a number of periods or seasons under normal circumstances, taking into account the loss of capacity resulting from planned maintenance. The actual level of production may be used if it approximates normal capacity. The amount of fixed overhead allocated to each unit of production is not increased as a consequence of low production or idle plant. Unallocated overheads are recognised as an expense in the period in which they are incurred. In periods of abnormally high production, the amount of fixed overhead allocated to each unit of production is decreased so that inventories are not measured above cost. Variable production overheads are allocated to each unit of production on the basis of the actual use of the production facilities.

14 A production process may result in more than one product being produced simultaneously. This is the case, for example, when joint products are produced or when there is a main product and a by-product. When the costs of conversion of each product are not separately identifiable, they are allocated between the products on a rational and consistent basis. The allocation may be based, for example, on the relative sales value of each product either at the stage in the production process when the products become separately identifiable, or at the completion of production. Most by-products, by their nature, are immaterial. When this is the case, they are often measured at net realisable value and this value is deducted from the cost of the main product. As a result, the carrying amount of the main product is not materially different from its cost.

Other costs

15 Other costs are included in the cost of inventories only to the extent that they are incurred in bringing the inventories to their present location and condition. For

example, it may be appropriate to include non-production overheads or the costs of designing products for specific customers in the cost of inventories.

16 Examples of costs excluded from the cost of inventories and recognised as expenses in the period in which they are incurred are:

(a) abnormal amounts of wasted materials, labour or other production costs;

(b) storage costs, unless those costs are necessary in the production process before a further production stage;

(c) administrative overheads that do not contribute to bringing inventories to their present location and condition; and

(d) selling costs.

17 IAS 23 *Borrowing Costs* identifies limited circumstances where borrowing costs are included in the cost of inventories.

18 An entity may purchase inventories on deferred settlement terms. When the arrangement effectively contains a financing element, that element, for example a difference between the purchase price for normal credit terms and the amount paid, is recognised as interest expense over the period of the financing.

Cost of inventories of a service provider

19 To the extent that service providers have inventories, they measure them at the costs of their production. These costs consist primarily of the labour and other costs of personnel directly engaged in providing the service, including supervisory personnel, and attributable overheads. Labour and other costs relating to sales and general administrative personnel are not included but are recognised as expenses in the period in which they are incurred. The cost of inventories of a service provider does not include profit margins or non-attributable overheads that are often factored into prices charged by service providers.

Cost of agricultural produce harvested from biological assets

20 In accordance with IAS 41 *Agriculture* inventories comprising agricultural produce that an entity has harvested from its biological assets are measured on initial recognition at their fair value less costs to sell at the point of harvest. This is the cost of the inventories at that date for application of this Standard.

Techniques for the measurement of cost

21 Techniques for the measurement of the cost of inventories, such as the standard cost method or the retail method, may be used for convenience if the results approximate cost. Standard costs take into account normal levels of materials and supplies, labour, efficiency and capacity utilisation. They are regularly reviewed and, if necessary, revised in the light of current conditions.

22 The retail method is often used in the retail industry for measuring inventories of large numbers of rapidly changing items with similar margins for which it is impracticable to use other costing methods. The cost of the inventory is determined by reducing the sales value of the inventory by the appropriate percentage gross margin. The percentage used takes into consideration inventory that has been marked down to below its original selling price. An average percentage for each retail department is often used.

Cost formulas

23 The cost of inventories of items that are not ordinarily interchangeable and goods or services produced and segregated for specific projects shall be assigned by using specific identification of their individual costs.

24 Specific identification of cost means that specific costs are attributed to identified items of inventory. This is the appropriate treatment for items that are segregated for a specific project, regardless of whether they have been bought or produced. However, specific identification of costs is inappropriate when there are large numbers of items of inventory that are ordinarily interchangeable. In such circumstances, the method of

selecting those items that remain in inventories could be used to obtain predetermined effects on profit or loss.

25 **The cost of inventories, other than those dealt with in paragraph 23, shall be assigned by using the first-in, first-out (FIFO) or weighted average cost formula. An entity shall use the same cost formula for all inventories having a similar nature and use to the entity. For inventories with a different nature or use, different cost formulas may be justified.**

26 For example, inventories used in one operating segment may have a use to the entity different from the same type of inventories used in another operating segment. However, a difference in geographical location of inventories (or in the respective tax rules), by itself, is not sufficient to justify the use of different cost formulas.

27 The FIFO formula assumes that the items of inventory that were purchased or produced first are sold first, and consequently the items remaining in inventory at the end of the period are those most recently purchased or produced. Under the weighted average cost formula, the cost of each item is determined from the weighted average of the cost of similar items at the beginning of a period and the cost of similar items purchased or produced during the period. The average may be calculated on a periodic basis, or as each additional shipment is received, depending upon the circumstances of the entity.

Net realisable value

28 The cost of inventories may not be recoverable if those inventories are damaged, if they have become wholly or partially obsolete, or if their selling prices have declined. The cost of inventories may also not be recoverable if the estimated costs of completion or the estimated costs to be incurred to make the sale have increased. The practice of writing inventories down below cost to net realisable value is consistent with the view that assets should not be carried in excess of amounts expected to be realised from their sale or use.

29 Inventories are usually written down to net realisable value item by item. In some circumstances, however, it may be appropriate to group similar or related items. This may be the case with items of inventory relating to the same product line that have similar purposes or end uses, are produced and marketed in the same geographical area, and cannot be practicably evaluated separately from other items in that product line. It is not appropriate to write inventories down on the basis of a classification of inventory, for example, finished goods, or all the inventories in a particular operating segment. Service providers generally accumulate costs in respect of each service for which a separate selling price is charged. Therefore, each such service is treated as a separate item.

30 Estimates of net realisable value are based on the most reliable evidence available at the time the estimates are made, of the amount the inventories are expected to realise. These estimates take into consideration fluctuations of price or cost directly relating to events occurring after the end of the period to the extent that such events confirm conditions existing at the end of the period.

31 Estimates of net realisable value also take into consideration the purpose for which the inventory is held. For example, the net realisable value of the quantity of inventory held to satisfy firm sales or service contracts is based on the contract price. If the sales contracts are for less than the inventory quantities held, the net realisable value of the excess is based on general selling prices. Provisions may arise from firm sales contracts in excess of inventory quantities held or from firm purchase contracts. Such provisions are dealt with under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

32 Materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at or above cost. However, when a decline in the price of materials indicates that the cost of the finished products exceeds net realisable value,

the materials are written down to net realisable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realisable value.

33 A new assessment is made of net realisable value in each subsequent period. When the circumstances that previously caused inventories to be written down below cost no longer exist or when there is clear evidence of an increase in net realisable value because of changed economic circumstances, the amount of the write-down is reversed (ie the reversal is limited to the amount of the original write-down) so that the new carrying amount is the lower of the cost and the revised net realisable value. This occurs, for example, when an item of inventory that is carried at net realisable value, because its selling price has declined, is still on hand in a subsequent period and its selling price has increased.

Recognition as an expense

34 **When inventories are sold, the carrying amount of those inventories shall be recognised as an expense in the period in which the related revenue is recognised. The amount of any write-down of inventories to net realisable value and all losses of inventories shall be recognised as an expense in the period the write-down or loss occurs. The amount of any reversal of any write-down of inventories, arising from an increase in net realisable value, shall be recognised as a reduction in the amount of inventories recognised as an expense in the period in which the reversal occurs.**

35 Some inventories may be allocated to other asset accounts, for example, inventory used as a component of self-constructed property, plant or equipment. Inventories allocated to another asset in this way are recognised as an expense during the useful life of that asset.

Disclosure

36 **The financial statements shall disclose:**

- **(a) the accounting policies adopted in measuring inventories, including the cost formula used;**
- **(b) the total carrying amount of inventories and the carrying amount in classifications appropriate to the entity;**
- **(c) the carrying amount of inventories carried at fair value less costs to sell;**
- **(d) the amount of inventories recognised as an expense during the period;**
- **(e) the amount of any write-down of inventories recognised as an expense in the period in accordance with paragraph 34;**
- **(f) the amount of any reversal of any write-down that is recognised as a reduction in the amount of inventories recognised as expense in the period in accordance with paragraph 34;**
- **(g) the circumstances or events that led to the reversal of a write-down of inventories in accordance with paragraph 34; and**
- **(h) the carrying amount of inventories pledged as security for liabilities.**

37 Information about the carrying amounts held in different classifications of inventories and the extent of the changes in these assets is useful to financial statement users. Common classifications of inventories are merchandise, production supplies, materials, work in progress and finished goods. The inventories of a service provider may be described as work in progress.

38 The amount of inventories recognised as an expense during the period, which is often referred to as cost of sales, consists of those costs previously included in the measurement of inventory that has now been sold and unallocated production overheads and abnormal amounts of production costs of inventories. The circumstances of the entity may also warrant the inclusion of other amounts, such as

distribution costs.

39 Some entities adopt a format for profit or loss that results in amounts being disclosed other than the cost of inventories recognised as an expense during the period. Under this format, an entity presents an analysis of expenses using a classification based on the nature of expenses. In this case, the entity discloses the costs recognised as an expense for raw materials and consumables, labour costs and other costs together with the amount of the net change in inventories for the period.

Effective date

40 An entity shall apply this Standard for annual periods beginning on or after 1 January 2005. Earlier application is encouraged. If an entity applies this Standard for a period beginning before 1 January 2005, it shall disclose that fact.

40A [Deleted]

40B [used in future updates]

40C IFRS 13, issued in May 2011, amended the definition of fair value in paragraph 6 and amended paragraph 7. An entity shall apply those amendments when it applies IFRS 13.

Withdrawal of other pronouncements

41 This Standard supersedes IAS 2 *Inventories* (revised in 1993).

42 This Standard supersedes SIC-1 *Consistency — Different Cost Formulas for Inventories.*

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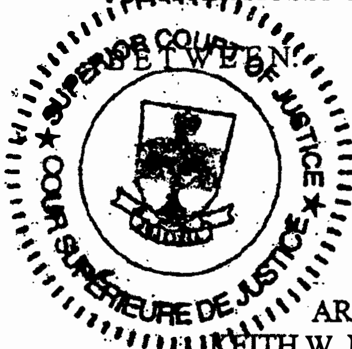
Court File No. 59725

ONTARIO
SUPERIOR COURT OF JUSTICE

THE HONOURABLE MR.	)	Friday, THE 1st
	)	
JUSTICE TAUSENDFREUND	)	DAY OF June, 2012



BETWEEN:

ALEXANDER DOBBIE and MICHAEL BENSON

Plaintiffs

- and -

ARCTIC GLACIER INCOME FUND, ARCTIC GLACIER INC., KEITH W. MCMAHON, DOUGLAS A. BAILEY, and, in their personal capacities and as trustees of Arctic Glacier Income Fund, JAMES E. CLARK, ROBERT J. NAGY GARY A. FILMON, DAVID R. SWAINE, FRANK G. LARSON and GARY D. COOLEY

Defendants

Proceeding under the *Class Proceedings Act, 1992*

ORDER

THIS MOTION, made by the Plaintiffs for an Order approving the Settlement Agreement, dated April 25, 2012, was heard on June 1, 2012, at the Belleville Courthouse, 235 Pinnacle Street, Belleville, Ontario

ON READING the materials filed, including the Settlement Agreement, dated April 25, 2012, attached hereto as **Schedule "A"** (the "Settlement Agreement") and on hearing the submissions of counsel for the Plaintiffs and counsel for the Defendants:

1. **THIS COURT DECLARES** that except as otherwise stated, this Order incorporates and adopts the definitions set out in the Settlement Agreement.

2. **THIS COURT DECLARES** that the Settlement Agreement is fair, reasonable and in the best interests of the Class.

3. **THIS COURT ORDERS** that the Settlement Agreement is approved pursuant to s.29 of the *CPA*.

4. **THIS COURT ORDERS** that the Settlement Agreement shall be implemented in accordance with its terms.

5. **THIS COURT DECLARES** that the Settlement Agreement, in its entirety, forms part of this Order and is binding upon the Defendants, the Representative Plaintiffs, and upon all Class Members who do not opt out of the Class in accordance with the Approval Notices (as defined below), including those persons who are minors or mentally incapable, and that the requirements of Rules 7.04(1) and 7.08(4) of the *Rules of Civil Procedure* are hereby disposed of.

6. **THIS COURT DECLARES** that the Plan of Allocation, attached hereto as **Schedule "B"**, is hereby approved as fair and reasonable and that the Settlement Amount shall be distributed in accordance with the Plan of Allocation after the payment of Class Counsel Fees and Administration Expenses.

7. **THIS COURT ORDERS** that NPT RicePoint be and hereby is appointed the Administrator as defined in the Settlement Agreement.

8. **THIS COURT ORDERS** that the form and content of the Second Long Form Notice, attached hereto as **Schedule "C"**, is hereby approved.

9. **THIS COURT ORDERS** that the form and content of the Second Short Form Notice, attached hereto as **Schedule "D"** (together with the Second Long-Form Notice, the "Approval Notices"), is hereby approved.

10. **THIS COURT ORDERS** that the Opt-Out Form, substantially in the form attached hereto as **Schedule "E"**, is hereby approved.

11. **THIS COURT ORDERS** that the Claim Form, substantially in the form attached hereto as **Schedule "F"**, is hereby approved.

12. **THIS COURT ORDERS** that the Approval Notices, Claim Form and Opt-Out Form shall be disseminated in accordance with the Plan of Notice.

13. **THIS COURT ORDERS** that a person who would otherwise be a Class Member may opt out in accordance with the directions contained in the Second Long Form Notice attached hereto as **Schedule "C"**.

14. **THIS COURT ORDERS** that on notice to the Court but without further order of the Court, the parties to the Settlement Agreement may agree to reasonable extensions of time to carry out any of the provisions of the Settlement Agreement.

15. **THIS COURT ORDERS AND DECLARES** that, other than as provided in s. 4.1 (1)(e) of the Settlement Agreement, the Releasees have no responsibility for and no liability whatsoever with respect to the administration of the Settlement Agreement.

16. **THIS COURT ORDERS** that if the Settlement Agreement is terminated pursuant to any rights of termination therein, then:

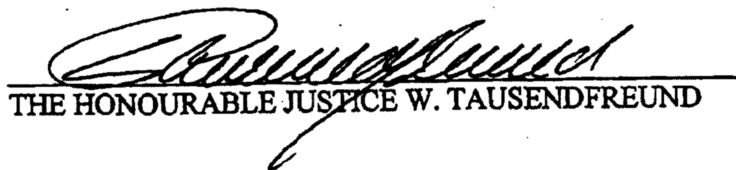
(a) the Order (except for paragraphs 1, 15 and 16 herein) shall be set aside, be of no further force or effect, and be without prejudice to any party; and

(b) each party to the Action shall be restored to his, her or its respective position in the Action as it existed immediately prior to the execution of the Settlement Agreement.

17. **THIS COURT ORDERS AND DECLARES** that, upon the Effective Date, the Releasors shall release and discharge, and shall be conclusively deemed to have fully, finally and forever released and discharged the Releasees from the Released Claims.

18. **THIS COURT ORDERS** that, upon the Effective Date, no Class Member shall institute, continue, maintain or assert, either directly or indirectly, on their own behalf or on behalf of any class or any other person, any action, suit, cause of action, proceeding, complaint, claim or demand against any Released Party or any other person who may claim any form of contribution or indemnity from any Released Party in respect of the Released Claims or any matter related thereto, and are permanently barred and enjoined from doing so.

19. **THIS COURT ORDERS** that, upon the Effective Date, the Action shall be dismissed against the Defendants with prejudice and without costs.



THE HONOURABLE JUSTICE W. TAUSENDFREUND

ORDER ENTERED
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JUN 05 2012
1165

SCHEDULE "B"

Court File No.: 59725

ONTARIO
SUPERIOR COURT OF JUSTICE

BETWEEN:

ALEXANDER DOBBIE and MICHAEL BENSON

Plaintiffs

- and –

ARCTIC GLACIER INCOME FUND, ARCTIC GLACIER INC., RICHARD L. JOHNSON, KEITH W. MCMAHON, DOUGLAS A. BAILEY, FRANK LARSON, GARY COOLEY and, in their personal capacities and as Trustees of Arctic Glacier Income Fund, JAMES E. CLARK, ROBERT J. NAGY, GARY A. FILMON and DAVID R. SWAINE

Proceeding under the *Class Proceedings Act*, 1992

PLAN OF ALLOCATION

(Supplement to the Settlement Agreement, dated April 25, 2012)

DEFINED TERMS

1. For the purposes of this Plan of Allocation, the definitions set out in the Settlement Agreement apply to and are incorporated into this Plan of Allocation and, in addition, the following definitions apply:

   (a) "**Acquisition Expense**" means the total monies paid by the Claimant (including brokerage commissions) to acquire Eligible Units;

   (b) "**Claimant**" means a Class Member who submits a properly completed Claim Form and all required supporting documentation to the Administrator, on or before the Claims Bar Deadline;

   (c) "**Disposition Proceeds**" means the total proceeds paid to the Claimant (without deducting any commissions paid in respect of the dispositions) in consideration of the sale of all of his/her/its Eligible Units; provided, however, that with respect to any Eligible Units that the Claimant continues to hold, they shall be deemed to have been disposed of for an amount equal to the number of Eligible Units still held, multiplied by $1.84 [being the 10 trading day volume weighted average trading price of Arctic Glacier Units on the TSX from September 17, 2008 to September 30, 2008 inclusive];

   (d) "**FIFO**" means the principle of first-in, first-out, wherein Units are deemed to be sold in the same order that they were purchased (i.e. the first Units purchased are

deemed to be the first sold); and which requires, in the case of a Claimant who held Units of Arctic Glacier at the commencement of the Class Period, that those Units be deemed to have been sold completely before Eligible Units are sold or deemed sold;

(e) "**Net Loss**" means that the Claimant's Disposition Proceeds are less than the Claimant's Acquisition Expense;

(f) "**Net Settlement Amount**" means the Escrow Settlement Amount remaining after payment of Administration Expenses and Class Counsel Fees; and

(g) "**Nominal Entitlement**" means a Claimant's nominal damages as calculated pursuant to the formula set forth herein, and which forms the basis upon which each Claimant's *pro rata* share of the Net Settlement Amount is determined.

CALCULATION OF NET LOSS AND NOMINAL ENTITLEMENT

2. A Claimant must have sustained a Net Loss in order to be eligible to receive a payment from the Net Settlement Amount. A Claimant who has not suffered a net loss as calculated hereunder shall not be entitled to receive any portion of the Net Settlement Amount.

3. The Administrator shall first determine whether a Claimant sustained a Net Loss. If the Claimant has sustained a Net Loss, they become an Authorized Claimant, and the Administrator will go on to calculate his/her/its Nominal Entitlement.

4. No Nominal Entitlement shall be allocated in respect Eligible Units acquired by a Class Member in its capacity as an underwriter to an offering of Units made during the Class Period.

5. The Administrator will apply FIFO to distinguish the sale of Arctic Glacier Units held at the beginning of the Class Period from the sale of Eligible Units, and will continue to apply FIFO to determine the purchase transactions which correspond to the sale of Eligible Units. The Administrator will use this data in the calculation of an Authorized Claimant's Nominal Entitlement according to the formulas listed below.

6. The date of a purchase, sale or deemed disposition shall be the trade date, as opposed to the settlement date, of the transaction.

7. For the purposes of any calculation under the Plan of Allocation, the Administrator will account for any unit splits or consolidations that occur during and after the Class Period, such that the Claimants' holdings for the purposes of the calculations are completed in units equivalent to those traded during the Class Period.

8. A Claimant's Nominal Entitlement will be calculated as follows:

   I. **No Nominal Entitlement shall be attributed to any Eligible Units *disposed of* prior to the first alleged corrective disclosure, that is, *prior to March 6, 2008.***

   II. **For Eligible Units *disposed of* between the first alleged corrective disclosure and the end of the 10 trading day period following the final alleged corrective disclosure on September 17, 2008, that is, *on or between March 6, 2008 and September 30, 2008*, the Nominal Entitlement shall be:**

      A. an amount equal to the number of Eligible Units thus disposed of, multiplied by the difference between the volume weighted average price paid for those Eligible Units (including any commissions paid in respect thereof) and the average price per share received upon the disposition of those Eligible Units (without deducting any commissions paid in respect of the disposition).

   III. **For Eligible Units *disposed of* after the 10 trading day period following the second alleged corrective disclosure, that is, *on or after September 30, 2008*, the Nominal Entitlement shall be the lesser of:**

      A. an amount equal to the number of Eligible Units thus disposed of, multiplied by the difference between the volume weighted average price paid for those Eligible Units (including any commissions paid in respect thereof) and the price per share received upon the disposition of those Eligible Units (without deducting any commissions paid in respect of the disposition); and

      B. an amount equal to the number of Eligible Units thus disposed of, multiplied by the difference between the volume weighted average price paid for those Eligible Units (including any commissions paid in respect thereof) and $1.84 [being the 10 trading day volume weighted average trading price of Arctic Glacier Units on the TSX from September 17, 2008 to September 30, 2008 inclusive].

IV. **For Eligible Units still held at the time the Claim Form is completed, the Nominal Entitlement shall be:**

A. an amount equal to the number of Eligible Units still held, multiplied by the difference between the volume weighted average price paid for those Eligible Units (including any commissions paid in respect thereof) and $1.84 [being the 10 trading day volume weighted average trading price of Arctic Glacier Units on the TSX from September 18, 2008 to September 30, 2008 inclusive].

FINAL DISTRIBUTION

9. Each Claimant's actual compensation shall be the portion of the Net Settlement Amount equivalent to the ratio of his/her/its Nominal Entitlement to the total Nominal Entitlements of all Authorized Claimants multiplied by the Net Settlement Amount, as calculated by the Administrator.

10. Compensation shall be paid to Claimants in Canadian currency.

11. The Administrator will not distribute entitlements of less than $1.00. Such amounts will instead be redistributed pro rata to the other Authorized Claimants.

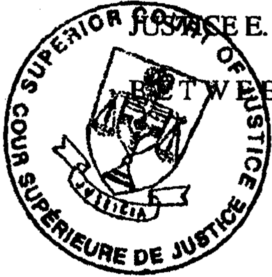
12. The Administrator shall be authorized to distribute the Net Settlement Amount in accordance with this Plan of Allocation upon having received and reviewed the Claim Forms submitted by the Claims Bar Deadline without further order of the Court.

13. If, one hundred eighty (180) days from the date on which the Administrator distributes the Net Settlement Amount to Claimants, the Escrow Account remains in a positive balance (whether due to tax refunds, uncashed cheques or otherwise), the Administrator shall, if feasible, reallocate such balance among the Claimants in an equitable and economic fashion. In the event any such remaining balance is less than CAN$25,000.00, such balance will be donated to FAIR Canada. Under no circumstances will any repayment be made to the Contributing Parties.

Court File No. 08-36143600CP

ONTARIO
SUPERIOR COURT OF JUSTICE

THE HONOURABLE	)	Tuesday, THE 4th
	)	
JUSTICE E. BELOBABA	)	DAY OF December, 2012



BETWEEN:

ED J. MCKENNA

Plaintiff

- and -

GAMMON GOLD INC., RUSSELL BARWICK, COLIN P. SUTHERLAND, DALE M. HENDRICK, FRED GEORGE, FRANK CONTE, KENT NOSEWORTHY, CANEK RANGEL, BRADLEY LANGILLE, ALEJANDRO CARAVEO, BMO NESBITT BURNS INC., SCOTIA CAPITAL INC. and TD SECURITIES INC.

Defendants

Proceeding under the *Class Proceedings Act, 1992*

ORDER

THIS MOTION, made by the Plaintiff for an Order approving the settlement agreement, dated October 5, 2012, was heard on December 4, 2012, at 361 University Ave., Toronto, ON, M5G 1T3.

ON READING the materials filed, including the settlement agreement, dated October 5, 2012, attached hereto as **Schedule "A"** (the "Settlement Agreement") and on hearing the submissions of counsel for the Plaintiff and counsel for the Defendants:

1. **THIS COURT DECLARES** that except as otherwise stated, this Order incorporates and adopts the definitions set out in the Settlement Agreement.

2. **THIS COURT DECLARES** that the Settlement Agreement is fair, reasonable, and in the best interests of the Class.

3. **THIS COURT DECLARES** that the Settlement Agreement, in its entirety, forms part of this Order and is binding upon the Defendants, the Plaintiff, and upon all Class Members who do not opt out of the Class in accordance with the Approval Notices (as defined below), including those persons who are minors or mentally incapable, and that the requirements of Rules 7.04(1) and 7.08(4) of the *Rules of Civil Procedure* are hereby disposed of.

4. **THIS COURT ORDERS** that the Settlement Agreement is approved pursuant to s.29 of the *Class Proceedings Act, 1992.*

5. **THIS COURT ORDERS** that the Settlement Agreement shall be implemented in accordance with its terms.

6. **THIS COURT DECLARES** that the Plan of Allocation, attached hereto as **Schedule "B"**, is hereby approved as fair and appropriate and that the Settlement Amount shall be distributed in accordance with the Plan of Allocation after the payment of Class Counsel Fees and Administration Expenses.

7. **THIS COURT ORDERS** that the form and content of the Second Long Form Notice, attached hereto as **Schedule "C"**, is hereby approved.

8. **THIS COURT ORDERS** that the form and content of the Second Short Form Notice, attached hereto as **Schedule "D"** (together with the Second Long Form Notice, the "Approval Notices"), is hereby approved.

9. **THIS COURT ORDERS** that the Opt-Out Form, attached hereto as **Schedule "E"**, is hereby approved.

10. **THIS COURT ORDERS** that the Claim Form, attached hereto as **Schedule "F"**, is hereby approved.

11. **THIS COURT ORDERS** that the Approval Notices, Claim Form and Opt-Out Form shall be disseminated in accordance with the Plan of Notice.

12. **THIS COURT ORDERS** that a person who would otherwise be a Class Member may opt out in accordance with the directions contained in the Second Long Form Notice.

13. **THIS COURT ORDERS** that on notice to the Court but without further order of the Court, the parties to the Settlement Agreement may agree to reasonable extensions of time to carry out any of the provisions of the Settlement Agreement.

14. **THIS COURT ORDERS AND DECLARES** that, other than as provided in s. 4.1(1)(e) of the Settlement Agreement, the Releasees have no responsibility for and no liability whatsoever with respect to the administration of the Settlement Agreement.

15. **THIS COURT ORDERS** that if the Settlement Agreement is terminated pursuant to any rights of termination therein, then:

(a) this Order (except for paragraphs 1, 14 and 15 herein) shall be set aside, be of no further force or effect, and be without prejudice to any party; and

(b) each party to the Action shall be restored to his, her or its respective position in the Action as it existed immediately prior to the execution of the Settlement Agreement.

16. **THIS COURT ORDERS AND DECLARES** that, upon the Effective Date, the Releasors shall release and discharge, and shall be conclusively deemed to have fully, finally and forever released and discharged the Releasees from the Released Claims.

17. **THIS COURT ORDERS** that, as of the Effective Date, the Releasors shall not institute, continue, maintain or assert, either directly or indirectly, on their own behalf or on behalf of any class or any other person, any action, suit, cause of action, proceeding, complaint, claim or demand against any Releasee or any other person who may claim any form of contribution or indemnity from any Releasee in respect of the Released Claims or any matter related thereto, and are permanently barred and enjoined from doing so.

18. **THIS COURT ORDERS** that, upon the Effective Date, the Action shall be dismissed against the Defendants with prejudice and without costs.

THE HONOURABLE JUSTICE E. BELOBABA

ENTERED AT / INSCRIT A TORONTO
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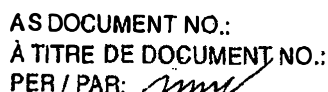


SCHEDULE "B" - PLAN OF ALLOCATION

Court File No.: 08-36143600CP

ONTARIO
SUPERIOR COURT OF JUSTICE

BETWEEN:

ED J. MCKENNA

Plaintiff

- and –

GAMMON GOLD INC., RUSSELL BARWICK, COLIN P. SUTHERLAND, DALE M. HENDRICK, FRED GEORGE, FRANK CONTE, KENT NOSEWORTHY, CANEK RANGEL, BRADLEY LANGILLE, ALEJANDRO CARAVEO, BMO NESBITT BURNS INC., SCOTIA CAPITAL INC. and TD SECURITIES INC.

Defendants

Proceeding under the *Class Proceedings Act, 1992*

PLAN OF ALLOCATION

(Supplement to the Settlement Agreement, dated October 5th, 2012)

DEFINED TERMS

1. The definitions set out in the Settlement Agreement apply to and are incorporated into this Plan of Allocation, in addition to the following definitions:

   (a) **"Acquisition Expense"** means the total monies paid by the Claimant (including brokerage commissions) to acquire Eligible Shares;

   (b) **"Claimant"** means a Class Member who submits a properly completed Claim Form and all required supporting documentation to the Administrator, on or before the Claims Bar Deadline;

   (c) **"Disposition Proceeds"** means the total proceeds paid to the Claimant (without deducting any commissions paid in respect of the dispositions) in consideration for the sale of all of the Claimant's Eligible Shares; provided, however, that with respect to any Eligible Shares that the Claimant continues to hold, they shall be deemed to have been disposed of for an amount equal to the number of Eligible Shares still held, multiplied by CAD$8.85 [being the 10 trading day volume weighted average trading price of Gammon Shares on the TSX from August 13, 2007 to August 24, 2007 inclusive];

(d) **"FIFO"** means the principle of first-in, first-out, wherein Shares are deemed to be sold in the same order that they were purchased (i.e. the first Shares purchased are deemed to be the first sold); and which requires, in the case of a Claimant who held Shares of Gammon at the commencement of the Class Period, that those Shares be deemed to have been sold completely before Eligible Shares are sold or deemed to have been sold;

(e) **"Net Loss"** means that the Claimant's Disposition Proceeds are less than the Claimant's Acquisition Expense;

(f) **"Net Settlement Amount"** means the Escrow Settlement Amount remaining after payment of Administration Expenses and Class Counsel Fees; and

(g) **"Nominal Entitlement"** means a Claimant's nominal damages as calculated pursuant to the formula set forth herein, and which forms the basis upon which each Claimant's *pro rata* share of the Net Settlement Amount is determined.

CALCULATION OF NET LOSS AND NOMINAL ENTITLEMENT

2. A Claimant must have sustained a Net Loss on all purchases in order to be eligible to receive a payment from the Net Settlement Amount. A Claimant that has not suffered a Net Loss as calculated under the Plan of Allocation will not be entitled to receive any portion of the Net Settlement Amount.

3. The Administrator will first determine whether a Claimant has sustained a Net Loss on all purchases. If the Claimant has sustained a Net Loss, the Claimant becomes an **"Authorized Claimant"**, and the Administrator will proceed to calculate the Authorized Claimant's Nominal Entitlement.

4. The Administrator will apply FIFO to distinguish the sale of Gammon Shares held at the beginning of the Class Period from the sale of Eligible Shares, and will continue to apply FIFO to determine the purchase transactions that correspond to the sale of Eligible Shares. The Administrator will use this data in the calculation of an Authorized Claimant's Nominal Entitlement according to the formulae listed below.

5. The date of a purchase, sale, or deemed disposition shall be the trade date, as opposed to the settlement date, of the transaction.

6. For the purposes of any calculation under the Plan of Allocation, the Administrator will account for any splits or consolidations that occurred during and after the Class Period,

such that the Claimants' holdings for the purposes of the calculations are completed in Shares equivalent to those traded during the Class Period.

7. The Net Settlement Amount will be allocated into two separate funds, one for claims relating to Eligible Shares acquired in Gammon's offering conducted pursuant to the Short Form Prospectus dated April 19, 2007 (the "Primary Market Fund"), and one for claims relating to Eligible Shares acquired on the secondary market (the "Secondary Market Fund").

8. An Authorized Claimant's Nominal Entitlement will be calculated as follows:

   I. **No Nominal Entitlement shall be attributed to any Eligible Shares *disposed of* prior to the first alleged corrective disclosure, that is, *prior to May 10, 2007.***

   II. **For Eligible Shares *disposed of* between the first alleged corrective disclosure and the end of the 10 trading day period following the final alleged corrective disclosure on August 10, 2007, that is, *on or between May 10, 2007 and August 24, 2007*, the Nominal Entitlement shall be:**

      A. an amount equal to the number of Eligible Shares thus disposed of, multiplied by the difference between the volume weighted average price paid for those Eligible Shares (including any commissions paid in respect thereof) and the average price per share received upon the disposition of those Eligible Shares (without deducting any commissions paid in respect of the disposition);

   III. **For Eligible Shares *disposed of* after the 10 trading day period following the second alleged corrective disclosure, that is, *on or after August 24, 2007*, the Nominal Entitlement shall be the lesser of:**

      A. an amount equal to the number of Eligible Shares thus disposed of, multiplied by the difference between the volume weighted average price paid for those Eligible Shares (including any commissions paid in respect thereof) and the price per share received upon the disposition of those Eligible Shares (without deducting any commissions paid in respect of the disposition); and

      B. an amount equal to the number of Eligible Shares thus disposed of, multiplied by the difference between the volume weighted average price paid for those Eligible Shares (including any commissions paid in respect thereof) and CAD$8.85 [being the 10 trading day volume weighted average trading price of Gammon Shares on the TSX from August 13, 2007 to August 24, 2007 inclusive].

IV. **For Eligible Shares still held at the time the Claim Form is completed, the Nominal Entitlement shall be:**

A. an amount equal to the number of Eligible Shares still held, multiplied by the difference between the volume weighted average price paid for those Eligible Shares (including any commissions paid in respect thereof) and CAD$8.85 [being the 10 trading day volume weighted average trading price of Gammon Shares on the TSX from August 13, 2007 to August 24, 2007 inclusive].

FINAL DISTRIBUTION

9. A separate Nominal Entitlement will be calculated for each Authorized Claimant's secondary market and primary market purchases. Whether particular dispositions are of securities purchased on the primary market or on the secondary market will be determined using FIFO.

10. Each Authorized Claimant's actual compensation in respect of primary market purchases will be the portion of the Primary Market Fund equivalent to the ratio of that Claimant's Nominal Entitlement arising from primary market purchases to the total Nominal Entitlements arising from primary market purchases of all Authorized Claimants multiplied by the Primary Market Fund, as calculated by the Administrator.

11. Each Authorized Claimant's actual compensation in respect of secondary market purchases will be the portion of the Secondary Market Fund equivalent to the ratio of that Claimant's Nominal Entitlement arising from secondary market purchases to the total Nominal Entitlements arising from secondary market purchases of all Authorized Claimants multiplied by the Secondary Market Fund, as calculated by the Administrator.

12. The Administrator will not distribute entitlements of less than CAD$5.00 to Class Members. Such amounts will instead be redistributed *pro rata* to the other Authorized Claimants.

13. The Administrator shall be authorized to distribute the Net Settlement Amount in accordance with this Plan of Allocation upon having received and reviewed the Claim Forms submitted by the Claims Bar Deadline without further order of the Court.

14. If, one hundred eighty (180) days from the date on which the Administrator distributes the Net Settlement Amount to Authorized Claimants, the Escrow Account remains in a positive balance (whether due to tax refunds, uncashed cheques, or otherwise), the Administrator shall, if feasible, reallocate such balance among the Authorized Claimants in an equitable and economic fashion. In the event any such remaining balance is less than CAD$25,000.00, such balance will be donated to FAIR Canada. Under no circumstances will any repayment be made to the Contributing Parties.

DISPUTE RESOLUTION

15. In the event that a Class Member disputes the Administrator's decision, whether in whole or in part, the Class Member may appeal the decision by submitting a dispute in writing to the Ontario Superior Court of Justice.

Court File No. CV-11-436360-00CP

ONTARIO
SUPERIOR COURT OF JUSTICE

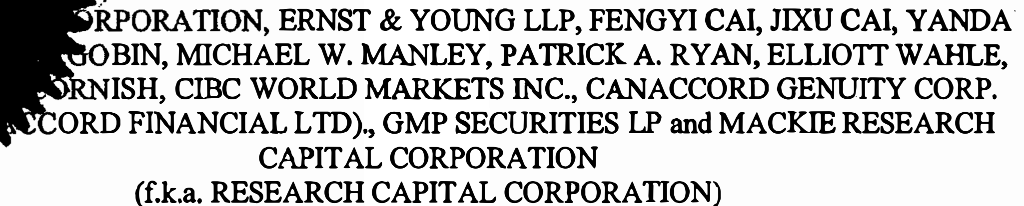
THE HONOURABLE	)	Monday, THE 26th
	)	
JUSTICE P. M. PERELL	)	DAY OF August, 2013

BETWEEN:

JERZY ROBERT ZANIEWICZ and EDWARD C. CLARKE

Plaintiffs

- and -


...RPORATION, ERNST & YOUNG LLP, FENGYI CAI, JIXU CAI, YANDA
...OBIN, MICHAEL W. MANLEY, PATRICK A. RYAN, ELLIOTT WAHLE,
...RNISH, CIBC WORLD MARKETS INC., CANACCORD GENUITY CORP.
...CORD FINANCIAL LTD)., GMP SECURITIES LP and MACKIE RESEARCH
CAPITAL CORPORATION
(f.k.a. RESEARCH CAPITAL CORPORATION)

Defendants

Proceeding under the *Class Proceedings Act, 1992*

ORDER

THIS MOTION, made by the Plaintiffs for an Order approving (i) a Settlement Agreement dated February 13, 2013 with the defendant, Ernst & Young LLP, (ii) a Settlement Agreement dated April 26, 2013 with the defendants, Matthew Gottlieb as Litigation Receiver of Zungui Haixi Corporation, Michelle Gobin, Michael W. Manley, Patrick A. Ryan, Elliott Wahle and Margaret Cornish, and (iii) a Settlement Agreement dated August 19, 2013 with the defendants, CIBC World Markets Inc., Canaccord Genuity Corp., f.k.a. Canaccord Financial Ltd., GMP Securities LP, and Mackie Research Capital Corporation, f.k.a. Research Capital Corporation, was heard this day at Osgoode Hall, 130 Queen Street West, Toronto, Ontario.

ON READING the materials filed, including the Settlement Agreement dated February 13, 2013 attached hereto as **Schedule "A"** ("Auditor Agreement"), the Settlement Agreement dated April 26, 2013 attached hereto as **Schedule "B"** ("Zungui Agreement"), the Settlement Agreement dated August 19, 2013 attached hereto as **Schedule "C"** ("Underwriter Agreement", collectively with the Auditor Agreement and Zungui Agreement, the "Agreements", and any one which is an "Agreement"), the affidavits of J. Robert Zaniewicz and Edward C. Clarke sworn June 24, 2013 and June 28, 2013, respectively, and the affidavits of Nicholas C. Baker sworn June [illegible] 20, 2013, and on hearing the submissions of Class Counsel and counsel for [illegible] appeared in the Action and are signatories under an Agreement (such defend[illegible] Defendants");

ON BEING ADVISED that the Settling Defendants, CIBC World Markets Inc., Canaccord Genuity Corp., GMP Securities LP and Mackie Research Capital Corporation consent to the certification of the Action against them, solely for the purposes of settlement;

AND ON BEING ADVISED that the Settling Defendants consent to the relief sought in respect of the Agreements, notice and administration of the Settlements;

AND ON BEING ADVISED that NPT RicePoint Class Action Services Inc. has consented to being appointed the Administrator pursuant to each of the Agreements;

1. **THIS COURT DECLARES** that except as otherwise stated, this Order incorporates and adopts the definitions set out in the Agreements, respectively.

2. **THIS COURT ORDERS** that this action is certified as a class proceeding as against the Settling Defendants, CIBC World Markets Inc., Canaccord Genuity Corp., GMP Securities LP and

Mackie Research Capital Corporation for the purpose of settlement only, pursuant to the *Class Proceedings Act, 1992,* S.O. 1992 c.6 ("*CPA*"), ss. 2 and 5, but subject to Articles 8.3 and 10 of the Underwriter Agreement.

3. **THIS COURT ORDERS** that the class certified ("Class"), for the purpose of settlement in accordance with the terms of the Underwriter Agreement is defined as:

> All persons or entities wherever they may reside or be domiciled, other than Excluded Persons and Opt-Out Parties, who acquired Eligible Shares.

4. **THIS COURT ORDERS** that Jerzy Robert Zaniewicz and Edward C. Clarke are appointed as Representative Plaintiffs for the Class for the purpose of settlement in accordance with the terms of the Underwriter Agreement.

5. **THIS COURT ORDERS** that the following issue is common to the Class for the purposes of settlement in accordance with the terms of the Underwriter Agreement:

> Did the IPO Prospectus contain one or more misrepresentations within the meaning of the Securities Act, R.S.O. 1990, c. S.5, as amended, or at common law?

6. **THIS COURT ORDERS** that notice of the certification of the Action against the Settling Defendants, CIBC World Markets Inc., Canaccord Genuity Corp., f.k.a. Canaccord Financial Ltd., GMP Securities LP, and Mackie Research Capital Corporation, f.k.a. Research Capital Corporation is hereby dispensed pursuant to section 17(2) of the *Class Proceedings Act, 1992*, S.O. 1992, c. 6.

7. **THIS COURT DECLARES** that the Agreements, individually and collectively, are fair, reasonable and in the best interests of the Class.

8. **THIS COURT ORDERS** that the Agreements are approved pursuant to section 29 of the *Class Proceedings Act, 1992*, S.O. 1992, c. 6.

9. **THIS COURT DECLARES** that all provisions of each of the Agreements in its entirety (including the Recitals and Definitions set out in sections 1 and 2 of each) form part of this Order and are binding upon the Settling Defendants (and the Related Defendants for purposes of section 13 of the Auditor Agreement) in accordance with the terms thereof, and upon the Plaintiffs and all Class Members that did not opt-out of this Action in accordance with paragraph 6 of the Certification and First Notice Orders in this Action, both of which were dated May 21, 2013, including those persons that are minors or mentally incapable.

10. **THIS COURT ORDERS** that all claims, direct and indirect, including but not limited to claims for contribution and indemnity or other claims over, whether asserted, unasserted or asserted in a representative capacity, inclusive of interest, taxes and costs, relating to the Released Claims and any other claims which were or could have been brought in this Action or otherwise by any Defendant or any other Person against any other Defendant are barred, prohibited and enjoined.

11. **THIS COURT DECLARES** that compliance with the requirements of Rules 7.04(1) and 7.08(4) of the *Rules of Civil Procedure*, R.R.O. Reg. 194 is hereby dispensed with.

12. **THIS COURT ORDERS** that each Agreement shall be implemented in accordance with its terms.

13. **THIS COURT DECLARES** that the Plan of Allocation, attached hereto as **Schedule "D"**, is fair and appropriate.

14. **THIS COURT ORDERS** that the Plan of Allocation is approved and that the Settlement Amount under each Agreement shall be distributed in accordance with the terms of the applicable

Agreement, following payment of Class Counsel Fees (to be approved) and Administration Expenses.

15. **THIS COURT ORDERS** that NPT RicePoint Class Action Services Inc. is hereby appointed as the Administrator pursuant to each Agreement.

16. **THIS COURT ORDERS** that the Plan of Notice, attached hereto as **Schedule "E"**, is hereby approved for the purpose of the publication and dissemination of the Short Form Notice of Settlement, Long Form Notice of Settlement and Claim Form.

17. **THIS COURT ORDERS** that the form and content of the Short Form Notice of Settlement, attached hereto as **Schedule "F"** is hereby approved.

18. **THIS COURT ORDERS** that the form and content of the Long Form Notice of Settlement, attached hereto as **Schedule "G"**, is hereby approved.

19. **THIS COURT ORDERS** that the form and content of the Claim Form, attached hereto as **Schedule "H"**, is hereby approved.

20. **THIS COURT ORDERS** that the Plaintiffs and the Settling Defendants may, on notice to the Court but without the need for a further order of the Court, agree to reasonable extensions of time to carry out any of the provisions of the Agreements.

21. **THIS COURT ORDERS AND DECLARES** that, other than as provided in section 4.1 of each Agreement, respectively, the Releasees (however defined) have no responsibility for and no liability whatsoever with respect to the administration of the Agreement pursuant to which they have been released.

22. **THIS COURT ORDERS AND DECLARES** that, upon the Effective Date, the Releasors under each Agreement shall release and discharge, and shall be conclusively deemed to have fully, finally and forever released and discharged the Releasees under each Agreement from the Released Claims (however defined) in each Agreement.

23. **THIS COURT ORDERS** that, within ten (10) business days of this Order, the insurer of Zungui Haixi Corporation shall pay to Siskinds LLP in trust the sum of CAD $100,000.00 which shall be added to the existing Settlement Amount paid under the Zungui Agreement.

24. **THIS COURT ORDERS** that, upon the Effective Date, the Action shall be dismissed against all Defendants with prejudice and without costs.

25. **THIS COURT ORDERS** that, upon the Effective Date, the Bardi Action be dismissed with prejudice and without costs.

Perell. J

THE HONOURABLE JUSTICE P.M. PERELL

ENTERED AT / INSCRIT À TORONTO
ON / BOOK NO:
LE / DANS LE REGISTRE NO
AUG 27 2013
AS DOCUMENT NO.:
À TITRE DE DOCUMENT NO.
PER / PAR:

SCHEDULE "D" - PLAN OF ALLOCATION

Court File No.: CV-11-436360-00CP

ONTARIO
SUPERIOR COURT OF JUSTICE

BETWEEN:

JERZY ROBERT ZANIEWICZ and EDWARD C. CLARKE

Plaintiffs

- and -

ZUNGUI HAIXI CORPORATION, ERNST & YOUNG LLP, FENGYI CAI, JIXU CAI, YANDA CAI, MICHELLE GOBIN, MICHAEL W. MANLEY, PATRICK A. RYAN, ELLIOTT WAHLE, MARGARET CORNISH, CIBC WORLD MARKETS INC., CANACCORD GENUITY CORP. (f.k.a. CANACCORD FINANCIAL LTD)., GMP SECURITIES LP and MACKIE RESEARCH CAPITAL CORPORATION (f.k.a. RESEARCH CAPITAL CORPORATION)

Defendants

Proceeding under the *Class Proceedings Act, 1992*

PLAN OF ALLOCATION

(Supplement to the Settlement Agreements, dated February 13, 2013 and April 26, 2013)

DEFINED TERMS

1. The definitions set out in the Settlement Agreements, dated February 13, 2013 and April 26, 2013 apply to and are incorporated into this Plan of Allocation, in addition to the following definitions:

    (a) **"Acquisition Expense"** means the total monies paid by the Claimant (including brokerage commissions) to acquire Eligible Shares;

    (b) **"Allocation Pool"** means the sum of the Settlement Amounts paid under the Settlement Agreements dated February 13, 2013 and April 26, 2013 after payment of Administration Expenses and Class Counsel Fees. For greater certainty, Allocation Pool includes the after tax amount of any accrued interest income on the Settlement Amounts;

    (c) **"Claimant"** means a Class Member who submits a properly completed Claim Form and all required supporting documentation to the Administrator, on or before the Claims Bar Deadline;

(d) **"Discounted Nominal Entitlement"** means a Claimant's Nominal Entitlement less the discount provided for herein, and which forms the second step upon which each Claimant's *pro rata* share of the Allocation Pool is determined;

(e) **"Disposition Proceeds"** means the total proceeds paid to the Claimant (without deducting any commissions paid in respect of the dispositions) in consideration for the sale of all of the Claimant's Eligible Shares;

(f) **"FIFO"** means the principle of first-in, first-out, wherein shares are deemed to be sold in the same order that they were purchased (i.e. the first shares purchased are deemed to be the first sold);

(g) **"Net Loss"** means that the Claimant's Disposition Proceeds are less than the Claimant's Acquisition Expense;

(h) **"Net Other Settlement Amount"** means the settlement amount of the approved settlement in the Action with the Defendants, CIBC World Markets Inc., Canaccord Genuity Corp., f.k.a. Canaccord Financial Ltd., GMP Securities LP, and Mackie Research Capital Corporation, f.k.a. Research Capital Corporation, after payment of Administration Expenses and Class Counsel Fees. For greater certainty, Net Other Settlement Amount includes the after tax amount of any accrued interest income on the settlement amount;

(i) **"Nominal Entitlement"** means a Claimant's nominal damages as calculated pursuant to the formula set forth herein, and which forms the first step upon which each Claimant's *pro rata* share of the Allocation Pool is determined;

(j) **"Primary Market Purchasers"** means Claimants who bought Eligible Shares on an "if, as and when issued" basis under Zungui's initial public offering pursuant the Zungui IPO Prospectus dated December 11, 2009;

(k) **"Secondary Market Purchasers"** means Claimants who bought Eligible Shares on a stock exchange (e.g. the Toronto Stock Exchange) or alternative trading system (e.g. Pure Trading, Omegan and Alpha Venture);

(l) **"Settlement Amounts"** means CAD $8.1 million, and CAD $2 million; and

(m) **"Share Exchange Acquirors"** means Claimants who received Eligible Shares under the Share Exchange Agreement.

CALCULATION OF NET LOSS AND NOMINAL ENTITLEMENT

2. The Allocation Pool and any Net Other Settlement Amount will be distributed in accordance with the Plan of Allocation described herein.

3. A Claimant must have sustained a Net Loss on all Eligible Shares in order to be eligible to receive a payment from the Allocation Pool and, if applicable, any Net Other

Settlement Amount. A Claimant that has not suffered a Net Loss as calculated under the Plan of Allocation will not be entitled to receive any portion of the Allocation Pool or any portion of a Net Other Settlement Amount.

4. First, the Administrator will determine whether a Claimant has sustained a Net Loss on all Eligible Shares. If the Claimant has sustained a Net Loss, the Claimant becomes an "**Authorized Claimant**", and the Administrator will proceed to calculate the Authorized Claimant's Nominal Entitlement.

5. The date of an acquisition, sale or deemed disposition shall be the trade date of the transaction, as opposed to the settlement date, except for an acquisition of Eligible Shares under the Share Exchange Agreement in which case it shall be the date of acquisition recorded in Zungui's securities register or branch register as may be the case.

6. For the purposes of any calculation relating to Eligible Shares acquired under the Share Exchange Agreement, the Administrator will account for such shares on a post-exchange cost of acquisition basis.

7. Second, the Administrator will calculate an Authorized Claimant's Nominal Entitlement according to the formulae listed below. The formulae reflect the opinion of the Plaintiffs' valuation expert as advanced in the Proceeding; namely, that the price of Zungui shares was corrected by statistically significant events on June 2, 2011, and August 22, 2011. Where applicable, certain formulae also reflect that Zungui shares last traded at CAD $0.34, and have been unable to trade since August 23, 2011.

8. Third, the Administrator will calculate an Authorized Claimant's Discounted Nominal Entitlement by applying the appropriate percentage discounts listed below. The discounts take into account the strengths and weaknesses of the claims made and proposed to be made in the Action by and on behalf of Primary Market Purchasers, Secondary Market Purchasers and Share Exchange Acquirors against the Settling Defendants.

<u>**Primary Market Purchasers**</u>

9. The Nominal Entitlement will be calculated as follows:

I. **No Nominal Entitlement shall be recognized for any Eligible Shares *disposed of before June 2, 2011.***

II. **For Eligible Shares *disposed of from June 2, 2011 to and including August 19, 2011*, the Nominal Entitlement shall be the lesser of:**

A. an amount equal to the number of Eligible Shares disposed of, multiplied by the difference between the price paid for those Eligible Shares (including any commissions paid in respect thereof) and the average price per share received upon the disposition of those Eligible Shares (without deducting any commissions paid in respect of the disposition); or

B. the sum of Eligible Shares disposed of multiplied by CAD $0.26.

III. **For Eligible Shares *disposed of on or after August 22, 2011*, the Nominal Entitlement shall be the lesser of:**

A. an amount equal to the number of Eligible Shares disposed of, multiplied by the difference between the price paid for those Eligible Shares (including any commissions paid in respect thereof) and the average price per share received upon the disposition of those Eligible Shares (without deducting any commissions paid in respect of the disposition); or

B. the sum of Eligible Shares disposed of multiplied by CAD $1.52.

IV. **For Eligible Shares *still held at the time the Claim Form is completed*, the Nominal Entitlement shall be the sum of Eligible Shares still held multiplied by CAD $1.86 per share.**

Secondary Market Purchasers

10. The Nominal Entitlement will be calculated as follows:

I. **No Nominal Entitlement shall be recognized for any Eligible Shares *purchased and disposed of before June 2, 2011.***

II. **For Eligible Shares *purchased before June 2, 2011 and disposed of from June 2, 2011 to and including August 19, 2011*, the Nominal Entitlement shall be the lesser of:**

A. an amount equal to the number of Eligible Shares disposed of, multiplied by the difference between the volume weighted average price paid for those Eligible Shares (including any commissions paid in respect thereof) and the average price per share received upon the disposition of those Eligible Shares (without deducting any commissions paid in respect of the disposition); or

B. the sum of Eligible Shares disposed of multiplied by CAD $0.26.

III. **For Eligible Shares** ***purchased from June 2, 2011 to and including August 19, 2011 and disposed of on or after August 22, 2011*****, the Nominal Entitlement shall be the lesser of:**

A. an amount equal to the number of Eligible Shares disposed of, multiplied by the difference between the volume weighted average price paid for those Eligible Shares (including any commissions paid in respect thereof) and the average price per share received upon the disposition of those Eligible Shares (without deducting any commissions paid in respect of the disposition); or

B. the sum of Eligible Shares disposed of multiplied by CAD $1.26.

IV. **For Eligible Shares** ***purchased from June 2, 2011 to and including August 19, 2011 and still held at the time the Claim Form is completed*****, the Nominal Entitlement shall be the lesser of:**

A. an amount equal to the number of Eligible Shares still held multiplied by the volume weighted average price paid for those Eligible Shares (including any commissions paid in respect thereof); or

B. the sum of Eligible Shares still held multiplied by CAD $1.60 per share.

V. **For Eligible Shares** ***purchased before June 2, 2011 and disposed of on or after August 22, 2011*****, the Nominal Entitlement shall be the lesser of:**

A. an amount equal to the number of Eligible Shares disposed of, multiplied by the difference between the volume weighted average price paid for those Eligible Shares (including any commissions paid in respect thereof) and the average price per share received upon the disposition of those Eligible Shares (without deducting any commissions paid in respect of the disposition); or

B. the sum of Eligible Shares disposed of multiplied by CAD $1.52.

VI. **For Eligible Shares** ***purchased before June 2, 2011 and still held at the time the Claim Form is completed*****, the Nominal Entitlement shall be the lesser of:**

A. an amount equal to the number of Eligible Shares still held multiplied by the volume weighted average price paid for those Eligible Shares (including any commissions paid in respect thereof); or

B. the sum of Eligible Shares still held multiplied by CAD $1.86 per share.

VII. **For Eligible Shares** ***purchased on August 22, 2011 and still held at the time the Claim Form is completed*****, the Nominal Entitlement shall be the lesser of:**

A. an amount equal to the number of Eligible Shares still held multiplied by the volume weighted average price paid for those Eligible Shares (including any commissions paid in respect thereof); or

B. the sum of Eligible Shares still held multiplied by CAD $0.34.

Share Exchange Acquirors

11. The Nominal Entitlement will be calculated as follows:

I. **No Nominal Entitlement shall be recognized for any Eligible Shares *disposed of before June 2, 2011.***

II. **For Eligible Shares *disposed of from June 2, 2011 to and including August 19, 2011*, the Nominal Entitlement shall be the lesser of:**

A. an amount equal to the number of Eligible Shares thus disposed of, multiplied by the difference between the price paid for those Eligible Shares (including any commissions paid in respect thereof) and the average price per share received upon the disposition of those Eligible Shares (without deducting any commissions paid in respect of the disposition); or

B. the sum of Eligible Shares disposed of multiplied by CAD $0.26.

III. **For Eligible Shares *disposed of on or after August 22, 2011*, the Nominal Entitlement shall be the lesser of:**

A. an amount equal to the number of Eligible Shares thus disposed of, multiplied by the difference between the price paid for those Eligible Shares (including any commissions paid in respect thereof) and the average price per share received upon the disposition of those Eligible Shares (without deducting any commissions paid in respect of the disposition); or

B. the sum of Eligible Shares disposed of multiplied by CAD $1.52.

IV. **For Eligible Shares *still held at the time the Claim Form is completed*, the Nominal Entitlement shall be the lesser of:**

A. an amount equal to the number of Eligible Shares still held multiplied by the price paid for those Eligible Shares (including any commissions paid in respect thereof); or

B. the sum of Eligible Shares still held multiplied by CAD $1.86 per share.

FINAL DISTRIBUTION

12. A separate Nominal Entitlement will be calculated for each Authorized Claimant's Share Exchange acquisition, Primary Market and Secondary Market purchases, as may be the case. Whether particular dispositions are of Zungui shares acquired pursuant to the Share Exchange Agreement, purchased in the Primary Market or in the Secondary Market will be determined using FIFO.

13. The Discounted Nominal Entitlement will be calculated for Authorized Claimants' Share Exchange acquisition, Primary Market and Secondary Market purchases by subtracting the applicable percentage amount below from the Nominal Entitlement:

    (a) For Share Exchange Acquirors, 40%;

    (b) For Primary Market Purchasers, 0%; and

    (c) For Secondary Market Purchasers

        (i) that purchased in the period from and including December 21, 2009 to and including August 19, 2011, 8%; and

        (ii) that purchased on August 22, 2011 and still held some of those Zungui shares at the time the Claim Form is completed, ~~98.5%~~ 80.0% ✓PMP.

14. Each Authorized Claimant's actual compensation shall be the portion of the Allocation Pool equivalent to the ratio of his/her/its Discounted Nominal Entitlement, to the total Discounted Nominal Entitlements of all Authorized Claimants multiplied by the Allocation Pool, as calculated by the Administrator.

15. In the event of an approved settlement in the Action with the Defendants, CIBC World Markets Inc., Canaccord Genuity Corp., f.k.a. Canaccord Financial Ltd., GMP Securities LP, and Mackie Research Capital Corporation, f.k.a. Research Capital Corporation:

    (a) the Net Other Settlement Amount shall be solely for the benefit of and distribution to Authorized Claimants who are Primary Market Purchasers; and

(b) the compensation to be paid to an Authorized Claimant who is a Primary Market Purchaser from any Net Other Settlement Amount shall be:

(i) in addition to any compensation received from the Allocation Pool for Primary Market purchases; and

(ii) that portion of the Net Other Settlement Amount equivalent to the ratio of his/her/its Discounted Nominal Entitlement for Primary Market purchases, to the total Discounted Nominal Entitlements for all Primary Market purchases multiplied by the Net Other Settlement Amount.

16. The Administrator will not distribute entitlements of less than CAD$5.00 to Class Members. Such amounts will instead be redistributed *pro rata* to the other Authorized Claimants.

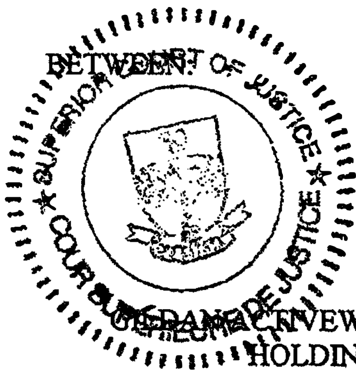
17. The Administrator shall be authorized to distribute the Allocation Pool and any Net Other Settlement Amount in accordance with this Plan of Allocation upon having received and reviewed the Claim Forms submitted by the Claims Bar Deadline without further order of the Court.

18. If, one hundred eighty (180) days from the date on which the Administrator distributes the Allocation Pool and any Net Other Settlement Amount to Authorized Claimants, the Escrow Account remains in a positive balance (whether due to tax refunds, uncashed cheques, or otherwise), the Administrator shall, if feasible, reallocate such balance among the Authorized Claimants in an equitable and economic fashion. In the event any such remaining balance is less than CAD$25,000.00 or less than $5.00 per Claimant, the Administrator will donate such balance to the Small Investor Protection Association (Canada), *cy pres*.

Court File No. 58574CP

ONTARIO
SUPERIOR COURT OF JUSTICE

THE HONOURABLE	) FRIDAY, THE 18 DAY
	)
JUSTICE LYNNE LEITCH	) OF Feb., 2011



BETWEEN:

METZLER INVESTMENT GMBH

Plaintiff

and

GILDAN ACTIVEWEAR INC., GLENN J. CHAMANDY, GLENN J. CHAMANDY HOLDINGS CORPORATION, and LAURENCE G. SELLYN

Defendants

Proceeding under the *Class Proceedings Act, 1992*

ORDER

THIS MOTION made by the Representative Plaintiff for, *inter alia,* an Order approving and implementing the Settlement Agreement dated August 2, 2010 (the "Settlement Agreement"), entered into between the parties herein and the parties to parallel class actions proceeding in Québec and in the United States was heard was heard in London, Ontario on January 25, 2011.

ON READING the materials filed, including the Settlement Agreement attached as Schedule "A," and on hearing the submissions of counsel for the Representative Plaintiff and counsel for the Defendants:

1. **THIS COURT DECLARES** that, except as otherwise stated, this Order incorporates and adopts the definitions set forth in the Settlement Agreement.

2. **THIS COURT DECLARES** that the settlement provided for in the Settlement Agreement is fair, reasonable and in the best interests of members of the Ontario Class.

3. **THIS COURT ORDERS** that the Settlement Agreement attached to this Order as **Schedule "A"** is hereby approved pursuant to s.29 of the *Class Proceedings Act, 1992*.

4. **THIS COURT ORDERS** that the Settlement Agreement forms part of this Order and is binding upon the Representative Plaintiff and upon all members of the Ontario Class including those persons who are minors or mentally incapable, and that the requirements of Rules 7.04(1) and 7.08(4) of the *Rules of Civil Procedure* are disposed of in respect of the Ontario Action, and the Settlement Agreement shall be implemented in accordance with its terms.

5. **THIS COURT ORDERS AND DECLARES** that, upon the Effective Date, the Representative Plaintiff and each member of the Ontario Class, on behalf of themselves, their personal representatives, agents, heirs, executors, administrators, trustees, beneficiaries, former and current employee plan members and contributors, successors and assigns, and any person they represent in relation to Gildan common stock purchased or otherwise acquired during the Class Period or in relation to the Settled Claims (all of the foregoing persons and entities are collectively referred to as the "Ontario Class Releasors"), shall release and discharge, and shall be conclusively deemed to have fully, finally and forever released and discharged the Released Parties from the Settled Claims.

6. **THIS COURT ORDERS AND DECLARES** that, upon the Effective Date, each of the Ontario Class Releasors shall consent and shall be deemed to have consented to the dismissal without costs and with prejudice of any other action or proceeding he, she or it has commenced against the Released Parties with respect to a Settled Claim, and is

hereby permanently barred and enjoined from instituting, commencing or prosecuting any Settled Claim against the Released Parties.

7. **THIS COURT ORDERS** that, upon the Effective Date, the Ontario Class Releasors shall not institute, continue, maintain or assert, either directly or indirectly, whether in the United States, Canada or elsewhere, on their own behalf or on behalf of any class or any other person, any action, suit, cause of action, proceeding, complaint, claim or demand against any Released Party or any other person who may claim any form of contribution or indemnity from any Released Party in respect of any Settled Claim or any matter related thereto, and are permanently barred and enjoined from doing so.

8. **THIS COURT ORDERS** that, upon the Effective Date, the Defendant Releasors release and forever discharge each and every one of the Settled Defendants' Claims against any of the Released Plaintiff Parties, and are hereby forever barred and enjoined from prosecuting a Settled Defendants' Claim against the Released Plaintiff Parties.

9. **THIS COURT ORDERS** that neither this Order, the Settlement Agreement, nor any of their terms and provisions, nor any of the negotiations or proceedings connected with the Settlement Agreement, nor any of the documents or statements referred to therein shall be:

   (a) offered or received against the Released Parties as evidence of or construed as or deemed to be evidence of any presumption, concession or admission by any of the Defendants with respect to the truth of any fact alleged in the Fresh as Amended Statement of Claim or the validity of any claim that has been or could have been asserted in the Ontario Action or in any litigation, or the deficiency of any defence that has been or could have been asserted in the Ontario Action, or in any

litigation, or of any liability, negligence, fault, or wrongdoing of the Released Parties;

(b) offered or received against the Released Parties as evidence of a presumption, concession or admission of any fault, misrepresentation or omission with respect to any statement or written document approved or made by any of the Released Parties;

(c) offered or received against the Released Parties as evidence of a presumption, concession or admission with respect to any liability, negligence, fault or wrongdoing or in any way referred to for any other reason as against any of the Released Parties, in any other civil, criminal or administrative action or proceeding, other than such proceedings as may be necessary to enforce and give effect to the provisions of the Settlement Agreement; provided, however, that the Released Parties may refer to it to effect the release and liability protection granted them hereunder;

(d) construed against the Released Parties as an admission or concession that the consideration to be given hereunder represents the amount which could be or would have been recovered after trial; or

(e) construed as or received in evidence as an admission, concession or presumption against the Representative Plaintiff or any member of the Ontario Class that any of their claims are without merit, or that any defences asserted by the Defendants have any merit, or that damages recoverable under the Fresh as Amended Statement of Claim would not have exceeded the amounts set forth under the Settlement Agreement.

10. **THIS COURT DECLARES** that the Plan of Allocation, attached as Schedule "A" to the Settlement Agreement, is approved as fair and reasonable.

11. **THIS COURT ORDERS** that this Court shall retain jurisdiction over the parties herein, the members of the Ontario Class, the Escrow Agent and the Administrator for all matters relating to the Ontario Action and the Ontario Class, including the administration, interpretation, effectuation or enforcement of the Settlement Agreement and this Order, and including any application for fees and expenses incurred by or paid to counsel for the Plaintiff and the Administrator in overseeing and administering the Settlement Agreement, in distributing settlement proceeds to members of the Ontario Class, and in complying with the terms of this Order.

12. **THIS COURT ORDERS** that, on notice to the Court but without further order of the Court, the parties to the Settlement Agreement may agree to reasonable extensions of time to carry out any of the provisions of the Settlement Agreement.

13. **THIS COURT ORDERS AND DECLARES** that the Released Parties have no responsibility for and no liability whatsoever with respect to the administration of the Settlement Agreement.

14. **THIS COURT ORDERS** that if the Settlement Agreement is terminated pursuant to any rights of termination therein, then:

    (a) this Order (except for paragraphs 1, 9, 11, 13 and 14 herein) shall be set aside, be of no further force or effect, and be without prejudice to any party;

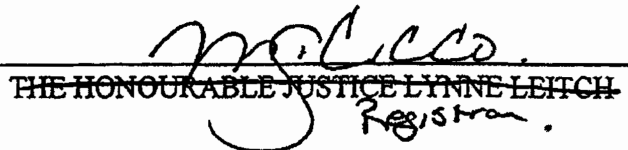
    (b) the Ontario Action shall be immediately decertified as a class proceeding pursuant to Section 10 of the *Class Proceedings Act, 1992*, without prejudice to the

Representative Plaintiff's ability to reapply for certification and the Defendants' ability to oppose certification on any and all grounds; and

(c) each party to the Ontario Action shall be restored to his, her or its respective position in the Ontario Action as it existed immediately prior to the execution of the Settlement Agreement.

15. **THIS COURT ORDERS AND ADJUDGES** that, upon the Effective Date, the Ontario Action shall be and is hereby dismissed against the Defendants with prejudice and without costs.

Date: Feb 24-2011



~~THE HONOURABLE JUSTICE LYNNE LEITCH~~
Registrar.

ORDER ENTERED
77-72
FEB 2 4 2011

SCHEDULE "A" – PLAN OF ALLOCATION

DEFINED TERMS

1. For the purposes of this Plan of Allocation, the definitions set out in the Settlement Agreement apply to and are incorporated into this Plan of Allocation and, in addition, the following definitions apply:

   (a) "**Acquisition Expense**" means the total monies paid by the Claimant (including brokerage commissions) to purchase or otherwise acquire Eligible Shares;

   (b) "**Authorized Canadian Claimant**" means an Authorized Claimant who purchased or otherwise acquired their Eligible Shares on the TSX, or who was a Canadian resident at the time some or all of their Eligible Shares were purchased or acquired, regardless of the exchange over which the Eligible Shares were purchased or acquired. For the purposes of this Plan of Allocation, residency shall be confirmed by consideration of a Claimant's address at the time their Eligible Shares were purchased or acquired;

   (c) "**Authorized U.S. Claimant**" means an Authorized Claimant who purchased or otherwise acquired their Eligible Shares on the NYSE, other than Canadian residents. Where an Authorized U.S. Claimant has acquired Eligible Shares on both the TSX and NYSE, such claimant will be treated as an Authorized U.S. Claimant with respect to those Eligible Shares acquired on the NYSE and as an Authorized Canadian Claimant with respect to those Eligible Shares acquired on the TSX;

   (d) "**Claimant**" means a Class Member who submits a properly completed Claim Form and all required supporting documentation to the Administrator, on or before the Claims Deadline;

   (e) "**Disposition Proceeds**" means the total proceeds paid to the Claimant (without deducting any commissions paid in respect of the dispositions) in consideration of the sale of all of their Eligible Shares; provided, however, that with respect to any Eligible Shares that the Claimant continues to hold, they shall be deemed to have been disposed of for an amount equal to the number of Eligible Shares still held, multiplied by the difference between the average price per common share paid for those Eligible Shares (including any commissions paid in respect thereof determined on a per common share basis) and (i) in the case of TSX transactions CAD$26.51; or (ii) in the case of NYSE transactions USD$25.97.

   (f) "**FIFO**" means the principle of first-in first-out, wherein common shares are deemed to be sold in the same order that they were purchased or otherwise acquired (i.e. the first common shares purchased or otherwise acquired are deemed to be the first sold); and which requires, in the case of a Claimant who held common shares of Gildan at the commencement of the Class Period, that

those common shares be deemed to have been sold completely before Eligible Shares are sold, or deemed sold;

(g) **"Net Loss"** means that the Claimant's Disposition Proceeds are less than the Claimant's Acquisition Expense;

(h) **"Nominal Entitlement"** means an Authorized Claimant's nominal damages as calculated pursuant to the formula set forth herein, and which forms the basis of each Authorized Claimant's *pro rata* share of the Net Settlement Amount.

CALCULATION OF NET LOSS

2. A Claimant must have sustained a Net Loss in order to be eligible to receive a payment from the Net Settlement Amount.

3. The Administrator shall first determine whether a Claimant sustained a Net Loss. If the Claimant has sustained a Net Loss they become an Authorized Claimant, and the Administrator will go on to calculate their Nominal Entitlement.

CALCULATION OF COMPENSATION

4. The Administrator will apply FIFO to distinguish the sale of Gildan common shares held at the beginning of the Class Period from the sale of Eligible Shares, and will continue to apply FIFO to determine the purchase or acquisition transactions which correspond to the sale of Eligible Shares. The Administrator will use this data in the calculation of an Authorized Claimant's Nominal Entitlement according to the formulas listed below.

5. The date of sale or deemed disposition shall be the trade date, as opposed to the settlement date, of the transaction.

6. For the purposes of any calculation under the Plan of Allocation, the Administrator will account for any stock splits or consolidations that occur after the Class Period, such that Authorized Claimants' holdings for the purposes of the calculations are completed in units equivalent to those traded during the Class Period.

7. An Authorized Claimant's Nominal Entitlement will be calculated as follows:

I. No Nominal Entitlement shall be available for any Eligible Shares *disposed of* prior to the first alleged corrective disclosure, that is, *prior to April 29, 2008.*

II. For Eligible Shares *disposed of* during the 10 trading day period following the alleged corrective disclosure, that is, *on or between April 29 and May 12, 2008*, the Nominal Entitlement shall be:

A. an amount equal to the number of Eligible Shares thus disposed of, multiplied by the difference between the volume weighted average price paid for those Eligible Shares (including any commissions paid in respect thereof) and the per share price received upon the disposition of those Eligible Shares (without deducting any commissions paid in respect of the disposition).

III. For Eligible Shares *disposed of* after the 10 trading day period following the alleged corrective disclosure, that is, *after the close of trading on May 12, 2008*, the Nominal Entitlement shall be the lesser of:

A. an amount equal to the number of Eligible Shares thus disposed of, multiplied by the difference between the volume weighted average price paid for those Eligible Shares (including any commissions paid in respect thereof) and the per share price received upon the disposition of those Eligible Shares (without deducting any commissions paid in respect of the disposition); and

B. an amount equal to the number of Eligible Shares thus disposed of, multiplied by the difference between the volume weighted average price paid for those Eligible Shares (including any commissions paid in respect thereof) and (i) in the case of TSX transactions CAD$26.51; or (ii) in the case of NYSE transactions USD$25.97 [in both cases being the 10 trading day volume weighted average trading price of Gildan common shares from April 29 to May 12, 2008].

IV. For Eligible Shares still held at the time the Claim Form is completed, the Nominal Entitlement shall be:

A. an amount equal to the number of Eligible Shares still held, multiplied by the difference between the volume weighted average price paid for those Eligible Shares (including any commissions paid in respect thereof) and (i) in the case of TSX transactions CAD$26.51; or (ii) in the case of NYSE transactions USD$25.97 [in both cases being the 10 trading day volume weighted average trading price of Gildan common shares from April 29 to May 12, 2008].

FINAL DISTRIBUTION

8. 89% of the Net Settlement Fund is allocated for *pro rata* distribution among Authorized Canadian Claimants. Such distributions shall be made in Canadian currency. The remaining 11% of the Net Settlement Fund shall be distributed in U.S. currency on a *pro rata* basis among Authorized U.S. Claimants.

9. Once all Nominal Entitlements have been calculated, the Administrator will convert the Nominal Entitlements of all Authorized Canadian Claimants who conducted transactions on the NYSE from U.S. currency to Canadian currency based on the exchange rate as of the date the currency conversion is performed. After currency conversion, the Nominal Entitlements of all Authorized Canadian Claimants will be recorded in Canadian currency.

Court File No. CV-12-9667-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

THE HONOURABLE	)	FRIDAY,	THE
	)		
REGIONAL SENIOR JUSTICE MORAWETZ	)		
	)	27TH DAY OF DECEMBER, 2013	

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 AND ARRANGEMENT OF SINO-FOREST CORPORATION

Court File No.: CV-11-431153-00CP

ONTARIO
SUPERIOR COURT OF JUSTICE

BETWEEN:

THE TRUSTEES OF THE LABOURERS' PENSION FUND OF CENTRAL AND EASTERN CANADA, THE TRUSTEES OF THE INTERNATIONAL UNION OF OPERATING ENGINEERS LOCAL 793 PENSION PLAN FOR OPERATING ENGINEERS IN ONTARIO, SJUNDE AP-FONDEN, DAVID GRANT and ROBERT WONG

Plaintiffs

- and –

SINO-FOREST CORPORATION, ERNST & YOUNG LLP, BDO LIMITED (formerly known as BDO MCCABE LO LIMITED), ALLEN T.Y. CHAN, W. JUDSON MARTIN, KAI KIT POON, DAVID J. HORSLEY, WILLIAM E. ARDELL, JAMES P. BOWLAND, JAMES M.E. HYDE, EDMUND MAK, SIMON MURRAY, PETER WANG, GARRY J. WEST, PÖYRY (BEIJING) CONSULTING COMPANY LIMITED, CREDIT SUISSE SECURITIES (CANADA), INC., TD SECURITIES INC., DUNDEE SECURITIES CORPORATION, RBC DOMINION SECURITIES INC., SCOTIA CAPITAL INC., CIBC WORLD MARKETS INC., MERRILL LYNCH CANADA INC., CANACCORD FINANCIAL LTD., MAISON PLACEMENTS CANADA INC., CREDIT SUISSE SECURITIES (USA) LLC and MERRILL LYNCH, PIERCE, FENNER & SMITH INCORPORATED (successor by merger to Banc of America Securities LLC)

Defendants

Proceeding under the *Class Proceedings Act, 1992*

ORDER

THIS MOTION, made by the plaintiffs for an order approving the process for the allocation and distribution of the net proceeds of the settlement with Ernst & Young LLP, was heard on December 13, 2013 at the Court House, 330 University Avenue, Toronto, Ontario.

WHEREAS this Court issued an order dated December 10, 2012 approving the Plan of Compromise and Reorganization of the Applicant under the *Companies' Creditors Arrangement Act* ("CCAA") dated December 3, 2012 (the "Plan");

AND WHEREAS this Court issued an order on March 30, 2013 approving the Ernst & Young Settlement and such order (a) established a settlement trust for the Ernst & Young settlement proceeds (the "Settlement Trust"); (b) appointed the plaintiffs as representatives of persons that purchased Sino-Forest securities ("Securities Claimants") for the purposes of the settlement; (c) appointed Koskie Minsky LLP and Siskinds LLP (together "Canadian Class Counsel"), along with insolvency counsel Paliare Roland Rosenberg Rothstein LLP, as counsel for the Securities Claimants; and (d) directed that Canadian Class Counsel and insolvency counsel are to establish a process for the allocation and distribution of the net settlement proceeds among Securities Claimants and that such process shall be approved by this Court (the "Claims and Distribution Protocol");

AND WHEREAS this Court issued an order on October 23, 2013 approving the form of notice of the hearing to approve the Claims and Distribution Protocol and the plan for distribution of the notice;

AND ON READING the plaintiffs' motion record and supplementary motion record, and on reading such other material, filed, and on hearing the submissions of counsel for the plaintiffs, and those other persons present,

1. **THIS COURT ORDERS** that the time for service and manner of service of the notice of motion and the plaintiffs' motion record and supplementary motion record on any person are, respectively, hereby abridged and validated, and any further service thereof is hereby dispensed

with so that this motion was properly returnable December 13, 2013 in both proceedings set out in the title of proceedings herein.

2. **THIS COURT ORDERS** that capitalized terms not otherwise defined in this order shall have the meanings attributed to those terms in the Plan or the Claims and Distribution Protocol attached as **Schedule "A"** to this order.

3. **THIS COURT ORDERS** that the Claims and Distribution Protocol attached as **Schedule "A"** to this order is hereby approved and that EY Compensation Fund shall be distributed in accordance with the Claims and Distribution Protocol and this order.

4. **THIS COURT ORDERS** that NPT RicePoint Class Action Services Inc. (the "Claims Administrator") is hereby authorized to pay out of the Settlement Trust (a) Class Counsel Fees that are approved by this Court (including amounts in respect of tax); (b) costs of administration of the Settlement Trust (including taxes); (c) payment to Claims Funding International pursuant to the order of Justice Perell dated May 17, 2012; and (d) any expenses and taxes relating to the notice of the settlement approval hearing, notice of the hearing to approve the Claims and Distribution Protocol and Class Counsel Fees and any notice of the Claims and Distribution Protocol.

5. **THIS COURT ORDERS** that nothing in this order, the materials filed in support thereof or the Claims and Distribution Protocol shall fetter the discretion of any court to determine the damages of Securities Claimants at a trial or other disposition of an action in respect of the claims for which compensation is available under the Claims and Distribution Protocol.

6. **THIS COURT ORDERS** that the issue of the admissibility, producibility and compellability of the materials filed for this motion, including any determination of inflation for Sino-Forest securities by Frank Torchio of Forensic Economics for the purposes of the Claims and Distribution Protocol, in the Ontario Class Action, Quebec Class Action or US Class Action is reserved to the motions and trial judges presiding over those proceedings if and/or when such admissibility, producibility and/or compellability is an issue for determination.

7. **THIS COURT ORDERS** that counsel to the Initial Consenting Noteholders, Goodmans LLP, is hereby authorized to direct the amounts provided in section 8 of the Claims and

Distribution Protocol be paid from the EY Compensation Fund to the Noteholders through The Depository Trust Company in a manner consistent with the distributions made to the Noteholders under the Plan on the Initial Distribution Date (as defined in the Plan) as consented to by the Monitor and Goodmans LLP, and that the Claims Administrator, The Depository Trust Company, the Monitor and Goodmans LLP shall not incur any liability as a result of acting in accordance with the terms of this order.

8. **THIS COURT ORDERS** that 30 days following the conclusion of the distribution of the EY Compensation Fund, Canadian Class Counsel shall report to the Court, on notice to the parties to the Ontario Class Action, (a) the total amount of the EY Compensation Fund distributed, and (b) the allocation of that distribution to the categories of Claimants listed in paragraph 10(e) of the Claims and Distribution Protocol.

Morawetz, J.

SCHEDULE "A"

Court File No. CV-11-431153-00CP

Re Sino-Forest Corporation* and *Trustees of Labourers' Fund v. Sino-Forest

CLAIMS AND DISTRIBUTION PROTOCOL
Distribution Of EY Compensation Fund To Securities Claimants

1. The following definitions apply in this Schedule:

   (a) "2011 Notes" means the aggregate principal amount of US$300,000,000 of 9.125% Guaranteed Senior Notes due 2011.

   (b) "ACB" means the adjusted cost base for the purchase of share or notes (as the case may be), inclusive of brokerage commissions.

   (c) "Allocation System" means the method of determining the Compensable Loss assigned to a claim in order determine the amount of compensation to be awarded for that claim (as set out below). This is based on the Securities Claimant's estimated losses attributable to misrepresentations in Sino-Forest's public disclosure and risk adjustments to account for the liability risks for different categories of Securities Claimants.

   (d) "Claims Administrator" means NPT RicePoint Class Action Services Inc.

   (e) "Claim Form" means a written claim in the prescribed form seeking compensation from the EY Compensation Fund.

   (f) "Claimant" means any person, other than the Noteholders, making a claim as purporting to be a Securities Claimant or on behalf of a purported Securities Claimant, with proper authority (as determined by the Claims Administrator or Class Counsel).

   (g) "Class Counsel Fees" means the aggregate of the fees and disbursements of Koskie Minsky LLP, Siskinds LLP, Paliare Roland Rothstein Rosenberg LLP, Siskinds, Desmeules senclr, Kessler, Topaz,Meltzer & Check, LLP and Cohen Millstein Sellers & Toll PLLC (including taxes) as provided in the EY Allocation Order;

   (h) "Compensable Damages" mean the amount of a Claimant's damages for each type of purchase of securities after accounting for Offset Profits for those purchases.

   (i) "Compensable Loss" is the sum of the Claimant's damages after Offset Profits are deducted and risk adjustments applied for each type of purchase.

   (j) "Distribution Record Date" has the meaning ascribed to that term in the Plan.

   (k) "Excluded Claims" means

      (i) a claim by or on behalf of any Noteholder in respect of Notes held as of the Distribution Record Date;

      (ii) a claim in respect of a purchase in the June 2007 offering of shares or any earlier offering other than the May 2004 offering;

(iii) a claim in respect of a purchase in any note offering that occurred before the offering for the 2011 Notes on August 17, 2004;

(iv) a claim by on behalf of any person or entity for securities purchased on or after August 26, 2011; and

(v) a claim by or on behalf of any person or entity that is as of the date of the EY Settlement Approval Order a named defendant to any of the Class Actions (as defined in the Plan), Albert Ip, Alfred C.T. Hung, George Ho and Simon Yeung and their past and present subsidiaries, affiliates officers, directors, senior employees, partners, legal representatives heirs predecessors, successors and assigns, and any individual who is a member of the immediate family of Allen T.Y. Chan a.k.a. Tak Yuen Chan, W. Judson Martin, Kai Kit Poon, David J. Horsley, William E. Ardell, James P. Bowland, James M.E. Hyde, Edmund Mak, Simon Murray, Peter Wang, Garry J. West, Albert Ip, Alfred C.T. Hung, George Ho and Simon Yeung.

(l) "EY Allocation Order" means the order approving the claims process for the distribution of the Ernst & Young settlement.

(m) "EY Compensation Fund" means the Settlement Fund less Class Counsel Fees, costs of administration of the Settlement Trust (including taxes), payment to Claims Funding International and any expenses and taxes relating to the notice of the settlement approval hearing, notice of the fee and allocation hearing and notice of this claims and distribution protocol.

(n) "EY Settlement Approval Order" means the order of Morawetz J. dated March 20, 2013, approving the Ernst & Young settlement.

(o) "FIFO" means the method applied to the holdings of Securities Claimants who made multiple purchases or sales such that sales of securities will be matched, in chronological order, first against securities first purchased.

(p) "Initial Consenting Noteholders" has the meaning ascribed to that term in the Plan.

(q) "Notes" has the meaning ascribed to that term in the Plan.

(r) "Noteholders" has the meaning ascribed to that term in the Plan.

(s) "Offset Profits" means the total increase in inflation of each security sold by a Securities Claimant prior to June 2, 2011 where such security was purchased after March 19, 2007. Such inflation for Sino-Forest securities shall be determined by Frank Torchio of Forensic Economics, in consultation with Class Counsel.

(t) "Ontario Class Action" means the action commenced against Sino-Forest Corporation and others in the Ontario Superior Court of Justice, bearing (Toronto) Court File No. CV-11-431153-00CP.

(u) "Plan" means the Plan of Compromise and Reorganization of Sino-Forest Corporation, sanctioned and approved pursuant to the Plan Sanction Order of Morawetz J. dated December 10, 2012.

(v) "Quebec Class Action" means the action commenced against Sino-Forest Corporation and others in the Quebec Superior Court, bearing Court File No. 200-06-000132-111.

(w) "Risk Adjusted Damages" mean the Compensable Damages for each type of purchase of securities, after it has been adjusted by a risk adjustment.

(x) "Risk Adjusted Loss" means the sum of the Risk Adjusted Damages for each type of purchase of securities.

(y) "Sale Price" means the price at which the Claimant disposed of shares or notes, taking into account any commissions paid in respect of the disposition, such that the Sale Price reflects the economic benefit the Claimant received on disposition.

(z) "Securities Claimants" have the meaning ascribed to that term in the EY Settlement Approval Order.

(aa) "Settlement Fund" has the meaning ascribed to that term in the EY Settlement Approval Order"

(bb) "Settlement Trust" has the meaning ascribed to that term in the EY Settlement Approval Order"

(cc) "Tradegate Purchasers" means all Securities Claimants who acquired shares over the Tradegate Exchange and who are not members of the Ontario Class Action, Quebec Class Action or US Class Action.

(dd) "US Class Action" means the action commenced against Sino-Forest Corporation and others in the United States District Court (SDNY), bearing Court File No. 1:12-cv-01726-VM.

2. The Claims Administrator shall distribute the EY Compensation Fund as set out below.

Goal

3. The goal is to divide the EY Compensation Fund among Securities Claimants who submit valid and timely claims provided that Noteholders are not required to submit a claim in order to receive their allocation of the EY Compensation Fund provided in paragraph 8. This division among Securities Claimants, other than Noteholders who shall receive the allocation provided in paragraph 8, is based on a *pro rata* distribution that takes into account the risk adjustments of the Allocation System.

Deadline for Claims

4. Any person, other than the Noteholders, who wishes to claim compensation shall deliver to or otherwise provide the Claims Administrator a Claim Form by February 14, 2014 or such other date set by the Court. If the Claims Administrator does not receive a Claim

Form from a Claimant by the deadline, then the Claimant shall not be eligible for any compensation whatsoever.

Processing Claim Forms

5. The Claims Administrator shall review each Claim Form and verify that the Claimant is eligible for compensation, as follows:

   (a) For a Claimant claiming as a Securities Claimant, the Claims Administrator shall be satisfied that (i) the Claimant is a Securities Claimant; and (ii) the claim is not an Excluded Claim.

   (b) For a Claimant claiming on behalf of a Securities Claimant or a Securities Claimant's estate, the Claims Administrator shall be satisfied that (i) the Claimant has authority to act on behalf of the Securities Claimant or the Securities Claimant's estate in respect of financial affairs; (ii) the person or estate on whose behalf the claim was submitted is a Securities Claimant; and (iii) the claim is not an Excluded Claim.

6. The Claims Administrator shall review the Claim Forms and assign the Compensable Loss to the claims prescribed by the Allocation System.

7. The Claims Administrator shall take reasonable measures to verify that the Claimants are eligible for compensation and that the information in the Claim Forms is accurate. The Claims Administrator may make inquiries of the Claimants in the event of any concerns, ambiguities or inconsistencies in the Claim Forms.

Allocation and Payment of EY Compensation Fund

8. $5,000,000 of EY Compensation Fund shall be allocated to the Noteholders. Such amount shall be paid to counsel to the Initial Consenting Noteholders (Goodmans LLP) in trust, for the benefit of the Noteholders as soon as practicable following final court approval of this Claims and Distribution Protocol.

9. Tradegate Purchasers who filed CCAA claims shall be treated as domiciled in Canada for the purposes of paragraph 10. Tradegate Purchasers who did not file CCAA claims shall be assigned a risk adjustment of 0.01 notwithstanding any other provision of this protocol.

10. As soon as possible after (i) all timely Claim Forms have been processed; (ii) the time to request a reconsideration for disallowed claims under paragraph 20 below has expired;

and (iii) all administrative reviews under paragraphs 21-22 have concluded, the Claims Administrator shall determine each Claimant's Risk Adjusted Loss as follows:

(a) The ACB for each security purchased are determined using FIFO on a per security, per account, basis.

(b) the securities purchased are divided into the types of securities described in the chart at paragraph 10(e).

(c) For each type of purchase of securities, the damages for those purchases are calculated as follows:

[illegible]	[illegible]
Sold before June 2, 2011	No damages
Sold from June 3 to August 25, 2011	(#of securities sold) X (ACB - Sale Price)
Sold or held after August 25, 2011	
Shares	(#of shares sold or held) X (ACB per share - CAD$1.40)
2013 Notes	(#of notes sold or held) X (ACB per note - USD$283)
2014 Notes	(#of notes sold or held) X (ACB per note - USD$276.20)
2016 Notes	(#of notes sold or held) X (ACB per note - USD$283)
2017 Notes	(#of notes sold or held) X (ACB per note - USD$289.80)

(d) The damages for each type of purchase are reduced by subtracting the Claimant's Offset Profits for those purchases to obtain the Compensable Damages.

(e) The Compensable Damages for each type of purchase are multiplied by the risk adjustment in the following chart to obtain the Risk Adjusted Damages:

[illegible]	Risk Adjustment
A. Share Purchases	
(a) Primary Market (Mar. 2007-Aug. 2011)	
June 09 and December 09 offering	1.00
(b) Secondary Market (Mar. 2007-Aug. 2011)	
Canadian market or Canadian resident[1]	
March 19, 2007-March 17, 2008	0.10
March 18, 2008-August 11, 2008	0.30
August 12, 2008-June 2, 2011	0.45
June 3, 2011-August 25, 2011	0.15

[1] This is a reference to any purchase (a) on the Toronto Stock Exchange or any secondary market in Canada; or (b) by a person who is currently a Canadian resident or was at time of purchase.

If CCAA claim filed	0.25
Over-The-Counter (OTC) Market in the US	
March 19, 2007-March 17, 2008	0.10
March 18, 2008-August 25, 2011	0.35
(c) Pre-Mar. 2007 Acquisitions (primary or secondary)	
Shares acquired before March 19, 2007 If CCAA claim filed	0.01 0.10
B. Note Purchases (excluding the Noteholders)	
(a) Primary Market (2013, 2014, 2016, 2017 notes)	
2013, 2014, 2016, 2017 notes (Canadian)[2]	0.15
2017 notes (non-Canadian)	0.10
2013, 2014 and 2016 notes (non-Canadian) If CCAA claim filed	0.01 0.10
(b) Secondary Market (2013, 2014, 2016, 2017 notes)	
Canadian market or Canadian resident (2013, 2014, 2016, 2017 notes)	
July 17, 2008-August 11, 2008	0.20
August 12, 2008-June 2, 2011	0.35
June 3, 2011-August 25, 2011 If CCAA claim filed	0.15 0.25
Non-Canadian market and non-Canadians (2013, 2014, 2016, 2017 notes)	
July 17, 2008- August 25, 2011	0.25
(c) 2011 Notes (primary or secondary)	
Purchase of 2011 Notes	0.01

(f) The Compensable Loss is equal to the sum of the Risk Adjusted Damages for each type of purchase.

11. As soon as is practicable thereafter, the Administrator shall allocate the net amount of the EY Compensation Fund (after the payment in paragraph 8) to the eligible Claimant on a *pro rata* basis based upon each Claimant's Compensable Loss.

[2] This is a reference to any primary market note purchase (a) in a distribution in Canada; or (b) by a person who is currently a Canadian resident or was at time of purchase.

12. The Claims Administrator shall make payments to the eligible Claimants based on the allocation under paragraphs 10 and 11, subject to the following:

(a) The Claims Administrator shall not make payments to Claimants whose allocation under paragraphs 10 and 11 is less than $5.00. Such amount shall instead be allocated *pro rata* to the other eligible Claimants.

(b) All Claimants, other than class members of the US Class Action that are not members of the Ontario or Quebec Class Actions, are required to pay 5% of any recovery, up to a maximum of $5,000,000 in aggregate, to Claims Funding International ("CFI"). The Claims Administrator shall reserve 5% of the allocation to Claimants, other than class members of the US Class Action that are not members of the Ontario or Quebec Class Actions, for payment to CFI, up to a maximum of $5,000,000.

(c) The Claims Administrator shall make payment to a Claimant by either bank transfer or by cheque to the Claimant at the address provided by the Claimant or the last known postal addresses for the Claimant. If, for any reason, a Claimant does not cash a cheque within 6 months after the date of the cheque, the Claimant shall forfeit the right to compensation and the funds shall be distributed in accordance with paragraph 13.

Remaining Amounts

13. If there are amounts remaining after payment to Securities Claimants have been made under paragraphs 10 to 12 and all other financial commitments have been met pursuant to the EY Allocation Order or in order to implement the settlement, then the remaining amount shall be held in the Settlement Trust and paid out for the purposes of future disbursements in the Ontario, Quebec or US Class Actions.

14. If there has been full and final settlements of the Ontario, Quebec and US Class Actions or final judgments against the defendants in those actions (such that there is no prospect of additional amounts being added to the Settlement Trust), then payment of any remaining balance from the Settlement Trust shall be determined by further motion before the Court.

Completion of Claim Form

15. If, for any reason, a living Securities Claimant is unable to complete the Claim Form then it may be completed by the Securities Claimant's personal representative or a member of the Securities Claimant's family.

Irregular Claims

16. The claims process is intended to be expeditious, cost effective and "user friendly" and to minimize the burden on Securities Claimants. The Claims Administrator shall, in the absence of reasonable grounds to the contrary, assume the Securities Claimants to be acting honestly and in good faith.

17. Where a Claim Form contains minor omissions or errors, the Claims Administrator shall correct such omissions or errors if the information necessary to correct the error or omission is readily available to the Claims Administrator.

18. The claims process is also intended to prevent fraud and abuse. If, after reviewing any Claim Form, the Claims Administrator believes that the claim contains unintentional errors which would materially exaggerate the Compensable Loss to be awarded to the Claimant, then the Claims Administrator may disallow the claim in its entirety or make such adjustments so that an appropriate Compensable Loss is awarded to the Claimant. If the Claims Administrator believes that the claim is fraudulent or contains intentional errors which would materially exaggerate the Compensable Loss to be awarded to the Claimant, then the Claims Administrator shall disallow the claim in its entirety.

19. Where the Claims Administrator disallows a claim in its entirety, the Claims Administrator shall send to the Claimant at the address provided by the Claimant or the Claimant's last known email or postal address, a notice advising the Claimant that he or she may request the Claims Administrator to reconsider its decision. For greater certainty, a Claimant is not entitled to a notice or a review where a claim is allowed but the Claimant disputes the determination of Compensable Loss or his or her individual compensation.

20. Any request for reconsideration must be received by the Claims Administrator within 21 days of the date of the notice advising of the disallowance. If no request is received within this time period, the Claimant shall be deemed to have accepted the Claims Administrator's determination and the determination shall be final and not subject to further review by any court or other tribunal.

21. Where a Claimant files a request for reconsideration with the Claims Administrator, the Claims Administrator shall advise Class Counsel of the request and conduct an

administrative review of the Claimant's complaint.

22. Following its determination in an administrative review, the Claims Administrator shall advise the Claimant of its determination. In the event the Claims Administrator reverses a disallowance, the Claims Administrator shall send the Claimant at the Claimant's last known postal address, a notice specifying the revision to the Claims Administrator's disallowance.

23. The determination of the Claims Administrator in an administrative review is final and is not subject to further review by any court or other tribunal.

24. Data from each Claim Form shall be retained such that a Claimant is not required to file further claim forms in any future settlement or distribution.

25. The failure to file a timely valid Claim Form shall not prejudice any person's ability to file a claim form in any future settlement or distribution.

26. Any matter not referred to above shall be determined by analogy by the Claims Administrator in consultation with Class Counsel.

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 AND ARRANGEMENT OF SINO-FOREST CORPORATION

Court File No: CV-12-9667-00CL

THE TRUSTEES OF THE LABOURERS' PENSION FUND OF CENTRAL AND EASTERN CANADA. et al.
Plaintiffs

SINO-FOREST CORPORATION, et al.
Defendants

Court File No. CV-11-431153-00CP

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

Proceeding commenced at Toronto

Proceeding under the *Class Proceedings Act, 1992*

ORDER

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Commercial Court File No.: CV-12-9667-00CL

The Trustees of the Labourer's Pension Fund of Central and Eastern Canada, et al.

Plaintiffs

and

Sino-Forest Corporation, et al.

Defendants

Superior Court File No: CV-10-414302

ONTARIO
SUPERIOR COURT OF JUSTICE
Commercial List

Proceeding under the *Class Proceedings Act, 1992*
Proceeding commenced at Toronto

BOOK OF AUTHORITIES OF THE PLAINTIFFS DEALERS SETTLEMENT APPROVAL (Returnable May 11, 2015) VOLUME II OF II

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