

**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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**FACTUM OF THE APPLICANT,**  
**SINO-FOREST CORPORATION**

**(Motion Regarding the Status of Shareholder Claims  
and Related Indemnity Claims under the CCAA,  
Returnable June 26, 2012)**

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Dated: June 22, 2012

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TO: THE SERVICE LIST

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**I. OVERVIEW**

1. The Applicant, Sino-Forest Corporation ("SFC"), seeks an order that claims against SFC, which result from the ownership, purchase or sale of an equity interest in SFC, are "equity claims" as defined in section 2 of the *Companies' Creditors Arrangement Act* (the "CCAA") including, without limitation, (i) the claims by or on behalf of current or former shareholders asserted in the proceedings listed in Schedule "C" (collectively, the "Shareholder Claims"), and (ii) any indemnification claims against SFC related to or arising from the Shareholder Claims, including, without limitation, by or on behalf of any of the other defendants to the proceedings listed in Schedule "C" (the "Related Indemnity Claims").

2. The relief sought herein is without prejudice to SFC's right to apply for a similar order with respect to (i) any claims in the Shareholder Claims that are in respect of securities other than shares and (ii) any indemnification claims against SFC related thereto.

3. The Shareholder Claims are clearly "equity claims" as defined in the CCAA as they are claims in respect of monetary losses resulting from the ownership, purchase or sale of an equity interest, being shares in SFC, and therefore come squarely within the definition of equity claims. The Related Indemnity Claims are clearly "equity claims" as defined in the CCAA as they are claims for contribution or indemnity in respect of a claim that is an equity claim, and therefore also come squarely within the definition of equity claims.

4. In light of the need to complete the restructuring of SFC as soon as possible, and with a view to having a meeting of creditors in August 2012, it is necessary and desirable to have the claims described above declared as "equity claims" as soon as possible to ensure that the business and operations of SFC are protected under the current circumstances.

## **II. FACTS**

### **A. Background**

5. On March 30, 2012, this Honourable Court made the Initial Order granting the CCAA Stay against SFC and certain of its subsidiaries and appointing FTI Consulting Canada Inc. as the Monitor in the CCAA proceedings.

Initial Order dated March 30, 2012, Book of Previously Filed Materials and Court Orders, Tab 1.

6. Also on March 30, 2012, this Honourable Court made the Sale Process Order approving sale process procedures in the form attached thereto and authorizing and directing SFC, the Monitor and Houlihan Lokey to carry out the sale process.

Sales Process Order dated March 30, 2012, Book of Previously Filed Materials and Court Orders, Tab 2.

7. On May 14, 2012, this Honourable Court issued a Claims Procedure Order, which established June 20, 2012 as the Claims Bar Date.

Claims Procedure Order dated May 14, 2012, Book of Previously Filed Materials and Court Orders, Tab 3.

8. The stay of proceedings issued in this proceeding has been extended to September 28, 2012.

Stay Extension Order dated May 31, 2012, Book of Previously Filed Materials and Court Orders, Tab 4.

**B. The Urgent Need to Have These Proceedings Successfully Completed**

9. At the commencement of these proceedings, SFC advised that it was very important for these proceedings to be successfully completed as soon as possible in order to, among other things, (i) enable the business operated in the People's Republic of China (the "PRC") to be separated from SFC and put under new ownership; (ii) enable the restructured business to participate in the Q4 sale season in the PRC market, and (iii) maintain the confidence of stakeholders in the PRC (including local and national governmental bodies, PRC lenders and other stakeholders) that the business in the PRC can be successfully separated from SFC and operate in the ordinary course in the near future. As summarized by the Monitor in its pre-filing

report, "In summary, Sino-Forest's state of affairs is such that it cannot maintain a status quo for much longer."

Pre-Filing Report of the Monitor dated March 30, 2012, Book of Previously Filed Materials and Court Orders, Tab 5, at para. 21

10. To that end, and consistent with the Support Agreement that SFC has negotiated with the ad hoc committee of noteholders, SFC intends to file a plan of compromise or arrangement (the "Plan") under the CCAA by no later than August 27, 2012, based on the deadlines set out in the Support Agreement and the commercial reality that SFC must complete its restructuring as soon as possible.

Restructuring Support Agreement dated as of March 30, 2012, s. 5(c), Book of Previously Filed Materials and Court Orders, Tab 6.

11. Noteholders holding in excess of \$1,296,000,000 and approximately 72% of the total debt of approximately \$1.8 billion of SFC's noteholder debt have executed written support agreements to support the plan outlined in the announced SFC CCAA plan of March 30, 2012. Accordingly, there is significant support for SFC to emerge from CCAA to maximize value for all stakeholders and ensure certainty with the overall business of SFC and its subsidiaries.

Press Release dated June 8, 2012, Exhibit "E" to the Affidavit of Elizabeth Fimio sworn June 8, 2012 (the "Fimio Affidavit"), Motion Record Tab 2(E), p. 261

## **C. Shareholder Claims Asserted against SFC**

### **1. Ontario**

12. By Fresh as Amended Statement of Claim dated April 26, 2012 (the "Ontario Statement of Claim"), the Trustees of the Labourers' Pension Fund of Central and Eastern Canada and other

plaintiffs asserted various claims in a class proceeding (the "Ontario Class Proceeding") against SFC, certain of its current and former officers and directors, Ernst & Young LLP ("E&Y"), BDO Limited ("BDO"), Poyry (Beijing) Consulting Company Limited ("Poyry") and SFC's underwriters (collectively, the "Underwriters").

Fresh as Amended Statement of Claim (Ontario), Exhibit "A" to the Fimio Affidavit, Motion Record Tab 2(A), pp. 14-141

13. Siskinds LLP and Koskie Minsky LLP are co-counsel to the plaintiffs in that proceeding.

Fresh as Amended Statement of Claim (Ontario), Exhibit "A" to the Fimio Affidavit, Motion Record Tab 2(A), p. 140

14. Section 1(m) of the Ontario Statement of Claim defines "Class" and "Class Members" as:

[A]ll persons and entities, wherever they may reside who acquired Sino's Securities during the Class Period by distribution in Canada or on the Toronto Stock Exchange or other secondary market in Canada, which includes securities acquired over-the-counter, and all persons and entities who acquired Sino's Securities during the Class Period who are resident of Canada or were resident of Canada at the time of the acquisition and who acquired Sino's Securities outside of Canada, except the Excluded Persons.

Fresh as Amended Statement of Claim (Ontario), Exhibit "A" to the Fimio Affidavit, Motion Record Tab 2(A), p. 21

15. The term "Securities" is defined as "Sino's common shares, notes or other securities, as defined in the *OSA*". The term "Class Period" is defined as the period from and including March 19, 2007 to and including June 2, 2011.

Fresh as Amended Statement of Claim (Ontario), Exhibit "A" to the Fimio Affidavit, Motion Record Tab 2(A), pp. 26, 21

16. The Ontario Class Proceeding seeks damages in the amount of approximately \$9.2 billion against SFC and the other defendants.

Fresh as Amended Statement of Claim (Ontario), Exhibit "A" to the Fimio Affidavit, Motion Record Tab 2(A), pp. 28-30

17. The gravamen of the complaint in the Ontario Class Proceeding is that the Class Members are alleged to have purchased Securities "at inflated prices during the Class Period" and that absent the alleged misconduct, sales of such Securities "would have occurred at prices that reflected the true value" of the Securities. It is further alleged that "the price of Sino's Securities was directly affected during the Class Period by the issuance of the Impugned Documents".

Fresh as Amended Statement of Claim (Ontario), Exhibit "A" to the Fimio Affidavit, Motion Record Tab 2(A), pp. 28-30

## 2. *Quebec*

18. By action filed in Quebec City on June 9, 2011, Guining Liu commenced an action (the "Quebec Class Proceedings") against SFC, certain of its current and former officers and directors, E&Y, and Poyry. The Quebec Class Proceedings do not name BDO or the Underwriters as defendants.

Motion to Authorize the Bringing of a Class Action and to Obtain the Status of Representative (the "Quebec Claim"), Exhibit "B" to the Fimio Affidavit, Motion Record Tab 2(B), pp. 145-163

19. Siskinds, Desmeules, Avocats are counsel to the plaintiff in the Quebec Class Proceedings.



Quebec Claim, Exhibit "B" to the Fimio Affidavit, Motion Record Tab 2(B), p. 162

20. The Petitioner in the Quebec Class Proceedings seeks to represent the following class members in that proceeding:

[A]ll persons or entities domiciled in Quebec (other than the Defendants, their past and present subsidiaries, affiliates, officers, directors, senior employees, partners, legal representatives, heirs, predecessors, successors and assigns, and any individual who is an immediate member of the families of the individual named defendants) who purchased or otherwise acquired, whether in the secondary market, or under a prospectus or other offering document in the primary market, equity, debt or other securities of or relating to Sino-Forest Corporation, form and including August 12, 2008 to and including June 2, 2011.

Quebec Claim, Exhibit "B" to the Fimio Affidavit, Motion Record Tab 2(B), p. 145

21. The Quebec Class Proceedings do not specify the quantum of damages sought, instead stating in more general terms that the Petitioner seeks "damages in an amount equal to the losses that it and the other Members of the Group suffered as a result of purchasing or acquiring the securities of Sino at inflated prices during the Class Period."

Quebec Claim, Exhibit "B" to the Fimio Affidavit, Motion Record Tab 2(B), p. 146

22. The complaints raised in the Quebec Class Proceedings center on the effect of alleged misrepresentations on the share price. The duty allegedly owed to the class members is said to be based in "law and under provisions of the *Securities Act*", to ensure the prompt dissemination of truthful, complete and accurate statements regarding SFC's business and affairs and to correct any previously-issued materially inaccurate statements. The defendants are alleged to have failed to do so.

Quebec Claim, Exhibit "B" to the Fimio Affidavit, Motion Record Tab 2(B), p. 150

23. All of the harm alleged in the Quebec Class Proceedings relates to the trading price of SFC's securities, including its shares:

The price of Sino's securities was directly affected during the Class Period by the issuance of the disclosure documents described herein [...]

The price of Sino's securities was directly affected each time SINO communicated new material information about Sino's financial results to the public. [...]

The price at which Sino's securities traded promptly incorporated material information about Sino's business and affairs, including the omissions and/or misrepresentations described herein, which were disseminated to the public through the documents referred to above and distributed by Sino, as well as by other means. [...]

As a result of the acts and omissions described above, the Petitioner and other Members of the Group were induced to over-pay substantially for Sino's securities. Such persons and entities have suffered damages equivalent to the loss in market value that occurred when Sino corrected the Misrepresentations.

Quebec Claim, Exhibit "B" to the Fimio Affidavit, Motion Record Tab 2(B), pp. 154-157

### 3. *Saskatchewan*

24. By Statement of Claim dated December 1, 2011 (the "Saskatchewan Statement of Claim"), Allan Haigh commenced an action (the "Saskatchewan Class Proceedings") against SFC, Allen Chan and David Horsley in the Queen's Bench, Judicial Centre of Regina. Tony Merchant is acting for the plaintiff in this proceeding.

Statement of Claim dated December 1, 2011, Exhibit "C" to the Fimio Affidavit, Motion Record Tab 2(C), pp. 165-207

25. Section 1(f) of the Saskatchewan Statement of Claim defines "Class" and "Class Members" as:

[A]ll persons and entities, wherever they may reside who acquired securities of Sino during the Class Period either by primary distribution in Canada or an acquisition on the TSX or other secondary market in Canada, other than the Defendants, their past and present subsidiaries, affiliates, officers, directors, senior employees, partners, legal representatives, heirs, predecessors, successors and assigns, and any individual who is an immediate member of the family of an Individual Defendant

Statement of Claim dated December 1, 2011, Exhibit "C" to the Fimio Affidavit, Motion Record Tab 2(C), p. 166

26. "Class Period" is defined in the Saskatchewan Class Proceeding as the period from and including March 19, 2007 to and including June 2 2011.

Statement of Claim dated December 1, 2011, Exhibit "C" to the Fimio Affidavit, Motion Record Tab 2(C), p. 166

27. The Saskatchewan Class Proceedings do not specify the quantum of damages sought, instead stating in more general terms that the plaintiff seeks "aggravated and compensatory damages against the Defendants in an amount to be determined at trial."

Statement of Claim dated December 1, 2011, Exhibit "C" to the Fimio Affidavit, Motion Record Tab 2(C), p. 206

28. The Saskatchewan Class Proceedings focus on the effect of the alleged wrongful acts upon the trading price of SFC's securities:

The price of Sino's securities was directly affected during the Class Period by the issuance of the Impugned Documents. The Defendants were aware at all material times of the effect of Sino's disclosure documents upon the price of its Sino's [sic] securities. [...]

Each time Sino communicated that new material information about Sino financial results to the public the price of Sino securities was directly affected. [...]

The price at which Sino's securities traded promptly incorporated material information from Sino's disclosure documents about Sino's business and affairs, including the Representation, which was disseminated to the public through the documents referred to above and distributed by Sino, as well as by other means. [...]

The Defendants further knew that the information contained in the Impugned Documents would be incorporated into the price of Sino's publicly traded securities such that the trading price of those securities would at all times reflect the information contained in the Impugned Documents. [...]

Statement of Claim dated December 1, 2011, Exhibit "C" to the Fimio Affidavit, Motion Record Tab 2(C), pp. 170-171, 201

#### 4. *New York*

29. By Verified Class Action Complaint dated January 27, 2012 (the "New York Complaint"), David Leopard and IMF Finance SA commenced a class proceeding in the Supreme Court of the State of New York against SFC, Allen Chan, David Horsley, Kai Kit Poon, a subset of the Underwriters (Banc of America Securities LLC and Credit Suisse Securities (USA) LLC), E&Y, and Ernst & Young Global Limited (the "New York Class Proceedings").

Verified Class Action Complaint dated January 27, 2012, Exhibit "D" to the Fimio Affidavit, Motion Record Tab 2(D), pp. 209-259

30. The plaintiffs in the New York Class Proceedings seek to represent the following class members:

[A]ll persons or entities who purchased (i) Sino-Forest's common stock during the Class Period on the OTC market who were damaged thereby; and (ii) all persons or entities who, during the Class Period, purchased Debt Securities issued by Sino-Forest

other than in Canada and who were damaged thereby. [...] The Class specifically excludes any investor who purchased Sino-Forest securities on the Toronto Stock Exchange or in Canada.

Verified Class Action Complaint dated January 27, 2012, Exhibit "D" to the Fimio Affidavit, Motion Record Tab 2(D), p. 244

31. The "Class Period" in the New York Class Proceedings is from March 19, 2007 through August 26, 2011.

Verified Class Action Complaint dated January 27, 2012, Exhibit "D" to the Fimio Affidavit, Motion Record Tab 2(D), p. 211

32. The New York Class Proceedings do not specify the quantum of damages sought, instead stating in more general terms that the plaintiff seeks "all compensatory damages they suffered, including lost profits and consequential and incidental damages, as a result of the wrongful conduct of the Defendants, in an amount to be determined at trial."

Verified Class Action Complaint dated January 27, 2012, Exhibit "D" to the Fimio Affidavit, Motion Record Tab 2(D), p. 257

33. The New York Class Proceedings focus on the effect of the alleged wrongful acts upon the trading price of SFC's securities:

The claims of Plaintiffs and the members of the Class have a common origin and share a common basis. The claims of all Class Members originate from the same improper conduct and arise from securities purchases entered into on the basis of the same materially misleading statements and omissions by Defendants during the Class Period. [...]

[The Defendants committed wrongful conduct] with the purpose of inflating the prices of Sino-Forest's common stock, the 2017 Notes and Sino-Forest's other debt securities. [...]

Verified Class Action Complaint dated January 27, 2012, Exhibit "D" to the Fimio Affidavit, Motion Record Tab 2(D), p. 244-245, 248

**D. Indemnity Claims Asserted against SFC**

34. As set out above, the plaintiffs in the various class actions have named parties other than SFC as defendants, notably, the Underwriters and the auditors, E&Y and BDO. The claims against those parties can be summarized as follows:

**Claims Against Third Parties**

	ONT	QUE	SASK	NY
E&Y LLP	X	X	-	X
E&Y Global	-	-	-	X
BDO	X	-	-	-
Poyry	X	X	-	-
Underwriters	11	-	-	2

35. Each of these defendants is dealt with below.

**1. Ernst & Young**

36. In its factum on the scope of stay motion in this proceeding, E&Y stated:

E&Y has contractual claims of indemnification against Sino-Forest and its subsidiaries for all relevant years, in respect of its annual audits as well as related to prospectus and note offerings. E&Y also has statutory and common law claims of contribution and/or indemnity against Sino-Forest and its subsidiaries for all relevant years.

Responding Factum of Ernst & Young LLP (Motion re Stay of Proceedings Returnable May 8, 2012), para. 10, Book of Previously Filed Materials and Court Orders, Tab 7.

37. In support of this proposition, E&Y relied on ten engagement letters. Most of those engagement letters either relate to debt offerings or do not contain specific indemnity language that would relate to the Shareholder Claims. However, the 2010 Audit Engagement Letter does contain the following provision:

To the fullest extent permitted by applicable law and professional regulations, you shall indemnify us, the other EY Firms and the EY Persons against all claims by third parties (including your affiliates) and resulting liabilities, losses, damages, costs and expenses (including reasonable external and internal legal costs) arising out of or relating to the Services or this Agreement.

Engagement Letter dated December 7, 2010, Exhibit "J" to the Affidavit of Christina Shiels sworn April 24, 2012, Book of Previously Filed Materials and Court Orders, Tab 8, p. 243.

**2. BDO**

38. BDO has similarly indicated that it intends to make indemnification claims against SFC, and in connection with the scope of stay motion, filed a number of agreements between BDO and SFC.

39. Several of these BDO agreements contain no indemnity provisions at all, or relate to offerings related to Notes, not Shares. However, the engagement letters dated May 23, 2007, May 15, 2009 and November 18, 2009 relate to the use of BDO audit opinions in connection with share offerings, and those letters contain the following provision or substantially the same provision:

You also agree to indemnify and hold harmless BDO McCabe Limited and our personnel from any claim by the Underwriters and the Underwriters' legal counsel, or any other third party, that arises as a result of our comfort letter or our responses to questions posted for the due diligence meeting.

May 23, 2007, May 15, 2009 and November 18, 2009 Engagement Letters, Exhibits C, E and G to the Affidavit of Diana Correia sworn April 23, 2012, Book of Previously Filed Materials and Court Orders, Tab 9, p. 247, 250, 253.

**3. Underwriters**

40. In their factum on the scope of stay motion in this proceeding, the Underwriters stated:

In connection with the Offerings, certain Underwriters have entered into related agreements (the "Related Agreements") with Sino-Forest and certain of its subsidiaries (the "Sino-Forest Subsidiary Companies") providing that Sino-Forest and, with respect to certain Offerings, the Sino-Forest Subsidiary Companies have agreed to indemnify and hold harmless the Underwriters (the "Indemnities") in connection with an array of matters that could arise from the Offerings.

Factum of the Underwriters (Stay of Proceedings returnable on May 8, 2012), para. 8, Book of Previously Filed Materials and Court Orders, Tab 10, p. 258.

41. Like the auditors, several of these agreements with the Underwriters relate to offerings related to Notes, not Shares. However, there are three Underwriting Agreements that relate to equity offerings that contain indemnification provisions, dated May 28, 2007, May 22, 2009, and December 10, 2009. Each of these indemnity provisions are lengthy (spanning more than three pages) but the most relevant provisions of which are largely the same:

The Company agrees to indemnify and hold harmless the Underwriters [...] from and against any and all losses, claims, damages and liabilities (including, without limitation, any legal or other expenses reasonably incurred in connection with defending or investigating any such action or claim) (collectively, a "Claim") caused by (i) any untrue statement or alleged untrue statement made by the Company in Section 2 hereof or in any certificate delivered to the Underwriters pursuant to this Agreement; (ii) any misrepresentation or alleged misrepresentation (for purposes of Canadian Securities Laws) or any untrue statement or alleged untrue statement of a material fact contained in any of the Offering Documents [...] (iii) the Company not complying with any requirement of Canadian Securities Laws or U.S. Securities Laws [...]

Underwriting Agreements dated May 28 2007, May 22, 2009 and December 10, 2009, section 9, Exhibits A, C, and F to the Affidavit of Rebecca Wise, sworn April 23, 2012, Book of Previously Filed Materials and Court Orders, Tabs 11, 12, 13, p. 317, 405, 465.



### III. LAW AND ARGUMENT

#### A. The Fundamental Difference Between Equity Claims and Debt Claims

42. Even before the 2009 amendments to the CCAA dealing with equity claims, the courts regularly recognized that there is a fundamental difference between shareholder equity claims and debt claims as they relate to an insolvent entity. The rule – which one court described as the "fundamental corporate principle" – is that "[s]hareholders cannot reasonably expect to maintain a financial interest in an insolvent company where creditors' claims are not being paid in full." Shareholders have no economic interest in an insolvent enterprise.

*Blue Range Resource Corp. (Re.)*, [2000] 4 W.W.R. 738 (Alta. Q.B.) at para. 29

*Stelco Inc. (Re.)*, 2006 CanLII 1773 (Ont. S.C.J.) at paras. 15-17

*Royal Bank of Canada v. Central Capital Corp.* (1996), 27 O.R. (3d) 494 (C.A.), per Weiler J.A. at p. 10

43. The basis for this differentiation flows from the fundamentally different nature of debt and equity investments. Shareholders have unlimited upside potential when purchasing shares. Creditors usually have no corresponding upside potential: their expectation is to be repaid with whatever interest was negotiated. Pappal J. as she then was stated the underlying rationale as follows:

This principle is premised on the notion that shareholders are understood to be higher risk participants who have chosen to tie their investment to the fortunes of the corporation. In contrast, creditors choose a lower level of exposure, the assumption being that they will rank ahead of shareholders in an insolvency. Put differently, amongst other things, equity investors bear the risk relating to the integrity and character of management.

*Nelson Financial Group Ltd. (Re.)*, 2010 ONSC 6229 at para. 25

44. As a result, the courts subordinated equity claims and denied such claims a vote in plans of arrangement. Even if the shareholders had commenced an action seeking recovery of damages, a shareholder cannot by way of a lawsuit convert what is an equity interest into a debt interest.

*Blue Range Resource Corp., supra*

*Stelco Inc., supra*

*EarthFirst Canada Inc. (Re.)* (2009), 56 C.B.R. (5<sup>th</sup>) 102 (Alta. Q.B.)

*Nelson Financial, supra*

## **B. The 2009 Amendments on Equity Claims**

45. The common law principles described above were "codified" in the 2009 amendments to the CCAA. Specific amendments were made "with the intention of clarifying that equity claims are to be subordinate to other claims. Equity claims are ownership interests and, as such, should be subject to the risks of insolvency."

Industry Canada, *Bill C-12: Clause by Clause Analysis*, Topic: Voting by Equity Claimants (<http://www.ic.gc.ca/eic/site/bsf-osb.nsf/eng/br01986.html#a78>)

*Return on Innovation v. Gandi Innovations*, 2011 ONSC 5018 at para. 55, lv. to app. denied, 2012 ONCA 10, [2012] O.J. No. 31 (QL)

*Nelson Financial Group, supra* at para. 27

46. The 2009 amendments begin by providing a definition of an "equity claim" and an "equity interest". Section 2 of the CCAA now includes the following definitions:

"equity claim" means a claim that is in respect of an equity interest, including a claim for, among others, [...]

(d) a monetary loss resulting from the ownership, purchase or sale of an equity interest or from the rescission, or, in

Quebec, the annulment, of a purchase or sale of an equity interest, [...]

“equity interest” means

(a) in the case of a company other than an income trust, a share in the company — or a warrant or option or another right to acquire a share in the company — other than one that is derived from a convertible debt [...]

*CCAA*, s. 2 [emphasis added]

47. The new equity claim language in the *CCAA* has been described by this Honourable Court as "clear and broad".

*Nelson Financial Group, supra* at para. 27

48. Giving effect to the plain meaning of the statute, where a shareholder seeks recovery of damages resulting from owning, purchasing, or selling his or her shares (or other equity interests), the *CCAA* clearly states that such a shareholder has an "equity claim".

*Bell ExpressVu Partnership v. Rex*, [2002] 2 S.C.R. 559, at para. 26 *et seq.*

49. Section 6(8) of the *CCAA* prohibits a distribution to equity claimants prior to payment in full of all non-equity claims. Section 6(8) provides as follows:

6(8) No compromise or arrangement that provides for the payment of an equity claim is to be sanctioned by the court unless it provides that all claims that are not equity claims are to be paid in full before the equity claim is to be paid.

*CCAA*, s. 6(8)

50. Under section 22.1 of the *CCAA*, equity claimants are prohibited from voting on a plan, unless the court orders otherwise. Section 22.1 of the *CCAA* provides as follows:

22.1 Despite subsection 22(1), creditors having equity claims are to be in the same class of creditors in relation to those claims unless the court orders otherwise and may not, as members of that class, vote at any meeting unless the court orders otherwise.

*CCAA*, s. 22.1

51. The amendments relating to equity claims closely parallel existing U.S. law on the subject. Canadian courts have also looked to the U.S. courts for guidance on the issue of equity claims where codification of the subordination of equity claims has been long-standing.

Standing Senate Committee on Banking Trade and Commerce, *Debtors and Creditors Sharing the Burden*, 2003 at 158

*Blue Range*, *supra*

*Nelson Financial*, *supra*

52. U.S. appellate courts have interpreted the parallel U.S. legislation to subordinate the claims of shareholders that have a nexus or causal relationship to the purchase or sale of securities, including damages arising from alleged illegality in the sale or purchase of securities or from corporate misconduct whether predicated on pre or post-issuance conduct.

*Re Telegroup Inc.*, 281 F. 3d 133 (3<sup>rd</sup> Cir., 2002)

*American Broadcasting Systems Inc. v. Nugent*, 240 F.3d 823 (9<sup>th</sup> Cir., 2001)

### **C. The Shareholder Claims are "Equity Claims"**

53. On the plain language of the CCAA, the Shareholder Claims in the present case are "equity claims" as defined in section 2 of the CCAA as they are claims in respect of subsection (d) for "a monetary loss resulting from the ownership, purchase or sale of an equity interest":

- (a) The Ontario, Quebec, Saskatchewan, and New York Class Actions (collectively, the "Class Actions") all advance claims on behalf of shareholders, which is specifically listed as a type of "equity interest" in section 2 of the CCAA;
- (b) The Class Actions allege wrongful conduct that affected the trading price of the shares, in that the alleged misrepresentations "artificially inflated" the share price; and
- (c) The Class Actions seek damages relating to the trading price of the SFC shares and as such allege "monetary loss" that resulted from the ownership, purchase or sale of shares, as defined in section 2 of the CCAA.

*CCAA, s. 2*

54. As the Shareholder Claims are "equity claims", such claims are expressly subordinated to creditor claims, and are prohibited from voting on a plan of arrangement, unless the court orders otherwise.

**D. The Related Indemnity Claims are also "Equity Claims"**

55. The definition of "equity claims" in section 2 of the CCAA also expressly includes indemnity claims that relate to other equity claims. The definition of "equity claims" includes the following:

“equity claim” means a claim that is in respect of an equity interest, including a claim for, among others, [...]

(d) a monetary loss resulting from the ownership, purchase or sale of an equity interest or from the rescission, or in Quebec, the annulment, of a purchase or sale of an equity interest, or

(e) contribution or indemnity in respect of a claim referred to in any of paragraphs (a) to (d);

*CCAA*, s. 2

56. As discussed, the Shareholder Claims are "equity claims" under subsection (d) of the definition of "equity claims". The Related Indemnity Claims are equity claims under subsection (e) above, as they are clearly claims for contribution or indemnity in respect of the Shareholder Claims.

*CCAA*, s. 2

57. There is no distinction in the CCAA between the source of any claim for contribution or indemnity, whether by statute, common law, contractual, or otherwise. To the contrary, the legal characterization of a contribution or indemnity claim in an insolvency proceeding depends solely on the characterization of the primary claim upon which contribution or indemnity is sought. Applying this test, the Court in *Return on Innovations* recently characterized the contractual indemnification claims of directors and officers in respect of an equity claim as "equity claims". The Court of Appeal affirmed the Court's characterization and denied leave to appeal.

*CCAA*, s. 2

*Return on Innovation, supra* at paras. 52-62

*Nelson Financial, supra* at para. 26.

58. Guidance on the treatment of underwriter and auditor indemnification claims can be obtained from the U.S. experience. In the U.S., the courts have held that indemnification claims

of underwriters for liability or defence costs constitute equity claims that are subordinated to the claims of general creditors.

*In re Mid-American Waste Sys.*, 228 B.R. 816, 1999 Bankr. LEXIS 27 (Bankr. D. Del. 1999)

*In re Jacom Computer Servs.*, 280 B.R. 570, 2002 Bankr. LEXIS 758 (Bankr. S.D.N.Y. 2002)

*In re Drexel Burnham Lambert Group*, 148 B.R. 982, 1992 Bankr. LEXIS 2023 (Bankr. S.D.N.Y. 1992)

59. Further, the U.S. courts have held that the degree of culpability of the respective parties is a non-issue in the disallowance of claims for indemnification of underwriters; the equities are meant to benefit the debtor's direct creditors, not secondarily liable creditors with contingent claims.

*In re Drexel Burnham Lambert Group, supra*

60. In the present case, the Indemnity Claims are clearly claims for "contribution and indemnity" based upon the Shareholder Claims. It does not matter whether the indemnity claim is seeking no more than allocation of fault and contribution at common law, or whether there is a free-standing contribution and indemnity claim based on contracts. Insofar as the primary source of liability is characterized as an equity claim, so too is any claim for contribution and indemnity based on that equity claim.

#### **IV. RELIEF SOUGHT**


61. SFC respectfully requests:

- (a) An order that claims against SFC resulting from the ownership, purchase or sale of an equity interest in SFC, including, without limitation, the claims by or on

behalf of current or former shareholders asserted in the proceedings listed in Schedule "C" are "equity claims" as defined in section 2 of the CCAA, being claims in respect of monetary losses resulting from the ownership, purchase or sale of an equity interest, being shares in SFC;

- (b) An order that any indemnification claims against SFC related to or arising from Shareholder Claims, including, without limitation, by or on behalf of any of the other defendants to the proceedings listed in Schedule "C", are "equity claims" under the CCAA, being claims for contribution or indemnity in respect of a claim that is an equity claim;
- (c) A direction that the order made is without prejudice to SFC's right to apply for a similar order with respect to (i) any claims in the Statement of Claim that are in respect of securities other than shares and (ii) any indemnification claims against SFC related thereto; and
- (d) Such further and other relief as counsel may request and this Honourable Court deems just.

ALL OF WHICH IS RESPECTFULLY SUBMITTED,

  
BENNETT JONES LLP

Lawyers for Sino-Forest Corporation



## SCHEDULE "A" – AUTHORITIES CITED

### Jurisprudence

1. *Blue Range Resource Corp. (Re.)*, [2000] 4 W.W.R. 738 (Alta. Q.B.).
2. *Stelco Inc. (Re)*, 2006 CanLII 1773 (Ont. S.C.J.).
3. *Royal Bank of Canada v. Central Capital Corp.* (1996), 27 O.R. (3d) 494 (C.A.), per Weiler J.A.
4. *Nelson Financial Group Ltd. (Re.)*, 2010 ONSC 6229.
5. *EarthFirst Canada Inc. (Re.)* (2009), 56 C.B.R. (5th) 102 (Alta. Q.B.).
6. *ROI Fund Inc. v. Gandi Innovations Ltd.*, 2011 ONSC 5018, lv. to app. denied, 2012 ONCA 10, [2012] O.J. No. 31 (QL).
7. *Bell ExpressVu Limited Partnership v. Rex*, [2002] 2 S.C.R. 559.
8. *In Re: Telegroup Inc.*, 281 F. 3d 133 (3rd Cir., 2002).
9. *American Broadcasting Systems Inc. v. Nugent*, 240 F.3d 823 (9th Cir., 2001).
10. *In re Mid-American Waste Sys.*, 228 B.R. 816, 1999 Bankr. LEXIS 27 (Bankr. D. Del. 1999).
11. *In re Jacom Computer Servs.*, 280 B.R. 570, 2002 Bankr. LEXIS 758 (Bankr. S.D.N.Y. 2002).
12. *In re Drexel Burnham Lambert Group*, 148 B.R. 982, 1992 Bankr. LEXIS 2023 (Bankr. S.D.N.Y. 1992).

### Secondary Material

1. Industry Canada, *Bill C-12: Clause by Clause Analysis*, Topic: Voting by Equity Claimants (<http://www.ic.gc.ca/eic/site/bsf-osb.nsf/eng/br01986.html#a78>).
2. Standing Senate Committee on Banking Trade and Commerce, *Debtors and Creditors Sharing the Burden*, 2003.

## SCHEDULE "B" – STATUTORY REFERENCES

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

#### Definitions

s. 2. In this Act,

“equity claim” means a claim that is in respect of an equity interest, including a claim for, among others, [...]

(a) a monetary loss resulting from the ownership, purchase or sale of an equity interest or from the rescission, or, in Quebec, the annulment, of a purchase or sale of an equity interest, [...]

“equity interest” means

(a) in the case of a company other than an income trust, a share in the company — or a warrant or option or another right to acquire a share in the company — other than one that is derived from a convertible debt [...]

#### Payment — equity claims

s. 6(8) No compromise or arrangement that provides for the payment of an equity claim is to be sanctioned by the court unless it provides that all claims that are not equity claims are to be paid in full before the equity claim is to be paid.

#### Class — creditors having equity claims

s. 22.1 Despite subsection 22(1), creditors having equity claims are to be in the same class of creditors in relation to those claims unless the court orders otherwise and may not, as members of that class, vote at any meeting unless the court orders otherwise.

**SCHEDULE "C" - SHAREHOLDER CLAIMS**

1. *Trustees of the Labourers' Pension Fund of Central and Eastern Canada et al. v. Sino-Forest Corporation et al.* (Ontario Superior Court of Justice, Court File No. CV-11-431153-00CP)
2. *Guining Liu v. Sino-Forest Corporation et al.* (Quebec Superior Court, Court File No: 200-06-000132-111)
3. *Allan Haigh v. Sino-Forest Corporation et al.* (Saskatchewan Court of Queen's Bench, Court File No. 2288 of 2011)
4. *David Leapard et al. v. Allen T.Y. Chan et al.* (District Court of the Southern District of New York, Court File No. 650258/2012)

**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 OR COMPROMISE OR ARRANGEMENT OF SINO-FOREST CORPORATION**

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

**ONTARIO  
SUPERIOR COURT OF JUSTICE  
(COMMERCIAL LIST)**

Proceedings commenced in Toronto

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