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

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

SUPPLEMENTARY BOOK OF AUTHORITIES OF THE AD HOC COMMITTEE OF PURCHASERS OF THE APPLICANT'S SECURITIES, INCLUDING THE REPRESENTATIVE PLAINTIFFS IN THE ONTARIO CLASS ACTION

(MOTION RETURNABLE AUGUST 28, 2012)

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TO: SERVICE LIST ATTACHED

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CANADA
PROVINCE OF QUEBEC
REGISTRY OF MONTREAL

No: 500-09-018525-089
(500-11-031130-079)

DATE: MAY 21, 2008

CORAM : THE HONOURABLE **J.J. MICHEL ROBERT, C.J.Q.**
LOUISE OTIS, J.A.
JOSEPH R. NUSS, J.A.
FRANÇOIS PELLETIER, J.A.
PIERRE J. DALPHOND, J.A.

IN THE MATTER of a proposed arrangement concerning BCE Inc.
and

A GROUP OF 1976 DEBENTUREHOLDERS
composed of:
AEGON CAPITAL MANAGEMENT INC.,
ADDENDA CAPITAL INC.,
PHILLIPS, HAGER & NORTH INVESTMENT MANAGEMENT LTD.
SUN LIFE ASSURANCE COMPANY OF CANADA,
CIBC GLOBAL ASSET MANAGEMENT INC.,
HER MAJESTY THE QUEEN IN RIGHT OF ALBERTA, AS REPRESENTED BY THE MINISTER OF FINANCE,
MANITOBA CIVIL SERVICE SUPERANNUATION BOARD,
and
MANULIFE FINANCIAL, CORPORATION
and
CIBC MELLON TRUST COMPANY
APPELLANTS – Contesting Parties
(Re : 1976 Trust Indenture)
and
A GROUP OF 1996 DEBENTUREHOLDERS
composed of:
AEGON CAPITAL MANAGEMENT INC.,

ADDENDA CAPITAL INC.,
PHILLIPS, HAGER & NORTH INVESTMENT MANAGEMENT LTD.,
SUN LIFE INSURANCE (CANADA) LIMITED,
CIBC GLOBAL ASSET MANAGEMENT INC.,
MANITOBA CIVIL SERVICE SUPERANNUATION BOARD
and
TD ASSET MANAGEMENT INC.
and
COMPUTERSHARE TRUST COMPANY OF CANADA
APPELLANTS – Contesting Parties
(Re : 1996 Trust Indenture)
v.

BCE INC.
RESPONDENT – Petitioner
and
6796508 CANADA INC.
RESPONDENT – Impleaded Party
and
THE DIRECTOR APPOINTED PURSUANT TO THE CBCA
and
BELL CANADA
IMPLEADED PARTIES

JUDGMENT

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[1] This is an appeal from a judgment of the Superior Court, District of Montreal (the Honourable Mr. Justice Joël A. Silcoff), rendered on March 7, 2008, which granted, in part, the *Motion for Final Order* presented by the respondent BCE Inc. and, *inter alia*, approved the Plan of Arrangement and reserved judgment on the costs to be dealt with according to an agreement between counsel.

1. INTRODUCTION

[2] In an Application entitled “Motion for Final Order” (S.C. Montreal 500-11-031130-079), Respondent BCE Inc. (“BCE”) sought, pursuant to s. 192 *CBCA*,[1] the approval of the Superior Court for the Plan of Arrangement (“Plan”) concluded with Respondent 6796508 Canada Inc. (“Purchaser”). The Plan, having a value of $51.7 billion, is with respect to what would be the largest leveraged buyout (LBO) in Canada.

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[1] *Canada Business Corporations Act*, R.S.C 1985, c. C-44 [*CBCA*].

[3] Contestations opposing the Motion for Final Order were filed on behalf of the following groups holding debentures issued by Bell Canada Inc. ("Bell Canada"), a wholly-owned subsidiary of BCE:

a) Holders of debentures issued pursuant to the 1976 Trust Indenture ("76 Debentureholders") and their Trustee CIBC Mellon Trust Company ("CIBC Mellon");

b) Holders of debentures issued pursuant to the 1996 Trust Indenture ("96 Debentureholders") and their Trustee Computershare Trust Company of Canada ("Computershare");

c) Holders of debentures issued pursuant to the 1997 Trust Indenture ("97 Debentureholders").

[4] The Motion for Final Order was heard together with four related legal proceedings, namely:

a) Motion for Declaratory Judgment ("76 Declaratory Motion") filed by CIBC Mellon (re: 76 Debentureholders) (S.C. Montreal 500-17-038866-078);

b) Motion for Declaratory Judgment ("96 Declaratory Motion") filed by Computershare (re: 96 Debentureholders) (S.C. Montreal 500-17-038867-076);

c) Motion, pursuant to s. 241 *CBCA*, for Order Based on Oppression ("76/96 Oppression Remedy") filed by 76 and 96 Debentureholders (S.C. Montreal 500-11-031677-079);

d) Motion, pursuant to s. 241 *CBCA*, for Order Based on Oppression ("97 Oppression Remedy") filed by the 97 Debentureholders (S.C. Montreal 500-11-031672-070).

[5] On March 7, 2008, five separate judgments were rendered by the Honourable Mr. Justice Joël A. Silcoff of the Superior Court:

a) The Motion for Final Order was granted in part. The Plan was declared, *inter alia*, to be fair and reasonable and was approved and ratified;

b) The 76 and 96 Declaratory Motions were dismissed and it was declared that section 8.01 of the respective Trust Indentures "(…) does not apply by reason of the proposed Plan of Arrangement and Proposed Transaction (…)";

c) The 76/96 and 97 Oppression Remedies were dismissed.

[6] On March 17, 2008, six appeals were filed with respect to these judgments. These reasons, given within the framework of the appeal of the 76/96 debentureholders from the judgment granting in part the Motion for Final Order, deal with all six appeals.

2. FACTUAL BACKGROUND

[7] BCE, Bell Canada and the Purchaser are described by the trial judge, in part, as follows:

> [16] BCE, Canada's largest communications company, was incorporated in 1970 and continued under the *CBCA* in 1979. Its Articles of Incorporation were amended by: (i) a Certificate and Articles of Amalgamation dated August 1, 2004, (ii) a Certificate and Articles of Arrangement dated July 10, 2006, and (iii) a Certificate and Articles of Amendment dated January 25, 2007.
>
> [17] There are more than 800 million BCE common shares and 110 million BCE preferred shares issued and outstanding in the hands of more than 600 thousand registered and beneficial shareholders.
>
> [18] Bell Canada was incorporated in the late 19th century by Federal Charter and was subsequently continued under the *CBCA.* It became a wholly-owned subsidiary of BCE in April 1983 pursuant to a plan of arrangement approved by this Court and confirmed by the Court of Appeal of Quebec. There is no evidence that the 1983 plan of arrangement was opposed by any of the Contesting Parties.
>
> [19] At the present time, Bell Canada represents, on a non-consolidated basis, approximately 56% of BCE's revenues and 77% of its assets. These percentages have changed significantly over time.
>
> [20] BCE and Bell Canada are now, and have always been, separate legal entities with separate charters, Articles and by-laws. They have separate assets, debt obligations, liabilities, credit ratings, bank accounts, accounting, bookkeeping and investments. Accordingly, although Bell Canada is a wholly-owned subsidiary of BCE, the stakeholders of the two entities are not identical.
>
> [21] While BCE and Bell Canada now share a common set of directors and some senior officers, this was not the case prior to January 2003. The operational officers of Bell Canada are not officers of BCE.
>
> [22] The Trust Indentures governing the Bell Canada Debentures define the "Company" or "Corporation" to be Bell Canada. That phrase has never been modified to include BCE or any other affiliate of BCE.
>
> [23] Purchaser is a corporation organized and incorporated under the *CBCA* by the Ontario Teachers' Pension Plan Board ("*Teachers*'") as well as by affiliates of

> Providence Equity Partners Inc. ("*Providence*") and Madison Dearborn Partners, LLC ("*Madison Dearborn*") (collectively the "*Purchaser Parties*") for the purpose of entering into the Definitive Agreement and consummating the Plan of Arrangement.

[8] The dispute involves debentures issued by Bell Canada under three separate trust indentures (and supplementary indentures thereunder) identified as 1976 Trust Indenture, 1996 Trust Indenture and 1997 Trust Indenture. Each Trust Indenture provides for the issuance of debentures in separate series.

[9] Debentures issued pursuant to the 1976 Trust Indenture are long-term debt with maturities in the range of 15 to 60 years. Debentures issued pursuant to the 1996 Trust Indenture have maturities of 30 and 35 years. Debentures issued pursuant to the 1997 Trust Indenture are also referred to as Medium Term Notes and have maturities in the range of 10 to 31 years.

[10] Excluding those debentures with maturities by August 2010 which, according to the Plan, would be redeemed, the outstanding debentures issued under the 1976, 1996 and 1997 Trust Indentures, as at the date of the hearing in the Superior Court, had a total face value of approximately $5.1 billion, of which the holdings of the appellant Debentureholders are set out in the following table:

Debentures issued under	**Total outstanding debentures maturing after August 2010**	**Debentures held by the appellants**
1976 Trust Indenture	$1.794 billion	$230 million (12.80%)
1996 Trust Indenture	$0.275 billion	$184 million (66.91%)
1997 Trust Indenture	$3.1 billion	$992 million approx. (32% approx.)
	TOTAL: $5.169 billion	$1.4 billion (27.2% approx.)

[11] Bell Canada's debentures were rated by credit rating agencies as investment grade.[2] While this does not constitute a guarantee for future maintenance of investment

[2] Credit rating agencies such as Moody's, Standard & Poor's (S&P) and Dominion Bond Rating Service Limited (DBRS) rate bonds based on their evaluation of the issuer's credit worthiness and capacity to meet financial commitments as they come due. While the language of different ratings agencies varies slightly, debt instruments are usually rated in one of the categories: investment grade and speculative grade (also referred to as non-investment grade or as "junk bonds"). In the case of DBRS, a rating of BBB (low) or higher, in the case of S&P, a rating of BBB- or higher and, in the case of Moody's a rating of Baa3 or higher are investment grade.

grade ratings, it was an important consideration for investors and enhanced Bell Canada's ability to sell long term debt on the market.

[12] Over the years, Bell Canada made representations to the investment community regarding the importance it attached to maintaining investment grade ratings and protecting the credit quality of the company. Michael Sabia, President and Chief Executive Officer of BCE and Chief Executive Officer of Bell Canada, confirmed on different occasions a commitment to maintaining investment grade ratings and described it as a core part of Bell Canada's financial strategy. The trial judge writes:

> [159] The particular representations upon which the Contesting Debentureholders rely are referred to at length in the various documents produced in evidence and summarized in their respective *Factums*. In those documents, subject to such *caveats* as may be contained therein, Bell Canada assured the market from time to time **and at such times**, *inter alia,* that it was:
>
> > […] "committed" to investment grade ratings; "totally focussed" on investment grade ratings; that there was "no doubt about their ability" to maintain investment grade ratings; that investment grade ratings were part of Bell's "financial architecture"; that relationships with bondholders would be based on "fairness," not literal interpretation of contracts; and that stakeholder interests would be balanced.[3]
>
> [Emphasis added by trial judge]

[13] While such statements were accompanied by warnings and safe harbour provisions, they were "designed to give comfort to investors" as confirmed by Michael Boychuk, Senior Vice-President and Treasurer of BCE and Bell Canada. BCE's expert witness on the bond market, Dr. Marlene Puffer, confirmed that such assurances given by companies are factors that debentureholders rely on in making their investment decisions. Mr. Sabia also acknowledged that, while they should examine other elements, investors can also place some reliance on Bell Canada's statements.

[14] Starting in February 2007, BCE was approached by private equity investors requesting the opportunity to review privatization options. The BCE Board of Directors ("Board") decided not to pursue consideration of a transaction at that time. In March 2007, meetings were held between BCE and private equity investors who reaffirmed their interest, which was once again declined.

[15] Media speculation concerning a potential privatization of BCE ensued, highlighted by a front page headline and article in *The Globe and Mail* on March 29,

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[3] Judgment on the 76/96 Oppression Remedy at para. 159.

2007.[4] On the same day, at the request of the Toronto Stock Exchange Market Regulation Services, BCE issued a statement to “confirm the fact that there are no ongoing discussions being held with any private equity investor with respect to any privatization of the Company or any similar transaction”, further stating that “the company has no current intention to pursue such discussions”.[5]

[16] On April 9, 2007, Teachers’, the largest shareholder of BCE,[6] filed with the United States Securities and Exchange Commission (“SEC”) a Schedule 13D Statement, "informing the market that it had changed its investment intent with respect to BCE from 'passive' to 'active'".[7] The filing mentioned that Teachers’ was “closely monitoring developments and is exploring its options” and reserving the right to, *inter alia*, purchase additional shares of BCE and “encourage [...] extraordinary transactions [...] or changes to [BCE]'s capitalization".

[17] Considering that the company was thus put "in play”,[8] the Board set up an independent Strategic Oversight Committee (“SOC”) to evaluate different alternatives and to "consider and review any Potential Transaction".[9] The trial judge found that "the overriding objective of the strategic review and auction process was to maximize shareholder value, while respecting the corporation's legal and contractual obligations."[10]

[18] With regard to the privatization alternative, the Board determined that it was in the best interests of BCE and its shareholders to have competing bidding groups. The SOC and the Board took action to facilitate a competitive multi-party private equity auction.

[19] In a press release dated April 17, 2007, BCE announced that it was “reviewing its strategic alternatives with a view to further enhancing shareholder value”. [11]

[20] Following that announcement, several debentureholders sent letters to the Board voicing their concerns about a potential LBO transaction. They sought assurance that the best interests of the bondholders were being considered and offered to meet the Board. By way of illustration, in a letter dated April 27, 2007 addressed to Mr. Sabia, one of the appellant debentureholders, Phillips, Hager & North, wrote:

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4 Eric Reguly & Andrew Willis "U.S. equity firm stalks BCE, plots takeover" *The Globe and Mail* (29 March 2007).

5 BCE Press Release dated March 29, 2007.

6 Holding approximately 5.3% of the outstanding shares at that time.

7 Judgment on the Motion for Final Order at para. 47.

8 In *CW Shareholdings Inc. v. WIC Western International Communications Ltd.* (1998), 39 O.R. (3d) 755 (Ont. Ct. J. (Gen. Div.)) at 768, Blair J., as he then was, defined the "in play" concept as "where it is apparent there will be a sale of equity and/or voting control".

9 Minutes of the Board, April 20, 2007.

10 Judgment on the Motion of Final Order at para. 147.

11 Press Release of BCE dated April 17, 2007, entitled “BCE reviewing strategic alternatives: Includes privatization talks with Canadian-led consortium”.

> […]
>
> There is clearly a great deal of uncertainty concerning the outcome of your strategic review. That said, we take comfort from the protection afforded to bondholders under the Trust Indentures and expect BCE/Bell Canada bondholders will be given proper and due consideration - especially given the longstanding support the Canadian bond market has provided BCE and the need for BCE to tap Canadian markets in the future.
>
> We have a fiduciary duty to our investors and, as such, must vigorously defend bondholder rights as provided in the trust indentures. We have been consulted informally by other like-minded bondholders and we seek assurance from you that the best interests of bondholders will be considered as part of your deliberations.
>
> To that end, we have a number of ideas on how a fair and equitable treatment of bondholders could be affected without jeopardizing some of the value enhancing alternatives being contemplated. We would be pleased to discuss these ideas with you at your convenience. Please refer any questions or comments you may have to […].
>
> [Emphasis added]

[21] On May 4, 2007, BCE responded by sending a standard reply letter, which it had also sent to other debentureholders, confirming that a copy of the letter was provided to the SOC and that BCE intended to respect the terms of the applicable trust indentures:

> […]
>
> As you may appreciate, we are unable to comment as to what may or may not transpire in connection with the company's review of strategic alternatives. We can however confirm that we intend to respect the terms of the applicable trust indentures which govern the bonds.
>
> […]

[22] Despite these approaches by debentureholders, no meeting or discussion occurred between them and BCE, the Board having concluded that their "overriding duty is to maximize shareholder value and obtain the highest value for the shareholders, while respecting the contractual obligations of the corporation and its subsidiaries".[12]

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[12] Judgment on the 76/96 Oppression Remedy at para. 132.

[23] The strategic review and auction process continued from April 20, 2007 until the end of June 2007. Guidelines relating to the auction process were put in place by BCE in early June 2007.

[24] On June 13, 2007, Goldman, Sachs & Co., acting on behalf of BCE, sent a letter to all potential participants in the auction process, providing them with the bidding rules and the form of a proposed definitive transaction agreement. The bidding rules set out the details required for the submission of offers by the participants in the auction process as well as the criteria to be considered in evaluating any bids that were received. The deadline for the submission of offers was fixed at 9:00 a.m., June 26, 2007.

[25] The auction process resulted in three offers. They are described by the trial judge, in part, as follows:

> [69] All three offers contemplated the addition of a substantial amount of new debt for which Bell Canada would be liable, either as borrower or as guarantor. In addition, all three offers would have resulted in BCE having a consolidated debt/EBITDA ratio of at least 5.8 and, accordingly, all would likely have resulted in a downgrade of the Bell Debentures to below investment grade. As well, all three of the offers left the Bell Canada Debentures issued under the various Trust Indentures in place except for those with near term maturities.[13]

[26] The Purchaser submitted an offer on June 26, 2007 of $42.25 per common share. It contemplated, among other things, an amalgamation of Bell Canada to be effected following the acquisition of the BCE shares, to permit tax savings. BCE's advisors informed the Purchaser that "the proposed amalgamations introduced unnecessary transaction risks into the acquisition and, accordingly, advised Purchaser that its bid was less competitive from a structural standpoint relative to the other bidders".[14] These "unnecessary transaction risks" refer to the triggering of protection mechanisms for debentureholders stipulated in the 1976 and 1996 Trust Indentures in case of an amalgamation.

[27] On June 29, 2007, the Purchaser submitted a revised proposal that provided an alternative transaction structure (spider structure) that could preserve tax savings while avoiding the amalgamation of Bell Canada with another entity and the risk of triggering the protection mechanisms. The Purchaser's revised proposal also increased its initial offer of $42.25 per common share to $42.75.

[28] That same day, after comparing the three offers, the Board determined, on the recommendation of the SOC, that Purchaser's revised offer of $42.75 per common share was better than the other offers. It instructed its advisors to conclude negotiations

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13 Judgment on the 76/96 Oppression Remedy at para. 69.

14 Judgment on the Motion for Final Order at para. 79.

with the Purchaser on the remaining outstanding issues with a view to concluding the Definitive Agreement that evening or by no later than June 30, 2007. Under this offer, BCE would "have $38.5 billion of debt which represents [approximately] 6.2x debt/EBITDA"[15] and Bell Canada would guarantee the approximately $30 billion acquisition debt.

[29] On June 30, 2007, BCE entered into the Definitive Agreement with the Purchaser for the acquisition of its outstanding common and preferred shares, at a price of $42.75[16] per common share in cash and at varying prices per preferred share. The Definitive Agreement also involved Pre-Acquisition and Post-Acquisition Reorganization transactions such as the provision of guarantees by Bell Canada for the acquisition debt to enable the purchase of the shares contemplated by the LBO.

[30] The Board unanimously recommended that BCE shareholders vote to approve the Plan.

[31] BCE, in an application entitled "Motion for Interim and Final Orders in Connection with a Proposed Arrangement" dated August 9, 2007, sought, pursuant to s. 192 *CBCA*, an order approving the Plan, as well as, *inter alia*, an interim order.

[32] On August 10, 2007, the trial judge issued an interim order authorizing BCE to hold a special shareholders' meeting in order to submit the Plan to the vote of the shareholders. The Interim Order also set out the delays for contesting the Motion for Final Order.

[33] On September 21, 2007, BCE shareholders approved the Plan. A majority holding 97.93% of the outstanding shares voted in favour.

[34] The two sets of appellants filed contestations to the approval of the Plan alleging that it adversely affected their interests. They also filed the two Declaratory Motions and the two Oppression Remedies referred to above, which were heard together with the Motion for Final Order.

3. RELEVANT LEGISLATIVE PROVISIONS

Loi canadienne sur les sociétés par actions (« LCSA »)	**Canada Business Corporation Act ("CBCA")**
2. (1) Les définitions qui suivent s'appliquent à la présente loi.	**2.** (1) In this Act,

[15] Judgment on the Motion for Final Order at para. 96. The acronym EBITDA means "Earnings Before Interest, Taxes, Depreciation and Amortization".

[16] This price represents a premium of approximately 40.1% to the average closing price of the common shares for the three-month period ending March 28, 2007, being the last trading day prior to any public speculation of a potential privatization transaction involving BCE.

[…]

«valeur mobilière»
"*security*"
«valeur mobilière» Action de toute catégorie ou série ou titre de créance sur une société, y compris le certificat en attestant l'existence.

[…]

122. (1) Les administrateurs et les dirigeants doivent, dans l'exercice de leurs fonctions, agir :
a) avec intégrité et de bonne foi au mieux des intérêts de la société;

b) avec le soin, la diligence et la compétence dont ferait preuve, en pareilles circonstances, une personne prudente.

[…]

192. (1) Au présent article, «arrangement » s'entend également de :
a) la modification des statuts d'une société;

b) la fusion de sociétés;

c) la fusion d'une personne morale et d'une société pour former une société régie par la présente loi;

d) le fractionnement de l'activité commerciale d'une société;

e) la cession de la totalité ou de la quasi-totalité des biens d'une société à une autre personne morale moyennant du numéraire, des biens

[…]
"security"
«valeur mobilière »
"security" means a share of any class or series of shares or a debt obligation of a corporation and includes a certificate evidencing such a share or debt obligation;

[…]

122. (1) Every director and officer of a corporation in exercising their powers and discharging their duties shall
(*a*) act honestly and in good faith with a view to the best interests of the corporation; and

(*b*) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

[…]

192. (1) In this section, "arrangement" includes
(*a*) an amendment to the articles of a corporation;

(*b*) an amalgamation of two or more corporations;

(*c*) an amalgamation of a body corporate with a corporation that results in an amalgamated corporation subject to this Act;

(*d*) a division of the business carried on by a corporation;

(*e*) a transfer of all or substantially all the property of a corporation to another body corporate in exchange

ou des valeurs mobilières de celle-ci;

f) l'échange de valeurs mobilières d'une société contre des biens, du numéraire ou d'autres valeurs mobilières soit de la société, soit d'une autre personne morale;

*f.*1) une opération de fermeture ou d'éviction au sein d'une société;

g) la liquidation et la dissolution d'une société;

h) une combinaison des opérations susvisées.

[…]

(3) Lorsqu'il est pratiquement impossible pour la société qui n'est pas insolvable d'opérer, en vertu d'une autre disposition de la présente loi, une modification de structure équivalente à un arrangement, elle peut demander au tribunal d'approuver, par ordonnance, l'arrangement qu'elle propose.

(4) Le tribunal, saisi d'une demande en vertu du présent article, peut rendre toute ordonnance provisoire ou finale en vue notamment :

a) de prévoir l'avis à donner aux intéressés ou de dispenser de donner avis à toute personne autre que le directeur;

b) de nommer, aux frais de la société, un avocat pour défendre les intérêts des actionnaires;

for property, money or securities of the body corporate;

(*f*) an exchange of securities of a corporation for property, money or other securities of the corporation or property, money or securities of another body corporate;

(*f*.1) a going-private transaction or a squeeze-out transaction in relation to a corporation;

(*g*) a liquidation and dissolution of a corporation; and

(*h*) any combination of the foregoing.

[…]

(3) Where it is not practicable for a corporation that is not insolvent to effect a fundamental change in the nature of an arrangement under any other provision of this Act, the corporation may apply to a court for an order approving an arrangement proposed by the corporation.

(4) In connection with an application under this section, the court may make any interim or final order it thinks fit including, without limiting the generality of the foregoing,

(*a*) an order determining the notice to be given to any interested person or dispensing with notice to any person other than the Director;

(*b*) an order appointing counsel, at the expense of the corporation, to represent the interests of the shareholders;

c) d'enjoindre à la société, selon les modalités qu'il fixe, de convoquer et de tenir une assemblée des détenteurs de valeurs mobilières, d'options ou de droits d'acquérir des valeurs mobilières;	(*c*) an order requiring a corporation to call, hold and conduct a meeting of holders of securities or options or rights to acquire securities in such manner as the court directs;
d) d'autoriser un actionnaire à faire valoir sa dissidence en vertu de l'article 190;	(*d*) an order permitting a shareholder to dissent under section 190; and
e) d'approuver ou de modifier selon ses directives l'arrangement proposé par la société.	(*e*) an order approving an arrangement as proposed by the corporation or as amended in any manner the court may direct.
[…]	[…]
238. Les définitions qui suivent s'appliquent à la présente partie.	**238.** In this Part,
[…]	[…]
«plaignant» "complainant" «plaignant » *a)* Le détenteur inscrit ou le véritable propriétaire, ancien ou actuel, de valeurs mobilières d'une société ou de personnes morales du même groupe;	"complainant" «plaignant » "complainant" means (*a*) a registered holder or beneficial owner, and a former registered holder or beneficial owner, of a security of a corporation or any of its affiliates,
b) tout administrateur ou dirigeant, ancien ou actuel, d'une société ou de personnes morales du même groupe;	(*b*) a director or an officer or a former director or officer of a corporation or any of its affiliates,
c) le directeur;	(*c*) the Director, or
d) toute autre personne qui, d'après un tribunal, a qualité pour présenter les demandes visées à la présente partie.	(*d*) any other person who, in the discretion of a court, is a proper person to make an application under this Part.
[…]	[…]
241. (1) Tout plaignant peut	**241.** (1) A complainant may apply to a

demander au tribunal de rendre les ordonnances visées au présent article.

(2) Le tribunal saisi d'une demande visée au paragraphe (1) peut, par ordonnance, redresser la situation provoquée par la société ou l'une des personnes morales de son groupe qui, à son avis, abuse des droits des détenteurs de valeurs mobilières, créanciers, administrateurs ou dirigeants, ou, se montre injuste à leur égard en leur portant préjudice ou en ne tenant pas compte de leurs intérêts :

a) soit en raison de son comportement;

b) soit par la façon dont elle conduit ses activités commerciales ou ses affaires internes;

c) soit par la façon dont ses administrateurs exercent ou ont exercé leurs pouvoirs.

(3) Le tribunal peut, en donnant suite aux demandes visées au présent article, rendre les ordonnances provisoires ou définitives qu'il estime pertinentes pour, notamment :

a) empêcher le comportement contesté;

b) nommer un séquestre ou un séquestre-gérant;

c) réglementer les affaires internes de la société en modifiant les statuts ou les règlements administratifs ou en établissant ou en modifiant une

court for an order under this section.

(2) If, on an application under subsection (1), the court is satisfied that in respect of a corporation or any of its affiliates

(*a*) any act or omission of the corporation or any of its affiliates effects a result,

(*b*) the business or affairs of the corporation or any of its affiliates are or have been carried on or conducted in a manner, or

(*c*) the powers of the directors of the corporation or any of its affiliates are or have been exercised in a manner that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of any security holder, creditor, director or officer, the court may make an order to rectify the matters complained of.

(3) In connection with an application under this section, the court may make any interim or final order it thinks fit including, without limiting the generality of the foregoing,

(a) an order restraining the conduct complained of;

(b) an order appointing a receiver or receiver-manager;

(c) an order to regulate a corporation's affairs by amending the articles or by-laws or creating or amending a unanimous shareholder agreement;

(d) an order directing an issue or

convention unanime des actionnaires;

d) prescrire l'émission ou l'échange de valeurs mobilières;

e) faire des nominations au conseil d'administration, soit pour remplacer tous les administrateurs en fonctions ou certains d'entre eux, soit pour en augmenter le nombre;

f) enjoindre à la société, sous réserve du paragraphe (6), ou à toute autre personne, d’acheter des valeurs mobilières d’un détenteur;

g) enjoindre à la société, sous réserve du paragraphe (6), où à tout autre personne, de rembourser aux détenteurs une partie des fonds qu'ils ont versé pour leurs valeurs mobilières;

h) modifier les clauses d'une opération ou d'un contrat auxquels la société est partie ou de les résilier avec indemnisation de la société ou des autres parties;

i) enjoindre à la société de lui fournir, ainsi qu'à tout intéressé, dans le délai prescrit, ses états financiers en la forme exigée à l'article 155, ou de rendre compte en telle autre forme qu'il peut fixer;

j) indemniser les personnes qui ont subi un préjudice;

k) prescrire la rectification des registres ou autres livres de la société, conformément à l'article 243;

l) prononcer la liquidation et la

exchange of securities;

(e) an order appointing directors in place of or in addition to all or any of the directors then in office;

(*f)* an order directing a corporation, subject to subsection (6), or any other person, to purchase securities of a security holder;

(*g*) an order directing a corporation, subject to subsection (6), or any other person, to pay a security holder any part of the monies that the security holder paid for securities;

(h) an order varying or setting aside a transaction or contract to which a corporation is a party and compensating the corporation or any other party to the transaction or contract;

(i) an order requiring a corporation, within a time specified by the court, to produce to the court or an interested person financial statements in the form required by section 155 or an accounting in such other form as the court may determine;

(j) an order compensating an aggrieved person;

(k) an order directing rectification of the registers or other records of a corporation under section 243;

(l) an order liquidating and dissolving the corporation;

(m) an order directing an investigation under Part XIX to be made; and

dissolution de la société; m) prescrire la tenue d'une enquête conformément à la partie XIX; n) soumettre en justice toute question litigieuse.	*(n)* an order requiring the trial of any issue.

Code civil du Québec	***Civil Code of Quebec***
1425. Dans l'interprétation du contrat, on doit rechercher quelle a été la commune intention des parties plutôt que de s'arrêter au sens littéral des termes utilisés.	**1425.** The common intention of the parties rather than adherence to the literal meaning of the words shall be sought in interpreting a contract.
1426. On tient compte, dans l'interprétation du contrat, de sa nature, des circonstances dans lesquelles il a été conclu, de l'interprétation que les parties lui ont déjà donnée ou qu'il peut avoir reçue, ainsi que des usages.	**1426.** In interpreting a contract, the nature of the contract, the circumstances in which it was formed, the interpretation which has already been given to it by the parties or which it may have received, and usage, are all taken into account.
1428. Une clause s'entend dans le sens qui lui confère quelque effet plutôt que dans celui qui n'en produit.	**1428.** A clause is given a meaning that gives it some effect rather than one that gives it no effect.

4. ANALYSIS

PRELIMINARY REMARKS

The standing of the appellants

[35] The respondents contested the appellants' standing to oppose the Plan. The trial judge ruled that they had the necessary standing. The respondents appear to have abandoned their contention. In any event, the ruling of the trial judge was correct.

[36] Respondents also submitted, with respect to the two Oppression Remedies, that the appellants did not have standing before the Superior Court to institute the proceedings. They argued that there is a prohibition in the text of the Trust Indenture that prevents them from taking action unless certain conditions are met. The trial judge concluded that the 76 and 97 Debentureholders did not have standing, and he

expressed doubt regarding the standing of the 96 Debentureholders, while recognizing that their Trustee did have standing.

[37] The appellants are securityholders pursuant to ss. 2 and 238 *CBCA*. In none of the Trust Indentures does one find a renunciation by the appellants to their invoking the oppression remedies available under the *CBCA*, assuming, solely for the purpose of the argument, that such a prior renunciation is legally possible. The "no action" clause found in two of the Trust Indentures explicitly covers only the recourses further to an event of default under their provisions. The issue invoked in the Oppression Remedies is not based on an event of default. It follows that the appellants had standing to file a motion alleging oppression pursuant to the *CBCA*.

[38] Accordingly, the trial judge should have ruled that the appellants had standing to initiate their Oppression Remedies. They had standing in the Superior Court, both with respect to contesting the Motion for Final Order and for instituting proceedings under the Oppression Remedy, and they likewise have standing before this Court.

A. THE MOTIONS FOR DECLATORY JUDGMENT

[39] In their respective Motions Introductory of Suit for Declaratory Judgment, the appellants CIBC Mellon and Computershare, who are the Trustees pursuant to the 1976 and 1996 Trust Indentures, seek a declaration as to whether section 8.01 of their respective Trust Indentures are applicable by reason of the Plan, and in particular, that part where the requirement of the Trustees for approval is triggered. Sections 8.01 and 8.02 read in part:

> SECTION 8.01. *General Provisions* Nothing in this Trust Indenture shall prevent, if otherwise permitted by law, the reorganization or reconstruction of the Company or the consolidation, amalgamation or merger of the Company with any other corporation, including any affiliate, or shall prevent the transfer by the Company of its undertaking and assets as a whole or substantially as a whole to another corporation, including any affiliate, lawfully entitled to acquire and operate the same […]
>
> Provided that every such reorganization, reconstruction, consolidation, amalgamation, merger or transfer shall be made on such terms and at such times and otherwise in such manner as shall be approved by the Company and by the Trustee as being in no wise[17] prejudicial to the interests of the Debentureholders and, upon such approval, the Trustee shall facilitate the same in all respects […]
>
> SECTION 8.02. *Status of Successor Corporation.* In case of any reorganization, reconstruction, consolidation, amalgamation, or merger as aforesaid, the

[17] In the 1996 Trust Indenture, the word "way" replaces the word "wise".

> corporation formed by such consolidation or with which the Company shall have been amalgamated or merged, upon executing an indenture or indentures as provided in section 8.01, shall succeed to and be instituted for the Company (which may then be wound up, if so desired by its shareholders), with the same effect as if it had been named herein as the Party of the First Part, hereto, and shall possess and may exercise each and every right of the Company hereunder.
>
> [Emphasis added]

[40] Interpreting the above provision, the trial judge states:

> [45] In interpreting complex corporate agreements such as the Trust Indentures, and when faced with ambiguity, the Courts have generally favoured an interpretation that is commercially reasonable and that gives effect to the intention and reasonable expectations of the parties at the time the agreements were negotiated.[18]

[41] The trial judge found that many of the provisions of the Trust Indentures had been modeled after the 1967 Model Debenture Indenture Provisions ("Model Provisions") published by the American Bar Foundation. He also noted that the expression "reorganization or reconstruction" was not originally included in the wording of article 8 of the Model Provisions and was specifically added by the 76 Debentureholders at the time the 1976 Trust Indenture was entered into.

[42] Examining the definition given to the words "reorganization" and "reconstruction" added to section 8.01, the trial judge held that these concepts have essentially the same meaning in that they refer to the transfer of a corporation's undertaking (or part of it) to a new entity that is intended to carry on substantially the same business and that will be ultimately owned by substantially the same shareholders.

[43] The trial judge also concluded that in light of other provisions contained in the 1976 and 1996 Trust Indentures, it is clear that section 8.01 was not intended to restrict Bell Canada from incurring additional indebtedness.

[44] For these reasons, the trial judge ruled that the Plan and the Definitive Agreement do not trigger the application of the substantive and procedural mechanisms of section 8.01. In other words, the approval of the Trustees stating that the Plan was in no way prejudicial to the rights of the Debentureholders was not required.

[45] The author William K. Fraser expressly defines the term "reconstruction" to mean the "transfer of the assets (or the major part thereof) of one company to a new company formed for that purpose, in exchange for shares in the new company which are

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[18] Judgment on the 76 Declaratory Motion at para. 45, referring to *Eli Lilly & Co. v. Novopharm Ltd.; Eli Lilly & Co. v. Apotex Inc.*, [1998] 2 S.C.R. 129.

distributed among the shareholders of the old company".[19] The term "reorganization" is also commonly applied to a transaction of this nature. This description of the term "reconstruction" was adopted by *The Dictionary of Canadian Law*.[20]

[46] The authors J.L. Stewart and M. Laird Palmer,[21] for their part, explain that in English law the term “reconstruction” is applied to a certain type of reorganization involving a transfer of the undertaking of one company to a new company, formed for this purpose, in consideration of shares of the new company that are distributed to the shareholders of the old company or offered to the shareholders of the old company on certain terms. The authors also state: “In this country the term “reconstruction” is not in common use […]”.[22] However, they acknowledge that a "reconstruction" under English law falls within the meaning of s. 126 of the *Companies Act*:

> Under a common type of reconstruction, the undertaking and assets of a company (or the major part) are sold to a new company formed for the purpose. The transfer is made in consideration of the issuance or shares of the purchaser company to the vendor company which distributes the shares among its own shareholders. The vendor company then passes out of existence and its business is carried on by the new company.[23]

[47] In the case of *R. v. Santiago Mines Ltd.*,[24] the Court of Appeal for British Columbia, determining whether a sale by a company of a large block of its shares, without being registered as a broker, took place in the course of the reorganization of the company, affirmed that the term “reorganization” is a commercial term rather than a legal term, and that it is not a word of art and has no technical meaning in law. Smith J.A., writing for the majority, held that “the word “reorganization”, applied to company affairs, has substantially the same meaning as “reconstruction”, the word mostly used in the English authorities”.[25]

[48] In *Kennedy v. Minister of National Revenue*,[26] Cattanach J. had to determine whether the fact that a company conducted its business from rented premises rather

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19 William K. Fraser, *Fraser's Handbook on Canadian Company Law*, 7th ed. (Toronto: Carswell, 1985) at 348-349.

20 Daphne A. Dukelow, *The Dictionary of Canadian Law*, 3d ed. (Toronto: Thomson Carswell, 2004) at 1106.

21 J.L. Stewart & M. Laird Palmer, *Company Law of Canada*, 5th ed. (Toronto: Carswell, 1962) at 703 *et seq.*

22 *Ibid.* at 730.

23 *Ibid.*

24 [1946] B.C.J. No. 56 (B.C.C.A.).

25 *R. v. Santiago Mines Ltd.*, *supra* note 24, referring to *Hooper v. Western Counties and South Wales Telephone Company Limited*, (1893) 68 L.T. 78 (Ch.D.) [*Hooper*] and *In re South African Supply and Cold Storage Company*, [1904] 2 Ch. 268.

26 *Kennedy v. Minister of National Revenue*, 72 D.T.C. 6357 (F.C.T.D.), rev'd 73 D.T.C. 5359 (F.C.A.). In this case, the Federal Court of Appeal approved of Cattanach J.'s conclusion on this issue but reversed the decision on other grounds.

than from premises that it owned amounted to a reorganization of its business. He held that, even though what was referred to as a reconstruction in *Hooper*[27] is illustrative of what is normally done in the context of reorganization, namely that a new entity is created and another ceases to exist, it does not mean that it must be so in every case:

> If an undertaking of some definite kind is being carried on but it is concluded that this undertaking should not be wound up but should be continued in an altered form in such manner that substantially the same persons will continue to carry on the undertaking, that is what I understand to be a reorganization. It is that the same business is carried on by the same persons but in a different form.[28]

[49] Interpreting the term “reorganization” in light of the concepts contained in the other terms of the provision, namely “winding-up” and “discontinuance”, Cattanach J. concluded that an element of finality was presupposed: the termination of the conduct of the business in one form and its continuance in a different form. The facts of the case involving simply the sale by the company of a capital asset that did not result in the end of its business, was held not to be included in the meaning of the term "reorganization".

[50] A number of Canadian judgments with respect to the interpretation of the term "reorganization", in the context of taxation law, have followed this reasoning.[29]

[51] The Court agrees with the interpretation consistently given to the term “reorganization” by the aforementioned line of authorities in the context of commercial and corporate law.

[52] When considering the text of section 8.01 of the Trust Indentures in its entirety, all commercial terms pertinent to our analysis refer to the transactions involving consolidation, amalgamation, merger, transfer of undertaking or assets which necessitate the presence of two entities. Therefore it would be inconsonant and inconsistent to come to any conclusion other than that the terms “reorganization” and “reconstruction” in the context of section 8.01 both refer to transactions that involve separate corporate entities. The proposed Plan does not.

[53] Such a finding, contrary to the assertion of appellants, is not inconsistent with the trial judge’s conclusion that section 8.01 was added to the Trust Indentures by the 76 and 96 Debentureholders specifically for their benefit. Even if both terms refer to the same type of transaction, their insertion in section 8.01 provides the Debentureholders with additional protection in that it contemplates transfers that although to the same group, are not caught by the terms already there such as consolidation, amalgamation, merger, transfer of undertaking or assets.

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27 *Supra* note 25.
28 *Supra* note 26.
29 See *e.g. McMullen v. Canada*, 2007 D.T.C. 286 (T.C.C.); *Felray Inc. v. Canada*, 97 D.T.C. 5349 (F.C.T.D.).

[54] Furthermore, this interpretation is consistent with the rule of interpretation that states that each term of a clause must be interpreted in light of its context, especially when dealing with a very general term. In particular, the *noscitur a sociis* principle provides that a word can have a limited meaning by reason of the words with which it is associated:

> La règle *noscitur a sociis* est utile dans la mesure où elle attire l'attention de l'interprète sur le fait qu'un mot peut avoir, en raison du contexte formel, un sens plus restreint que son « sens du dictionnaire ».[30]

[55] Considering the foregoing, the trial judge came to the correct conclusion in deciding that section 8.01 is in fact a *successor obligor* provision.

[56] Regarding the interpretation of the provisions contained in the Model Provisions, the American Bar Foundation explains the *raison d'être* of article 8, the origin of sections 8.01 and 8.02:

> The decision to invest in the debt obligations of a corporation is based on the repayment potential of a business enterprise possessing specific financial characteristics. The ability of the enterprise to produce earnings often depends on particular assets which it owns. Obviously, if the enterprise is changed through consolidation with or merger into another corporation or through disposition of assets, the financial characteristics and repayment potential on which the lender relied may be altered adversely. Furthermore, in the case of a consolidation or a merger into another corporation, the borrowing corporation will, in fact, disappear. For these reasons, and because the lender may also expect to be paid from the physical assets of the enterprise if financial difficulty does arise, debenture indentures often contain some limitations on consolidations, mergers and dispositions of assets by the borrowing enterprise.[31]

[57] This interpretation is consistent with the wording used in section 8 in its entirety.

[58] As to the intent of section 5.09[32] of the 1976 and 1996 Trust Indentures, it serves to limit the amount of funded debt that may be incurred by Bell Canada. Such a

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30 Pierre-André Côté, *Interprétation des lois*, 3rd ed. (Montreal: Éditions Thémis, 1999) at 396.

31 American Bar Foundation, *Commentaries on Model Debenture Indenture Provisions 1965, Model Debenture Indenture Provisions All Registered Issues 1967 and Certain Negotiable Provisions which may be Included in a Particular Incorporating Indenture* at 290.

32 SECTION 5.09 *Limitations on Issuance of Additional Funded Debt* (a) The Company will not issue, assume or guarantee any Funded Debt (other than Funded Debt secured by Purchase Money Mortgages and other than Funded Debt issued as an extension, retirement, renewal or replacement of Debt which was Funded Debt at time of original issuance, assumption or guarantee without increasing the principal amount thereof) ranking equally with the Debentures unless Earnings Available for Payment of Interest Charges during any period of 12 successive calendar months selected by the Company out of 18 such months next preceding the date of the proposed issuance, assumption or guarantee of the new Funded Debt shall have been not less than one and three-

provision is intended to "preserve a margin of safety for the loan by preventing a dilution of the Debentureholders' position and a weakening of its financial structure through the creation of what is considered in the particular case to be an excessive amount of additional debt".[33]

[59] This is in essence the situation the 76/96 Debentureholders are seeking to prevent. The trial judge noted that section 5.09 of the 1976 and 1996 Trust Indentures "impose very strict limitations on the ability of Bell Canada to issue *Additional Funded Debt*".[34] However, 76/96 Debentureholders do not dispute that the conditions set out in section 5.09 are met in this instance.

[60] The Court therefore agrees with the trial judge's conclusion expressed in these terms:

> [56] Reading Articles Five and Eight of the 1976 Trust Indenture together and in context, it is clear that the intention of Section 8.01 is not to restrict Bell Canada from incurring additional indebtedness, which is essentially the principal complaint of the 1976 Debentureholders in these proceedings. Such interpretation would be in contradiction with and render superfluous the specific restrictions on incurrence of indebtedness contained in Section 5.09.[35]

[61] Furthermore, the debentureholders have failed to show any error in the trial judge's finding that the past conduct of the parties is consistent with this interpretation of the word "reorganization".

[62] Their contention with respect to the interpretation of sections 8.01 and 8.02 is unfounded and was correctly rejected by the trial judge.

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quarters times the sum of (i) annualized interest charges on all Funded Debt outstanding at the date of such proposed issuance, assumption or guarantee (except Funded Debt held in any purchase, sinking, amortization or analogous fund and Funded Debt to be retired by the Funded Debt proposed to be issued or to be retired by Funded Debt issued since the beginning of such 12 month period) plus (ii) annualized interest charges on the Funded Debt proposed to be issued, assumed or guaranteed.

(b) The Company will not issue, assume or guarantee any Funded Debt (other than Funded Debt secured by Purchase Money Mortgages and other than Funded Debt issued as an extension, retirement, renewal or replacement of Debt which was Funded Debt at time of original issuance, assumption or guarantee without increasing the principal amount thereof) ranking equally with the Debentures unless all Funded Debt of the Company outstanding at the date of such proposed issuance, assumption or guarantee (except Funded Debt held in any purchase, sinking, amortization or analogous fund) shall not exceed 66 2/3% of the Tangible Property of the Company (after giving effect to such issuance, assumption or guarantee and the receipt and application of the proceeds thereof).

33 American Bar Foundation, *supra* note 31 at 370.

34 Judgment on the 76 Declaratory Motion at para. 74.

35 *Ibid.* at para. 76.

[63] The Trustees raise an issue as to the form of the conclusions by the trial judge. In their Motions Introductory of Suit for Declaratory Judgment, they seek the following conclusions:

> GRANT and MAINTAIN the present Motion.
>
> […]
>
> DECLARE whether Section 8.01 of the Trust Indenture between Bell Canada and Plaintiff as trustee applies by reason of the proposed Plan of Arrangement and proposed transaction summarily described in the present Motion and Court Record herein.
>
> […]"[36]
>
> [Emphasis added]

[64] The Court agrees with the submission of the Trustees that since the Superior Court concluded that a declaration as to the meaning of section 8.01 was warranted and proceeded to give its interpretation, the declaratory motions should have been granted rather than dismissed. All the criteria required in order to succeed on such motions under article 453 of the *Code of Civil Procedure* were met and the trial judge, as requested, issued a declaration regarding the interpretation of section 8.01. The Trustees took no position as to what was the correct interpretation. In these circumstances, the Motions should have been granted.

[65] The appeals will therefore be allowed for the sole purpose of replacing the word "DISMISSES" by the word "GRANTS" in the trial judge's conclusions regarding the Motions for Declaratory Judgment.

B. MOTIONS FOR OPPRESSION IN THE CONTEXT OF THE MOTION FOR FINAL ORDER

[66] A corporation is comprised of different stakeholders. Shareholders are stakeholders, as are creditors, in this case the debentureholders. Shareholders and debentureholders are securityholders within the terms of the *CBCA*.[37] From time to time, their interests may differ. The Supreme Court of Canada in *Peoples*,[38] stated at paragraph 47 that "[i]n resolving these competing interests, it is incumbent upon the directors to act honestly and in good faith with a view to the best interests of the corporation […] and not to favour the interests of any one group of stakeholders". If the

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[36] CIBC Mellon's Re-amended Motion Introductory of Suit for Declaratory Judgment of November 23, 2007, Computershare's Amended Motion Introductory of Suit for Declaratory Judgment of September 27, 2007.

[37] Section 2 *CBCA*.

[38] *Peoples' Department Stores Inc. (Trustee of) v. Wise*, [2004] 3 S.C.R. 461 [*Peoples*].

Board fails in that task, stakeholders may invoke various statutory remedies available under the *CBCA*. Some are specific, as in the case of amalgamation (s. 185 *CBCA*), or arrangement (s. 192 *CBCA*), others are of broad application, such as the oppression remedy (s. 241 *CBCA*).

[67] With regard to creditors, a class of stakeholders, the Supreme Court stated in *Peoples*:

> [48] The Canadian legal landscape with respect to stakeholders is unique. Creditors are only one set of stakeholders, but their interests are protected in a number of ways. Some are specific, as in the case of amalgamation: s. 185 of the CBCA. Others cover a broad range of situations. The oppression remedy of s. 241(2)(*c*) of the CBCA and the similar provisions of provincial legislation regarding corporations grant the broadest rights to creditors of any common law jurisdiction: see D. Thomson, "Directors, Creditors and Insolvency: A Fiduciary Duty or a Duty Not to Oppress?" (2000), 58 *U.T. Fac. L. Rev.* 31, at p. 48. One commentator describes the oppression remedy as "the broadest, most comprehensive and most open-ended shareholder remedy in the common law world": S. M. Beck, "Minority Shareholders' Rights in the 1980s", in *Corporate Law in the 80s* (1982), 311, at p. 312. While Beck was concerned with shareholder remedies, his observation applies equally to those of creditors.
>
> [Emphasis added]

[68] Thus, one of the possible remedies of creditors is found in s. 241 *CBCA*. It authorizes a complainant who has been oppressed or whose interests have been unfairly prejudiced or unfairly disregarded by a corporation, its directors or its shareholders to apply for redress to a Superior Court. Debentureholders are a class of creditors who hold securities of a corporation, and as such they are specifically identified as complainants in s. 238(a) *CBCA* and have made use of the remedy from time to time.[39]

[69] The thwarted reasonable expectations of a complainant are an important element of establishing its right to a remedy. The reasonable expectations of a holder of a publicly issued debenture are derived from the trust indentures, debentures in their hands, the prospectuses, public statements of the company and the various other representations made from time to time.[40] Various factors can be examined, as stated by the author Kevin McGuiness:

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[39] See *e.g. Harbert Distressed Investment Master Fund, Ltd. v. Calpine Canada Energy Finance II ULC* (2005), 7 B.L.R. (4th) 276 (N.S.S.C) [*Calpine*]; *Deutsche Bank Canada v. Oxford Properties Group Inc*. (1998), 40 B.L.R. (2d) 302 (Ont. Ct. J. (Gen. Div.)) [*Oxford Properties*].

[40] *Casurina Ltd. Partnership v. Rio Algom Ltd.* (2002), 28 B.L.R. (3d) 44 (Ont. Sup. Ct. J.), aff'd (2004) 40 B.L.R. (3d) 112 (Ont. C.A.)*; Oxford Properties*, *supra* note 39; *Themadel Foundation v. Third Canadian General Investment Trust Ltd*. (1998), 38 O.R. (3d) 749 (Ont. C.A.).

> […] The identification of what were the reasonable expectations of the parties is a question of fact. In determining that fact, there is no error in principle in looking at prior statements and drawing an inference based on the respective weight of all the individual pieces of evidence. In deciding what is unfair, the history and nature of the corporation, the essential nature of the relationship between the corporation and the complainant, the type of rights affected and general corporate practice are material. Test of unfair prejudice or unfair disregard encompasses the protection of the underlying expectation of a creditor in its arrangement with the corporation, the extent to which the acts complained of were unforeseeable or the creditor could reasonably have protected itself from such acts, and the detriment to the interests of the creditor. The reasonable expectations of a shareholder or other potential complainant are not assessed in the abstract. They must be construed by reference to the context in which the complainant acquired his or her rights, and the context in which the conduct complained of transpired. […][41]

[70] This concept was also expressed by the Alberta Court of Appeal in *Westfair Foods v. Watt*[42] as follows:

> […] one clear principle that emerges is that we regulate voluntary relationships by regard to the expectations raised in the mind of a party by the word or deed of the other and which the first party ordinarily would realize it was encouraging by its words and deeds. This is what we call reasonable expectations, or expectations deserving of protection. Regard for them is a constant theme, albeit variously expressed, running through the cases on this section or its like elsewhere. I emphasize that all the words and deeds of the parties are relevant to an assessment of reasonable expectations, not necessarily only those consigned to paper, and not necessarily only those made when the relationship first arose.[43]

[71] In other words, these reasonable expectations are not limited to the legal rights spelled out in the contractual terms of the trust indentures. However, these expectations, to remain reasonable, cannot run contrary to the express terms of the relevant contracts.

[72] The concept of fairness is central to the application of s. 241 *CBCA*.[44]

[73] The *CBCA* requires a corporation to apply for approval to a Superior Court when it wishes to carry out certain specific transactions, such as an amalgamation (s. 182 *CBCA*) or an arrangement (s. 192 *CBCA*).

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41 Kevin Patrick McGuiness, *The Law and Practice of Canadian Business Corporations* (Markham: Butterworths, 1999) at para. 9. 241.

42 (1991), 79 D.L.R. (4th) 48 (Alta. C.A.), leave to appeal to S.C.C. refused, [1991] 2 S.C.R. viii.

43 *Ibid.* at 54.

44 *First Edmonton Place v. 315888 Alta. Ltd.* (1988), 40 B.L.R. 28 (Alta. Q.B.); *Calpine*, *supra* note 39.

[74] In the present case, BCE chose to proceed by way of a plan of arrangement. It is not disputed that the contemplated Plan constitutes an arrangement within the meaning of s. 192 *CBCA*.

[75] Amongst the securityholders affected by an arrangement, there can be shareholders as well as debentureholders.[45]

[76] It is now settled law that the court will approve a plan of arrangement only if it is fair and reasonable. Once more, the concept of fairness is crucial.

[77] Both the approval procedure under s. 192 *CBCA* and the oppression remedy under s. 241 *CBCA* are measures that Parliament designed to assure fairness in the conduct of the affairs of a corporation. In the first case, the proceedings are instituted by the corporation and in the second, they are generally taken against the corporation.

[78] The relationship between these two provisions has been discussed in various judgments. In *Re Canadian Pacific Ltd.*,[46] Austin J., as he then was, writes at p. 233:

> In my view, much the same tests apply in the present case. If anything, the standard is higher under s. 192. It does not specify what standard must be attained, whereas under s. 241 the conduct must be "oppressive" before it will be struck down. Although s. 192 provides no standard, the jurisprudence has established that for an arrangement to get court approval it must not only be not oppressive, it must be fair and reasonable.

[79] If a plan of arrangement is found to be fair and reasonable, it could generally not be argued that the implementation of the plan as approved is oppressive to a complainant. In *Re Pacifica Papers Inc.*,[47] Lowry J. states at paragraph 156:

> It becomes unnecessary to say very much about the claim of oppression made by Cerberus because, as indicated, an Arrangement that is fair cannot be oppressive.

[80] In *Re Canadian Airlines Corp.*,[48] Paperny J., as she then was, in the context of a bankruptcy matter, writes at paragraph 145:

> It is through the lens of insolvency legislation that the rights and interests of both shareholders and creditors must be considered. The reduction or elimination of rights of both groups is a function of the insolvency and not of oppressive conduct in the operation of the CCAA. The antithesis of oppression is fairness,

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45 *Amoco Canada Petroleum Co. v. Dome Petroleum Co.*, [1988] A.J. No. 68 (Alta. Q.B.).
46 (1990), 73 O.R. (2d) 212 (Ont. H.C.J.) [*Re Canadian Pacific Ltd. (1990)*].
47 (2001), 15 B.L.R. (3d) 249 (B.C.S.C.), aff'd (2001), 19 B.L.R. (3d) 62 (B.C.C.A.).
48 (2001), 9 B.L.R. (3d) 41 (Alta. Q.B.), leave to appeal to the C.A. refused, (2001), 9 B.L.R. (3d) 86 (Alta. C.A.).

> the guiding test for judicial sanction. If a plan unfairly disregards or is unfairly prejudicial it will not be approved. However, the court retains the power to compromise or prejudice rights to effect a broader purpose, the restructuring of an insolvent company, provided that the plan does so in a fair manner.
>
> [Emphasis added]

[81] However, the rejection of a motion alleging oppression is not conclusive on the fairness of a plan of arrangement. In *3017970 Nova Scotia Co. v. Johnstone*,[49] Cameron J. states at paragraph 15:

> The fairness hearing is open to consideration of all relevant issues, including good faith, the availability of fairness opinions, adequacy of disclosure in the information circular, the results of the shareholder vote and the right to exercise dissenting appraisal rights. The standard of fairness and reasonability for approval of the Arrangement under CBCA s. 192 is clearly higher than merely "not oppressive" or "not unfair". If CBCA s. 241 is breached, the Arrangement cannot be approved.
>
> [Emphasis added]

[82] In *Scion Capital, LLC v. Gold Fields Ltd.*,[50] Veale J. says at paragraph 72:

> The petition for oppression has been heard at the same time as the application for approval of the plan of arrangement. There is some relationship between the two proceedings in that a plan of arrangement cannot be approved if it is oppressive. However, if the oppression proceeding fails, it does not automatically result in approval of the proposed arrangement; the applicant must demonstrate that the requirements of s. 195 of the Y.B.C.A.[51] have been met; Re Canadian Pacific Ltd., cited above.

[83] Finally, if an arrangement has an oppressive result, it cannot be approved as fair.[52]

[84] The trial judge, correctly, agreed with the principles enunciated in the foregoing cases.[53]

[85] It follows that when a contemplated transaction is an arrangement under s. 192 *CBCA*, there would, in most cases, likely be no need for an affected

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49 [2001] O.J. No. 1809 (Ont. Sup. Ct. J.).
50 (2006), 16 B.L.R. (4th) 17 (Y.S.C.), aff'd (2006), 16 B.L.R. (4th) 10 (Y.C.A.) [*Scion Capital*].
51 Section 195 of the *Yukon Business Corporations Act*, R.S.Y. 2002, c. 20, regarding Court-Approved Arrangements is the equivalent of s. 192 *CBCA* [citation added].
52 *Scion Capital*, *supra* note 50 at 31.
53 See the judgment on the Motion for Final Order at para. 129 to 132.

securityholder to assert an oppression remedy under s. 241 *CBCA* to protect its interests. The affected securityholder could rather participate in the plan of arrangement proceedings and oppose the approval of the plan.

[86] In the case before the Court, the appellants acknowledged that their motions for an oppression remedy were made *ex abundante cautela*, after BCE asserted that they had no standing to participate in the arrangement proceedings. The principal remedy sought by the appellants under their oppression motions is refusal of the approval of the plan. In fact, their contestations of the motion for the approval of the plan of arrangement and their oppression motions are similar in their content, and seek to achieve the same result.

[87] Having regard to these circumstances, the Court will deal only with the plan of arrangement proceedings because if the plan is fair and reasonable, it cannot be said to be oppressive to securityholders, or unfairly prejudicial to, or unfairly disregard their interests. Therefore, the Motions for Oppression Remedy become moot and the appeals from the judgment of the Superior Court will accordingly be dismissed, but without costs, given the circumstances.

C. THE PLAN

[88] The trial judge correctly stated[54] that the burden to prove that the plan is fair and reasonable rests squarely on BCE, the applicant under s. 192 *CBCA*.

[89] As for the persons affected by the Plan, the trial judge in answering the question "Fairness to whom?"[55] included the debentureholders as a class of affected securityholders, even if their legal rights are not being arranged.[56] His answer is consistent with Policy Statement 15.1[57] issued by the *CBCA* Director, at s. 3.08:

> **3.08** Section 192 of the Act does not require security holder approval as a pre-condition to a court order approving an arrangement. However, the Director is of the view that, at a minimum, all security holders whose legal rights are affected by a proposed arrangement are entitled to vote on the arrangement. The Director is also of the view that, notwithstanding that a proposed arrangement may not affect the legal rights of holders of securities of a particular class, it may nevertheless be appropriate in cases where a proposed arrangement fundamentally alters the security holders' investment, whether economically or otherwise, that the right to vote on the arrangement should be provided to these security holders. For example, in an arrangement involving a divestiture of significant assets, the Director will review the financial statements, looking at

54 Judgment on the Motion for Final Order at para. 129.
55 Judgment on the Motion for Final Order at para. 133.
56 Judgment on the Motion for Final Order at para. 151 to 154.
57 *Policy of the Director Concerning Arrangements under Section 192 of the CBCA* – [*Policy Statement 15.1*], online: <http://www.ic.gc.ca/epic/site/cd-dgc.nsf/en/cs01073e.html>.

> such factors as the percentage of assets being "dividended-out", credit ratings and the rights of participation of any referred shareholder classes. At the same time, the Director recognizes that in determining whether debt security holders should be provided with voting and approval rights, the trust indenture or other contractual instrument creating such securities should ordinarily be determinative absent extraordinary circumstances.
>
> [Emphasis added]

[90] The Court agrees with the proposition that any securityholder whose legal rights or economic interests are affected by an arrangement presented pursuant to s. 192 *CBCA* has standing to contest it, even if such securityholder was not granted voting rights.

[91] The Plan is summarized by the trial judge as follows:

> [96] The essential elements of the Plan of Arrangement and the Definitive Agreement are not contested. The details are accurately described, in summary form, in Part 7 of the BCE *Factum*. Except for some self-serving characterizations expressed by BCE counsel, (all of which have been deleted from the following extract by the undersigned), the summary reflects accurately the essence of the Plan of Arrangement and the Definitive Agreement as described in the Circular.
>
> > The price to be paid by the Teachers' Consortium of $42.75 per common share represents a premium of approximately 40% over the price of BCE's common shares on the day prior to it first becoming publicly speculated that BCE might be subject to a change of control. This 40% premium represents approximately $10.2 billion in additional value to BCE common shareholders. The transaction proposed by the Teachers' Consortium contemplates a [...] new capital structure that will facilitate ongoing investment in BCE. The total capital required for the privatization transaction amounts to approximately $50 billion. Pro Forma for the transaction and acquisition financing, BCE will have $38.5 billion of debt which represents [approximately] 6.2x debt/EBITDA. This debt is supported by nearly $8 billion of new equity capital which is being committed to the transaction (one of the largest LBO equity commitments in history). [...]
> >
> > The senior secured debt will be unconditionally guaranteed by certain of the Purchaser's wholly-owned subsidiaries. This will include BCE and Bell Canada. However, with respect to Bell

> Canada, in compliance with the terms of the 1976 Trust Indenture and the 1997 Trust Indenture, the guarantee to be given by Bell Canada will rank equally with the debentures issued pursuant to the 1976 Trust Indenture and the 1997 Trust Indenture as well as the master lease and certain other senior debt obligations of Bell Canada but only to the extent that the total amount of senior secured first lien debt of Bell Canada does not exceed the maximum amount permitted by section 5.09 of the 1976 Trust Indenture (the "***Pari Passu Guarantee***"). Otherwise, the guarantee will be on a senior subordinated basis, with respect to both the *Pari Passu* Guarantee and the existing debt under the 1976 and 1997 Trust Indentures (the "***Senior Subordinated Guarantee***"). The *Pari Passu* Guarantee and the Senior Subordinated Guarantee will rank senior with respect to Bell Canada's Subordinated Debentures issued under the 1996 Trust Indenture.
>
> In very general terms, the various steps in the Plan of Arrangement will result in: (i) the transfer of all common and preferred shares of BCE (collectively, the "***Shares***") to the Purchaser in exchange for $42.75 per common share with the consideration paid to the preferred shareholders varying depending upon the particular series of preferred shares; (ii) the Purchaser will then transfer the Shares to one of its Subsidiaries ("***Subco***"), designated in writing prior to the Effective Time in consideration for the issuance of certain promissory notes and shares of Subco; and (iii) following the completion of the transfer of the Shares by the Purchaser to Subco as described above, Subco and BCE will amalgamate under section 192 of the *CBCA* to form BCE Amalco. None of the steps in the Plan of Arrangement involves Bell Canada, and none of the steps arranges or alters the rights of the Bell Debentureholders under the Trust Indentures.[58]
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> [...]
>
> [Emphasis added]

[92] The trial judge concluded that the Plan affects the appellants, because it is dependent on a number of post-reorganization steps, including Bell Canada providing

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[58] Judgment on the Motion for Final Order at para. 96.

guarantees for approximately $30 billion to be borrowed by the Purchaser to buy the shares of BCE:

> [122] More particularly, BCE contends that the Contesting Debentureholders should not be given standing because the Plan of Arrangement does not involve Bell Canada or the proposed $30 billion guarantee of the debt which Bell Canada is to assume. While in the strict sense and from a narrow non-commercial perspective, this may be true, there can be no doubt that in reality, this guarantee forms an integral part of the Plan of Arrangement. The full consequences of the implementation of the Plan of Arrangement cannot be analyzed in isolation and with commercial "blinders". They must be analyzed in the context of the concurrent obligations assumed by BCE to cause Bell Canada to assume $30 billion of the acquisition debt necessary to complete the Plan of Arrangement. Implementation of the Plan of Arrangement would not be possible without the Bell Canada guarantee.[59]
>
> [Emphasis added]

[93] The Court agrees with this analysis. The completion of all the steps described in the Definitive Agreement, including the Bell Canada guarantee, is part and parcel of the implementation of the Plan. BCE acknowledged that reality at paragraph 43 of its "Motion for Interim and Final Orders in Connection with a Proposed Arrangement" where it stated:

> […] the Arrangement is dependent upon the completion of a number of interrelated and sequenced corporate steps and it is essential that no element of the Arrangement occur unless there is certainty that all other elements of the Arrangement occur within the strict time periods provided and in the correct order.

[94] The appellants, who hold unsecured debentures issued by Bell Canada, opposed the approval of the Plan by contending that the addition of $34 billion of new debt fundamentally alters and adversely affects their investment. It materially increases the risk of default on their loans. This is reflected in the downgrading of their debentures. They submit that this credit downgrade will force some of the debentureholders to dispose of their debentures, at a loss. They also contend that the Board did not consider the effect on them of an approximately 20% drop in the market value of their debentures. They complain that the original offer of the Purchaser was restructured, at the request of BCE, to avoid seeking their approval, as would have been required in the event of an amalgamation of Bell Canada with another entity, as contemplated in the original offer.[60]

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[59] Judgment on the Motion for Final Order at para. 122.
[60] *Supra* para. 25.

D. THE CRITERIA FOR COURT APPROVAL

[95] As pointed out by the trial judge, to obtain approval of the Plan BCE must show: (1) that the statutory requirements have been fulfilled; (2) that the Plan is put forward in good faith; (3) that it complied with the interim order; and (4) that the Plan is fair and reasonable given all the circumstances.[61]

[96] There is no dispute that the first and the third elements have been satisfied. The appellants contend however that the second and fourth elements are not satisfied.

[97] With regard to the second element, the trial judge concluded that the Board was acting in good faith, a finding of fact on which there is no basis for this Court to intervene. He stated:

> [147] Moreover, there is no evidence whatsoever susceptible of creating any reasonable doubt in the minds of an informed investor in that regard [the wisdom, sincerity and good faith of the SOC and the Board in recommending the approval of the Plan of Arrangement]. The uncontradicted evidence supports BCE's contentions that the Plan of Arrangement is the result of an extensive, complex strategic review and auction process, whose overriding objective was to maximize shareholder value, while respecting the corporation's legal and contractual obligations.[62]

[98] As mentioned by the trial judge, the process supervised by the SOC, the independent oversight committee, was based on the premise that once BCE was in play, the overriding duty of the Board was to maximize the value for the shareholders, while complying with their obligations under the Trust Indentures. Moreover, the SOC was advised that the interests of the appellants were limited to their rights under the Trust Indentures and no more. The transaction was structured to avoid dealing with them or their interests. Therefore, the SOC did not take into consideration the adverse financial impact of the potential transaction on the debentureholders. No detailed analysis was made of the costs and benefits of the LBO insofar as it affects the securityholders other than the shareholders. From that point on, the process was fatally vitiated. This is in contrast with what occurred *Re Canadian Pacific Ltd. (1996)*, a case where a cost benefit analysis regarding all affected securityholders was made.[63]

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61 Judgment on the Motion for Final Order at para. 134.

62 Judgment on the Motion for Final Order at para. 147.

63 [1996] O.J. No. 2412 (Ont. Ct. (Gen. Div.)), aff'd [1998] O.J. No. 3699 (Ont. C.A.). In this case, the Ontario Court of Appeal stated:

> [6] The third argument was that what was offered to the U.S. C.D.S. holders was not fair and reasonable when compared with what was available to other security holders. The judge below made a detailed analysis of the costs and benefits of the arrangement insofar as it applied to holders of various securities, including the U.S. C.D.S. holders. We agree with his approach and with his conclusion that, in all of the circumstances, the

[99] It is clear from the principles enunciated by the Supreme Court in *Peoples* that at no time do the directors have an overriding duty to act only in the best interests of the shareholders and to ignore the adverse effect on the interests of the debentureholders.

[100] In *Peoples*, the Supreme Court stated that "'the best interests of the corporation' should be read not simply as the 'best interests of the shareholders'"[64] and enunciated:

> [43] The various shifts in interests that naturally occur as a corporation's fortunes rise and fall do not, however, affect the content of the fiduciary duty under s. 122(1)(*a*) of the CBCA. At all times, directors and officers owe their fiduciary obligation to the corporation. The interests of the corporation are not to be confused with the interests of the creditors or those of any other stakeholders.[65]

[101] In a recently published book entitled "Les devoirs des administrateurs lors d'une prise de contrôle, étude comparative du droit du Delaware et du droit canadien", the authors Stéphane Rousseau and Patrick Desalliers write at paragraphs 342 to 349:

> 342. La position adoptée par la Cour suprême dans l'arrêt *Peoples* remet en question l'application des devoirs *Revlon* au Canada. En effet, les devoirs *Revlon* sont difficiles à réconcilier avec l'opinion de la Cour selon laquelle les administrateurs doivent agir de manière à maximiser la valeur de la société, concept ne se limitant pas à maximiser la valeur pour les actionnaires. De plus, la Cour a souligné que les administrateurs devaient éviter de favoriser les intérêts de parties prenantes en particulier, incluant ceux des actionnaires.
>
> 343. À la lumière de l'arrêt *Magasins à rayons Peoples Inc.*, il devient possible de faire valoir que les administrateurs ont l'obligation d'évaluer l'offre et d'y répondre en cherchant à maximiser la valeur de l'entreprise, plutôt que la valeur du prix offert aux actionnaires à court terme. Pour ce faire, ils pourraient considérer les intérêts des autres parties intéressées et ne pas se limiter au seul prix offert pour les titres. En bout de ligne, les administrateurs auraient la possibilité de retenir l'offre qui, sans être celle qui propose le prix le plus élevé pour les titres des actionnaires, maximise la valeur de l'entreprise en tenant compte des intérêts des autres parties prenantes. De même, les administrateurs pourraient mettre en place une mesure défensive de type *Just Say No* empêchant une prise de contrôle ne maximisant pas la valeur de la société.
>
> 344. Un regard du côté du droit américain permet de constater que cette interprétation ne sera pas dénuée de fondement. L'intérêt du droit américain réside dans les lois sur les parties prenantes (*Constituency Statutes*) adoptées durant les années 1980 par environ une trentaine d'États américains, mis à part

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proposed arrangement was fair and reasonable to all parties, including the U.S. C.D.S. holders.

64 *Peoples*, *supra* note 38 at para. 42.

65 *Ibid.* at para. 43.

le Delaware. Ces lois particulières ont modifié la législation sur les sociétés pour reconnaître le pouvoir des administrateurs de considérer les intérêts des autres parties prenantes lors de la prise de décision. À titre d'exemple, depuis l'adoption d'une telle législation, la loi sur les sociétés de la Pennsylvanie édicte que :

> § 1715. Exercise of powers generally
>
> (a) General rule. – In discharging the duties of their respective positions, the board of directors, committees of the board and individual directors of a business corporation may, in considering the best interests of the corporation, consider to the extent they deem appropriate:
>
> (1) The effects of any action upon any or all groups affected by such action, including shareholders, employees, suppliers, customers and creditors of the corporation, and upon communities in which offices or other establishments of the corporation are located.
>
> (2) The short-term and long-term interests of the corporation, including benefits that may accrue to the corporation from its long-term plans and the possibility that these interests may be best served by the continued independence of the corporation.
>
> (3) The resources, intent and conduct (past, stated and potential) of any person seeking to acquire control of the corporation.
>
> (4) All other pertinent factors.

345. Comme nous pouvons le remarquer, il y a une grande similitude entre cette disposition et la position de la Cour suprême du Canada dans *Magasins à rayons Peoples Inc*. De fait, on serait tenté de considérer que la Cour a créé par voie jurisprudentielle une situation similaire à celle qui prévaut dans le droit des sociétés de la Pennsylvanie.

346. Encore plus intéressant, la législation de la Pennsylvanie prévoit en outre que :

> (b) Consideration of interest and factors. – The board of directors, committees of the board and individual directors shall not be required, in considering the best interests of the corporation or the effects of any action, to regard any corporate interest or the interests of any particular group affected by such action as a dominant or controlling interest or factor […]

> Ici encore, l'arrêt *Peoples* fait écho à cette disposition lorsque la Cour souligne que les administrateurs ne doivent pas donner prépondérance aux intérêts d'une partie prenante.
>
> 347. L'intérêt de cette comparaison entre la législation américaine et l'arrêt Peoples réside dans l'impact de ces lois particulières sur l'applicabilité des devoirs *Revlon*. Selon la majorité des commentateurs, la modification de la législation sur les sociétés a eu pour effet d'empêcher à toutes fins pratiques l'application des devoirs *Revlon* dans les États concernés. C'est ce que soulignait le professeur Orts :
>
> > Under constituency statutes, there is no magical time in control contests when directors must switch to an exclusive, unidimensional goal of "maximization of shareholder profit" and must jettison "considerations" of other corporate interests. The statutes recommend instead that decision making for complex modern business corporations must not degenerate, especially in corporate control situations, into "a simple mathematical exercise." Just as deciding important issues of corporate control should not be reduced to simplistic auctions, courts should restrict review of "lock-ups" and other defensive measures to assuring rational, informed, and considered business judgment, which may include considering interests beyond those of shareholders.
>
> 348. Les rares décisions où les tribunaux se sont penchés sur cette question supportent l'opinion des commentateurs. [...]
>
> 349. Les opinions jurisprudentielles et doctrinales américaines supportent donc la thèse selon laquelle les devoirs *Revlon* sont difficiles à réconcilier avec l'interprétation du devoir de loyauté proposée par la Cour suprême dans *Magasins à rayons Peoples Inc*. Lorsqu'un changement de contrôle est imminent, les administrateurs doivent agir de manière à maximiser la valeur de la société, sans favoriser une partie prenante (les actionnaires) en particulier. Selon cette interprétation, il n'y aurait donc plus de transformation de l'objectif guidant les administrateurs dans un contexte de changement de contrôle.[66]
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> [Emphasis added]

[102] The Court agrees with this analysis and concludes that the premise advanced by BCE that, once the corporation was in play, the Board could only consider ways to maximize the value for the shareholders, is erroneous. From a reading of all the

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[66] Stéphane Rousseau & Patrick Desalliers, *Les devoirs des administrateurs lors d'une prise de contrôle : une étude comparative du droit du Delaware et du droit canadien* (Montréal: Éditions Thémis, 2007) at 195-199.

judgments under appeal, it appears that the trial judge accepted this premise. By so doing, the trial judge erred and conducted his assessment of the conduct of the SOC and the Board and the fairness of the Plan from an erroneous perspective.

[103] Besides looking to the contractual rights flowing from the Trust Indentures, the Board should have considered the interests (including reasonable expectations) of the debentureholders.

[104] Even if the Board did not consider the aspect of reasonable expectations, the trial judge concluded that the debentureholders could have no reasonable expectation that there would be no LBO, which necessarily involves an additional debt for the corporation.

[105] The complaint of the appellants, however, is not that an LBO was not to be envisioned by the Board but rather that in structuring the guidelines for the offers from prospective purchasers and in negotiating the terms of the LBO, the Board gave no consideration to their interests, in particular the adverse situation in which the contemplated LBO would place them. The value of the debentures they were holding would diminish in market value by about 18%, the assets of the corporation which covered their loans would be burdened by an additional debt of approximately $30 billion, a very substantial increase. This in turn leads to a greater risk of default on their loans and results in the debentures losing the investment-grade status.

[106] The interests of the debentureholders, which are wider than their contractual legal rights flowing from the Trust Indentures, should have been considered by the Board. Having regard to the finding of fact that the Plan adversely affected the interests of a class of securityholder (debentureholders), it was incumbent on the Board to look at their interests with a view to examining whether it was possible to alleviate or attenuate all or some of the adverse effects. Could this have been accomplished? The answer is unknown, because the Board did not examine the issue. They operated on the principle expressed in *Revlon v. MAC Andrew & Orbes Holdings Inc.*[67] This, indeed was the finding of fact by the trial judge:

> In the present case, relying on the principles described by the Supreme Court of Delaware in Revlon, the Board determined that they had an overriding duty to maximize shareholder value and obtain the highest value for the shareholders, while respecting the contractual obligations of the corporation and its subsidiaries.[68]

[107] This approach by the Board was mistaken. In Canada, the directors of a corporation have a more extensive duty. This more extensive duty embodied in the statutory duty of care encompasses, depending on the circumstances of the case,

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[67] 506 A. 2d 173 (Del. Sup. Ct. 1986) [*Revlon*].
[68] Judgment on the 76/96 Oppression Judgment at para. 132.

giving consideration to the interests of all stakeholders, which, in this case includes the debentureholders. They must have regard, *inter alia*, to the reasonable expectations of the debentureholders, and those may be more extensive than merely respecting their contractual legal rights.

[108] Notwithstanding the fact that the Board and the SOC acted in good faith, the process was flawed. It follows that the Board's decisions are no longer entitled to the deference otherwise due in virtue of the business judgment rule.[69]

[109] Could the Court conclude nevertheless that the Plan is fair and reasonable, given all the circumstances? The answer could be affirmative, provided that the applicant at the hearing so proves. Since the trial judge did not assess the issue according to the applicable principles as enunciated in *Peoples*, his erroneous approach could not lead to a proper evaluation of the fairness and reasonableness of the Plan. In the circumstances, deference is not due to the evaluation of the trial judge, and the Court must perform its own assessment.

E. BCE DID NOT DISCHARGE ITS BURDEN OF PROVING THAT THE PLAN IS FAIR AND REASONABLE

[110] The trial judge acknowledged the existence of what the Court considers a significant negative impact on the debentureholders when he wrote "based on prevailing market prices during the hearing on the merits of these proceedings, they will see the value of their debentures decline by an average of some 18%",[70] and "that the implementation of the Plan of Arrangement and Definitive Agreement will no doubt expose the Contesting Debentureholders to an increased risk of default."[71]

[111] BCE never attempted to justify the fairness and reasonableness of an arrangement that results in a significant adverse economic impact on the debentureholders while at the same time it accords a substantial premium to the shareholders. Once there is, as in this case, a significant adverse effect on a class of securityholder (debentureholders), while other securityholders (shareholders) derive

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69 Recently, in *Ford Motor Co. of Canada v. Ontario Municipal Employees Retirement Board*, [2006] O.J. No. 27 (Ont. C.A.), leave to appeal to S.C.C. refused, [2006] 2 S.C.R. x, the Ontario Court of Appeal concluded that once the trial judge had found that the board did not act on reasonable grounds, there was an insufficient understanding of the transfer pricing system and its impact on the company, the board "was disentitled to the deference ordinarily accorded by the operation of the business judgment rule". In the present instance, clearly the SOC and the directors acted upon incorrect legal principles.

70 See the judgment on the 76/96 Oppression Remedy at para. 204 to which the trial judge referred at para. 162 of the judgment on the Motion for Final Order.

71 Judgment on the 76/96 Oppression Remedy at para. 184.

substantial benefits by an arrangement, the corporation has the burden of demonstrating that the arrangement is, nonetheless, fair and reasonable.[72]

[112] When one attempts to define what is a fair and reasonable arrangement, it may be useful to refer to what was said more than 100 years ago, by Bowen L.J. of the English Court of Appeal, in *Re Alabama, New Orleans, Texas & Pacific Junction Railway Co.*:[73]

> [E]verybody will agree that a compromise or agreement which has to be sanctioned by the Court must be reasonable, and that no arrangement or compromise can be said to be reasonable in which you can get nothing and give up everything. A reasonable compromise must be a compromise which can, by reasonable people conversant with the subject, be regarded as beneficial to those on both sides who are making it. 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.[74]

[113] What are the relevant circumstances that a reasonable business person would consider here? Among those of particular importance are the following:

(i) The debentureholders had a reasonable expectation that the Board would set up an independent process that would examine the impact on them of any potential transaction;

(ii) An LBO was a reasonable business option to be considered by the SOC and the Board;

(iii) A feature of the LBO was the addition of approximately $30 billion of additional debt;

(iv) An LBO was likely to cause a significant downgrade in the credit ratings of the debentures;

(v) Pursuant to numerous representations from BCE, debentureholders had a reasonable expectation that the Board would have concern for their particular interests in the investment-grade quality of these ratings;

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[72] In *Re Canadian Pacific Ltd. (1990)*, *supra* note 46, *Calpine*, *supra* note 39, *Palmer v. Carling O'Keefe Breweries of Canada Ltd.*, [1989] O.J. No. 32 (Ont. H.C.J.), it was found that it was unfair to a class of securityholders to expose them to an increased vulnerability as a result of a plan of arrangement for the sole benefit of another group of securityholders.

[73] [1891] 1 Ch. 213 (C.A.).

[74] *Ibid.* at 243.

(vi) The price that the Purchaser was ready to pay, $42.75 per share, was in the upper range of fairness viewed from a shareholder standpoint, as demonstrated by the fairness opinions received by the SOC.

[114] It is noteworthy that in this case the debentureholders took the initiative of offering to discuss with the Board a number of ideas expressed, for example, in a letter dated April 27, 2007, in the following terms:

> To that end, we have a number of ideas on how a fair and equitable treatment of bondholders could be affected without jeopardizing some of the value enhancing alternatives being contemplated. We would be pleased to discuss these ideas with you at your convenience.[75]

[115] This letter and other like approaches were summarily refused. Having regard to the offers by the debentureholders to consider their ideas on how it might be possible to structure a transaction that could in some way attenuate the adverse effects on them, the burden was clearly on BCE to prove that, without giving consideration to this request, the arrangement was nevertheless fair and reasonable.

[116] The circumstances in this case contrast with those in *Re Canadian Pacific Ltd. (1996)*,[76] where, after consultation, various conversion options were added to the debentures and a major bank provided a letter of credit to secure the payment of interest and capital. As a result, debentures' ratings were restored, and even improved.

[117] It may be that there is no way that an arrangement could have been structured to provide a satisfactory price for the shares, while avoiding an adverse effect on the debentureholders. However the burden was on BCE to make that proof. It failed to do so. If it was possible to structure an arrangement so that a satisfactory price could be obtained for the shares, while attenuating the adverse effect to the debentureholders, then the Board had a duty to examine it.

[118] The failure of BCE to present evidence on this issue precludes the Court from determining whether or not it is possible. BCE must bear the consequence of its failure to attempt to discharge this burden.

[119] The Court invited counsel at the hearing, in the event that it reached the conclusion that the Plan is not fair and reasonable, how it could be amended to achieve that objective. Appellants and respondents submitted that the arrangement was either to be approved or not, and that the Court should not envision any amendment.

[120] Accordingly, the appeals should be allowed and BCE's Motion for Final Order must be dismissed.

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[75] *Supra* para. 20.
[76] *Supra* note 63.

[121] There are likely no absolutes in considering the interests of the various securityholders in the event of an LBO.

[122] The Board's effort to obtain the best value reasonably available to the shareholders[77] cannot be considered in isolation from other factors, such as proper consideration for the interests of debentureholders. Similarly, the elimination of adverse effects on debentureholders cannot be examined in isolation from the proper consideration of the interests of the shareholders. As between obtaining the highest price for the shareholders and the elimination of all adverse effects on the debentureholders it might be possible, through accommodation or compromise, to reach a solution that is fair and reasonable; one that is in the best interests of the corporation and that gives proper consideration to the interests of the shareholders and the debentureholders, taking into account all the circumstances, including the relative weight of their interests.

[123] The interests of the various securityholders are not necessarily of the same weight. It is likely that the weight of the interests of the shareholders, in the event of an LBO, is appreciably higher than the weight of the interests of the debentureholders. In other words, if there are benefits flowing from the contemplated arrangement, the Court does not state that all the securityholders are *a priori* on an equal footing, and that the advantages have to be equally distributed. It is up to the Board to consider the relative weight and importance of the various interests and in its best business judgment to structure an arrangement that takes into account, and to the extent reasonably possible, satisfies the interests of the various securityholders.

FOR THESE REASONS, THE COURT:

[124] **ALLOWS** the appeal, with costs to the appellants;

[125] **SETS ASIDE** the judgment of the Superior Court dated March 7, 2008;

[126] **DISMISSES** the *Motion for Final Order*;

[127] **RETURNS** the file to the Superior Court for the determination of the costs in the Superior Court, in accordance with the agreement of the parties.

[77] See *Maple Leaf Foods Inc. v. Schneider Corporation*, [1998] O.J. No. 4142 (Ont. C.A.).

J.J. MICHEL ROBERT, C.J.Q.

LOUISE OTIS, J.A.

JOSEPH R. NUSS, J.A.

FRANÇOIS PELLETIER, J.A.

PIERRE J. DALPHOND, J.A.

Mtre Avram Fishman
Mtre Mark E. Meland
Mtre Fabrice Benoit
Mtre Suzanne Villeneuve
Mtre Genevieve Cloutier
Mtre Jason Dolman
Mtre Ponora Ang
FISHMAN, FLANZ, MELAND, PAQUIN, L.L.P.
And
Mtre John L. Finnigan
Mtre John T porter
Mtre Ray Thapar
Mtre Seema Aggarwal
Mtre Kim Ferreira
THORNTON, GROUT, FINNIGAN L.L.P. (Toronto)
For the appellants 1976/1996 Debentureholders

Mtre Robert Tessier
Mtre Ronald M. Auclair
MILLER, THOMSON, POULIOT L.L.P.
For CIBC Mellon Trust Company and Computershare Trust Company of Canada

Mtre Guy Du Pont
Mtre William Brock
Mtre Kent E. Thomson
Mtre James Doris
Mtre Louis-Martin O'Neill
Mtre Nick Rodrigo
DAVIES, WARD, PHILLIPS & VINEBERG L.L.P.
For Bell Canada and BCE Inc.

Mtre James A. Woods
Mtre Christopher L. Richter
Mtre François Touchette
Mtre Bogdan Catanu
Mtre Sarah Woods
WOODS L.L.P.
and
Mtre Benjamin Zarnett
Mtre Jessica A. Kimmel
GOODMANS L.L.P. (Toronto)
For 6796508 Canada Inc.

Mtre Markus Koehnen
Mtre Max Mendelsohn
Mtre Emmanuelle Saucier
Mtre Erin Cowling
McMILLAN, BINCH, MENDELSOHN L.L.P.
For the appellants 1997 Debentureholders

Dates of hearing: April 28, 29, 30 and May 1, 2008

COURT FILE NO.: 00-CL-4001
DATE: 20020822

ONTARIO
SUPERIOR COURT OF JUSTICE
(Commercial List)

B E T W E E N:	
CASURINA LIMITED PARTNERSHIP, FIRST WAVE INC. and JMM TRADING LLP Applicants	*Robert W. Staley & Robin Ryan Bell,* for the Applicants
- and -	
RIO ALGOM LIMITED, JAMES THOMPSON BLACK, WILLIAM ELWOOD BRADFORD, DEREK H. BURNEY, JOHN ARTHUR H. BUSH, GORDON CECIL GRAY, FAROKH SHAFIZADEH HAKIMI, PATRICK MICHAEL JAMES, DAVID S.R. LEIGHTON, JOHN WILLIAM LILL, WILLIAM ATWOOD MACDONALD, JAMES EDWARD NEWALL, JAMES E. PERRELLA, ROSS J. TURNER, JAMES D. WALLACE, MICHAEL H. WILSON, BILLITON PLC, DAVID CHARLES BRINK, MICHAEL LAWRENCE DAVIS, BRIAN PATRICK GILBERTSON, CORNELIUS ANTONIUS JOHANNES HERKSTROTER, JOHN BERNARD HAYSOM JACKSON, STEVE BOGDAN KESLER, DEREK LYLE KEYS, DAVID JOHN CHARLES MUNRO, ROBIN WILLIAM RENWICK, BARRY DAVID ROMERIL, MIKLOS SALAMON, MATTHYS HENDRIK VISSER and BILLITON COPPER HOLDINGS INC. Respondents	*Peter L. Roy & David F. O'Connor* for the Respondents, Rio Algom Limited, James Thompson Black, William Elwood Bradford, Derek H. Burney, John Arthur H. Bush, Gordon Cecil Gray, Farokh Shafizadeh Hakimi, Patrick Michael James, David S.R. Leighton, John William Lill, William Atwood MacDonald, James Edward Newall, James E. Perrella, Ross J. Turner, James D. Wallace and Michael H. Wilson *Joel Richler & Jeffrey W. Galway,* for the Respondents, Billiton PLC, David Charles Brink, Michael Lawrence Davis, Brian Patrick Gilbertson, Cornelius Antonius Johannes Herkstroter, John Bernard Haysom Jackson, Steve Bogdan Kesler, Derek Lyle Keys, David John Charles Munro, Robin William Renwick, Barry David Romeril, Miklos Salamon, Matthys Hendrik Visser and Billiton Copper Holdings Inc. **Heard: March 11 to 13 and May 29 to 31, 2002**

SPENCE J.

The Application: Overview

[1] The applicants are holders of 5.5% convertible unsecured debentures of Rio Algom Limited ("Rio Algom"). They seek an order for relief under the oppression remedy provisions of the *Ontario Business Corporations Act* ("OBCA") on the basis that their interests were unfairly disregarded in the course of the events referred to below relating to the takeover of Rio Algom in 2000 by Billiton plc ("Billiton"). They request an order that their Debentures are to be redeemed or repurchased by Billiton at a price of $125% of par.

[2] On August 24, 2000, Billiton made a take-over bid for 100% of the common shares of Rio Algom. The bid price of $27 per share represented a 49% premium to the pre-bid closing price of $18.10 per share. The bid was successful. The Debentures were outstanding the time the bid was made and completed.

[3] The Debentures provide that they may, at the option of the holder, be converted into common shares of Rio Algom. The shares were listed on the Toronto Stock Exchange ("TSE"). The Trust Indenture for the Debentures provided that Rio Algom was to keep the shares listed on the TSE.

[4] In planning to acquire Rio Algom, Billiton and its legal and financial advisors identified the Debentures and the rights of Debentureholders as a matter to be addressed as part of a successful bid.

[5] The applicants claim that Billiton adopted an approach designed to acquire the Debentures at a discount to par or at par and that the key element in this approach was a conscious, deliberate and self- induced breach of the listing promise

[6] The de-listing of the common shares was the natural consequence of a successful bid by Billiton for 100% of Rio Algom's common shares. The applicants say that Rio Algom and its directors induced Billiton to make a bid that would, if successful, result in the de-listing of Rio Algom's common shares contrary to the expectations of Debentureholders, and would defeat the conversion option attaching to the Debentures.

[7] The applicants say that in negotiating with Billiton and in inducing its bid, Rio Algom and its directors had regard only for the interests of shareholders and not for the interests of Debentureholders, which were forgotten or ignored.

[8] The applicants say that after Billiton acquired approximately 95% of Rio Algom's common shares (and with that control of Rio Algom), Billiton sought to coerce Debentureholders to agree to immediate redemption of the Debentures at par by threatening to create an "event of default" under the Trust Indenture for the Debentures by de-listing the common shares. The

applicants and various other Debentureholders did not sell to Billiton. Billiton proceeded to acquire the balance of Rio Algom's common shares. The shares were thereafter de-listed.

[9] At the outset of the hearing the respondents moved for a trial of the issues, which the applicants opposed. As set out below the issues that are to be determined on this application do not require a trial for their determination so the motion is not granted.

[10] These reasons for decision start, in Part I, with the factual background and matters relating to the applicants' submissions as to the proper application of the oppression remedy and related issues. Part II deals with the analysis of the issues.

[11] Ultimately, the decision turns on the proper interpretation of the relevant provisions of the Trust Indentures.

Part I

The Factual Background

The Parties

[12] Casurina Limited Partnership ("Casurina") is an Ontario limited partnership. First Wave Inc. ("First Wave") is an investment company incorporated under the laws of the Cayman Islands. JMM Trading LLP ("JMM") is an Ontario limited liability partnership.

[13] Casurina holds Debentures with a face value of (Cdn.) $24.221 million purchased at an average cost of $96.578 per $100. Casurina first began purchasing Debentures on August 5, 1999. First Wave holds Debentures with a face value of (Cdn.) $1 million, purchased at a cost of $96.125. First Wave purchased the Debentures on August 29, 2000. JMM holds Debentures with a face value of (Cdn.) $9.679 million, purchased at an average cost of $100.73. A predecessor of JMM first began purchasing Debentures on March 23, 2000.

[14] Rio Algom is a corporation incorporated under the *Business Corporations Act* (Ontario) (the "*OBCA*"). Rio Algom's head office is located in Toronto.

[15] Billiton is a corporation incorporated pursuant to *The Companies Act* 1985 (U.K.). Billiton's head office is located in London, England. Billiton is regarded as one of the world's major metals and mining groups. After this application was commenced, Billiton merged with Australian mining giant Broken Hill Properties Co. Ltd. and now carries on business under the name "BHP Billiton".

[16] Billiton Copper Holdings Inc. ("Holdings") is an *OBCA* corporation. Holdings is a wholly-owned subsidiary of Billiton and is the vehicle through which Billiton made its takeover bid for Rio Algom. Holdings' head office is located in Toronto.

[17] The respondents James Black, William Bradford, Derek Burney, Gordon Gray, Patrick James, David Leighton, William MacDonald, James Newall, James Perrella, Ross Turner, James Wallace and Michael Wilson at all material times were directors of Rio Algom.

[18] The respondents David Brink, Michael Davis, Brian Gilbertson, Cornelius Herkstroter, John Jackson, Steve Kesler, Derek Keys, David Munro, Robin Renwick, Barry Romeril, Miklos Salamon and Matthys Visser at all material times were directors of Billiton. The respondents Gilbertson and Davis joined the board of directors of Rio Algom on October 25, 2000 as Billiton nominees.

[19] Rio Algom is a reporting issuer in all the provinces and territories of Canada. Effective November 29, 2000, Rio Algom's common shares were de-listed from trading on the TSE and the New York Stock Exchange (the "NYSE"). The Debentures continue to be listed for trading on the TSE.

The 1997 Convertible Debenture Offering

[20] Rio Algom issued the Debentures pursuant to a Prospectus dated January 24, 1997 (the "Prospectus"). Rio Algom issued units consisting of 25 common shares and a Debenture in the principal amount of $2,000. Rio Algom raised $500,061,000 from the financing, of which $353,400,000 was attributable to the Debentures. The Debentures are the third largest component of "Shareholders' equity" on Rio Algom's balance sheet. The Debentures were issued for a ten-year term (maturing February 1, 2007) and are convertible into common shares of Rio Algom.

[21] With a convertible debenture, the holder typically accepts an interest rate below the interest rate that would be expected to be payable on a debt instrument without the conversion feature. Instead, holders obtain the prospect that the trading price of the common shares will exceed the conversion price prior to the date on which the debentures can be redeemed by the issuer. Where the trading price exceeds the conversion price, the holder can convert the debentures into freely trading common shares that can be sold at a profit.

Material Terms of the Prospectus and Trust Indenture

[22] As contemplated by the Prospectus, Rio Algom entered into a trust indenture dated as of February 4, 1997 (the "Trust Indenture"). The Trust Indenture provided for certain rights and

privileges attaching to the Debentures, as described in the Prospectus. Some of the material terms of the Prospectus and Trust Indenture are described below.

a) Right of Holders to Convert into Listed Common Shares of Rio Algom

[23] According to the Prospectus and Trust Indenture, so long as the Debentures are outstanding, they are to be convertible at the option of Debentureholders into common shares of Rio Algom at a conversion price of $40 per common share (or 25 common shares for each $1,000 principal value of Debentures). The conversion right is first described on the cover page of the Prospectus, highlighted in a rectangular box.

[24] Immediately below this box potential investors are told that the "outstanding Common Shares are traded on The Toronto Stock Exchange, the Montreal Exchange and the American Stock Exchange." This information is repeated on page 20 of the Prospectus.

[25] Article 6.1 of the Trust Indenture contains general covenants of Rio Algom. These include a covenant that Rio Algom's common shares are to be listed on the TSE or another nationally recognized Canadian stock exchange. Article 6.1(e) reads:

> "6.1 General Covenants
>
> The Corporation covenants with the Trustee for the benefit of the Trustee and the Debentureholders as follows:
>
> (e) the Corporation will do or cause to be done all things necessary to ensure that so long as any Debenture is outstanding:
>
> (i) the Corporation maintains its status as a reporting issuer, under the laws of the provinces of Canada which have such a concept, and that it is not in default of any of the requirements of the securities legislation of any province which would adversely affect the ability of the Corporation to issue, or the Debentureholders to freely trade, the common shares received on conversion of the Debentures; and
>
> (ii) all the Debentures, and all the Common Shares issued in the manner mentioned herein and in the Debentures, are listed or will be listed at the time of issue on The Toronto Stock Exchange or on another nationally recognized stock exchange in Canada."

[26] At page four of the Prospectus, the conversion right is described again:

[27] The conversion right is described again at page 16 of the Prospectus.

[28] Article 4 of the Trust Indenture provides for the conversion right. Article 4.1 of the Trust Indenture provides:

> "4.1 Conversion Privilege
>
> Subject to and upon compliance with the provisions of this Article 4, the Holder of each Debenture shall have the right, at his option, at any time prior to the close of business on the Business Day immediately preceding February 1, 2007, or if such Debenture shall have been called for redemption prior to such date, then up to, but not after, the close of business on the last Business Day immediately preceding the date fixed for redemption (such time and date being referred to as the "Time of Expiry") to convert such Debenture or any portion of the principal amount thereof which is $1,000 or an integral multiple of $1,000 into fully paid and non-assessable Common Shares at the Conversion Price then in effect.
>
> The Conversion Price in effect on the date hereof is $40.00 for each Common Share to be issued upon the conversion of the Debentures, being a conversion rate of 25 Common Shares for each of $1,000 principal amount of Debentures."

b) Limitations on Redemption by Rio Algom

[29] The Prospectus and Trust Indenture set out limitations on Rio Algom's right to redeem the Debentures. This limitation is first described on the front cover of the Prospectus:

> "The Debentures will not be redeemable prior to February 1, 2000. On or after that date and prior to February 1, 2002, the Debentures will be redeemable at $2,000 per $2,000 principal amount thereof plus accrued and unpaid interest, provided that the weighted average trading price of the Common Shares on The Toronto Stock Exchange during the 20 consecutive trading days ending five trading days preceding the date on which the notice of redemption is given is not less than 125% of the conversion price referred to below. On and after February 1, 2002, the Debentures will be redeemable at $2,000 per $2,000 principal amount thereof, plus accrued and unpaid interest."

[30] The limitation on the right to redeem is described again at page 5 and page 17 of the Prospectus.

[31] Article 3 of the Trust Indenture provides for Rio Algom's right to redeem the Debentures and the limitation on that right. Sections 3.1 and 3.2 of the Trust Indenture provide:

> "3.1 Redemption of Debentures
>
> Subject to the provisions of section 3.2, the Debentures shall be redeemable prior to maturity in whole at any time or in part from time to time, at the option of the Corporation (in the manner hereinafter provided and in accordance with and subject to the provisions hereinafter set forth) at a price equal to the principal amount of the Debentures so redeemed, together with accrued and unpaid interest on such principal amount to, but excluding, the date fixed for redemption (such price, including accrued and unpaid interest, at which Debentures may be redeemed being hereinafter referred to as the "Redemption Price").
>
> 3.2 Limitation on Redemption
>
> The Debentures shall not be redeemable prior to February 1, 2000. On and after February 1, 2000 and prior to February 1, 2002, the Debentures shall not be redeemable unless the Corporation shall have filed with the Trustee, on the day that notice of redemption of such Debentures is first given pursuant to section 3.4, a Certificate of the Corporation certifying that the Current Market Price of the Common Shares on the date on which such notice of redemption is first given is not less than 125% of the Conversion Price in effect on the date of filing such Certificate of Corporation."

[32] In summary, the Prospectus and the Trust Indenture represented that there would be restriction on Rio Algom's ability to redeem the Debentures prior to maturity, depending on the date and trading price of Rio Algom's common shares:

(a) the Debentures are not redeemable prior to February 1, 2000;

(b) between February 1, 2000 and January 31, 2002, the Debentures are redeemable at par only if the average trading price of the common shares of Rio Algom is equal to 125% of the conversion price; and

(c) on or after February 1, 2002, the Debentures are redeemable at par regardless of the trading price of the common shares.

c) Rights of Holders Must be Preserved Upon Merger or Acquisition

[33] Section 9.1 of the Trust Indenture prohibited Rio Algom from entering into a merger or similar transaction unless conditions were satisfied for the protection of Debentureholders:

> "9.1 Certain Requirements in Respect of Merger, etc.
>
> The Corporation shall not enter into any transaction, whether by way of amalgamation (except a vertical short-form amalgamation with one or more of its wholly-owned subsidiaries), merger, reconstruction, reorganization, consolidation, transfer, sale, lease or otherwise, whereby all or substantially all of its undertaking, property and assets would become the property of any other Person or, in the case of any such amalgamation, of the continuing corporation resulting therefrom, but may do so if:
>
> (a) such other Person or continuing corporation is a corporation (the "Successor Corporation") incorporated under the laws of Canada or any province thereof;
>
> (b) the Successor Corporation shall execute, prior to or contemporaneously with the completion of such transaction, such indenture supplemental hereto and other instruments (if any) as in the opinion of Counsel are necessary or advisable to evidence the assumption by the Successor Corporation of the liability for the due and punctual payment of all the Debentures and the interest thereon and all other moneys payable hereunder and the covenant of such Successor Corporation to pay the same and its agreement to observe and perform all the covenants and obligations of the Corporation under this Indenture;
>
> (c) such transaction shall, to the satisfaction of the Trustee and in the opinion of Counsel, be upon such terms as substantially to preserve and not to impair any of the rights or powers of the Trustees or of the Debentureholders hereunder; and

> (d) no condition or event shall exist in respect of the Corporation or the Successor Corporation, either at the time of such transaction or immediately thereafter after giving full effect thereto, which constitutes or would, after the giving of notice or the lapse of time or both, constitute an Event of Default hereunder;
>
> provided, however, that the requirements of this section 9.1 shall not apply to, need not be complied with in respect of, and shall not prevent, any sale, lease or exchange of all or substantially all the property of the Corporation in the ordinary course of its business."

[34] Accordingly, Rio Algom was prohibited from entering into a merger or acquisition transaction of the kind described in the section unless the rights of Debentureholders, including the conversion right, were substantially preserved and not impaired. The section does not apply to an acquisition of all the common shares of Rio Algom, as was effected in the present case.

d) Events of Default

[35] Article 7 of the Trust Indenture defines "Events of Default" and provides for the consequences of default. "Events of Default" are defined in section 7.1(c) to include the failure to observe covenants or conditions in the Trust Indenture:

> "7.1 Events of Default
>
> Each of the following events is hereinafter sometimes referred to as an "Event of Default":
>
> …
>
> if the Corporation makes default in observing or performing any other covenant or condition of this Indenture on its part to be observed or performed and if such default continues for a period of 60 days after notice in writing has been given to the Corporation by the Trustee specifying such default and requiring the Corporation to rectify the same, unless the Trustee (having regard to the subject matter of the default) shall have agreed to a longer period and, in such event, for the period agreed to by the Trustee."

[36] Section 7.3 of the Trust Indenture provides for the acceleration of principal and any outstanding interest upon the happening of an Event of Default:

> "7.3 Acceleration on Default
>
> If any Event of Default has occurred and is continuing, the Trustee may in its discretion, and shall upon receipt of a Debentureholders'

> Request (but subject to sufficient funds and/or indemnity having been provided in accordance with subsection 12.3(2)), subject to section 7.4, by notice in writing to the Corporation declare the principal of and interest on the Debentures then outstanding and any other moneys payable hereunder to be due and payable and the same shall forthwith become immediately due and payable to the Trustee, notwithstanding anything contained therein or herein to the contrary, and the Corporation shall pay forthwith to the Trustee for the benefit of the Debentureholders the principal of and accrued and unpaid interest (including interest on amounts in default) on such Debentures and all other moneys payable hereunder, together with subsequent interest thereon at the rate borne by the Debentures from the date of such declaration until payment is received by the Trustee. Such payment when made shall be deemed to have been made in discharge of the Corporation's obligations hereunder and any moneys so received by the Trustee shall be applied as provided in section 7.7."

The Course Of Events Prior To The Billiton Bid

[37] Billiton's interest in acquiring Rio Algom dates back at least to December 1997. Billiton has been advised throughout by Blake, Cassels & Graydon ("Blakes") and by BMO Nesbitt Burns ("Nesbitt Burns"). Each provided Billiton with detailed advice about the rights of Debentureholders and advice about schemes to defeat those rights.

[38] From the very beginning, Billiton's advisors identified the Debentures as a material issue to be addressed in making a takeover bid. From the very beginning, Billiton received detailed advice concerning the rights attaching to the Debentures.

[39] The basic options identified in the advice received from Blakes and Nesbitt Burns were:

a) make a cash bid for the Debentures concurrently with a takeover bid;

b) solicit an amendment to the Trust Indenture to remove the conversion feature in exchange for valuable consideration;

c) solicit the agreement of Debentureholders to exchange the Debentures for another security;

d) solicit an amendment to the Trust Indenture to provide for immediate redemption of the Debentures;

e) enter into a merger or arrangement with Rio Algom that complies with section 9.1 of the Trust Indenture and that preserves the rights of Debentureholders, including the conversion right; and

f) take up and pay for Rio Algom's common shares and de-list the common shares without an agreement with Debentureholders.

[40] In March, 2000 Billiton approached Rio Algom to discuss a possible friendly acquisition. When no agreement was reached, senior officers of Rio Algom anticipated that Billiton might make a hostile bid.

[41] Starting in April, Noranda Inc. ("Noranda") issued press releases announcing purchases of Rio Algom common shares, what one Rio Algom witness described as a "creeping takeover". In an effort to find an alternative to a hostile bid from Noranda, in July 2000 Rio Algom approached Billiton with a view to a friendly acquisition.

[42] By early August 2000, Billiton and Rio Algom were negotiating a friendly acquisition. A draft merger agreement was prepared under which Rio Algom would be acquired for consideration consisting of cash and shares. The agreement contemplated an acquisition pursuant to an *OBCA* plan of arrangement involving Billiton, an *OBCA* subsidiary of Billiton and Rio Algom.

[43] On August 22, 2000, Noranda announced its intention to make an all-cash bid to acquire all of the common shares of Rio Algom at a price of $24.50 per share. Noranda's all-cash bid raised the question whether Billiton was prepared to top Noranda's offer with a better all-cash bid of its own.

[44] On August 21, 2000, the day before the announcement of Noranda’s bid, the closing price of Rio Algom’s common shares on the TSE was $18.10. The Debentures closed that day at $79.

The Billiton Bid

[45] After Noranda's announcement further negotiations ensued between Billiton and Rio Algom. On August 23, 2000, Billiton told Rio Algom it was prepared to make an all-cash offer at $26.50 per share. On August 24, 2000, Rio Algom's board established a special committee of directors, which gave Rio Algom's then chairman Gray the responsibility for negotiating with Billiton's chairman Gilbertson. Rio Algom wanted Billiton to increase its bid. Rio Algom persuaded Billiton to increase its offer to $27. Rio Algom and Billiton then executed a "support agreement" dated August 24, 2000 (the "Support Agreement").

[46] Under the Support Agreement, in return for Billiton's agreement to make its $27 all-cash bid for all of Rio Algom's common shares, Rio Algom promised:

a) that its board would recommend to shareholders acceptance of Billiton's offer;

b) to waive the application of its shareholder rights plan or “poison pill” to Billiton's offer;

c) to give Billiton the right to match a superior proposal (as defined); and

d) to pay to Billiton a "break-up fee" of U.S. $45 million upon the successful completion of a superior proposal that Billiton chose not to match.

[47] As described in Billiton's takeover bid circular, in making its bid Billiton intended to forcibly acquire shares not tendered to its bid and to see the common shares de-listed:

> “Effect of the Offer on Market for Common Shares and Stock Exchange Listings
>
> If the Offer is successful, the Offeror’s current intention is to acquire the Common Shares of any Shareholders who have not accepted the Offer pursuant to a Compulsory Acquisition or a Subsequent Acquisition Transaction. See “Acquisition of Common Shares not Deposited on the Offer”. If the Offeror proceeds with the acquisition of the Common Shares not deposited on the Offer, the Offeror intends that the Common Shares will be delisted from the TSE and the NYSE.
>
> From the time that the Offeror begins to take up Common Shares pursuant to the Offer, the liquidity and market value of the remaining Common Shares held by the public could be affected adversely. The TSE and the NYSE could delist the Common Shares if the minimum listing requirements (including minimum requirements as to the number of public security holders and the aggregate market value of the publicly held securities) are not met.”

[48] In negotiating with Billiton to induce its bid, Rio Algom's focus was directed towards increasing the cash consideration to be paid to shareholders. In the Support Agreement, Rio Algom sought and obtained from Billiton written promises to protect shareholders.

[49] In the days after the Support Agreement was executed, Rio Algom inquired and was told by Billiton that Debentureholders would be treated in an “appropriate manner”, which was not specified. Rio Algom did not seek from Billiton, in writing or otherwise, specific promises or protections for Debentureholders.

[50] On August 24, 2000, the day Rio Algom's directors approved the Support Agreement, Rio Algom's special committee approved an incentive program under which specific directors were rewarded for maximizing the cash price per share to be received from Billiton.

[51] On August 25, 2000, Rio Algom and Billiton issued a joint press release announcing Billiton's $27 bid and the Support Agreement. The press release said Rio Algom's directors had "unanimously recommended" the Support Agreement.

[52] The Rio Algom's directors' circular gave the following reasons for their recommendation:

> "Reasons for the Recommendation
>
> The Board of Directors has carefully considered the Billiton Offer and received the benefit of advice from its financial and legal advisers and the Special Committee. In unanimously concluding that the Billiton Offer is fair, from a financial point of view, to holders of Common Shares and is in the best interests of Rio Algom, the Board of Directors identified a number of factors as being most relevant, including the following:
>
> - the price offered by Billiton represents a 49% premium over the closing price of the Common Shares on The Toronto Stock Exchange on August 21, 2000 (being the last day of trading prior to the announcement of a proposed offer for all of the Common Shares of Rio Algom by Noranda);
>
> - the opinion of RBC Dominion Securities Inc., which is reproduced in full as a schedule to this Directors' Circular, that the Billiton Offer is fair from a financial point of view to the holders of Common Shares;
>
> - the opinion of Credit Suisse First Boston corporation, which is reproduced in full as a schedule to this Directors' Circular, that the consideration to be received by the holders of Common Shares under the Billiton Offer is fair from a financial point of view;
>
> - the conclusion of the Special Committee that the Billiton Offer is fair to the shareholders of Rio Algom".

[53] The Debentures were discussed by Rio Algom's directors at the special committee meeting held on September 29, 2000.

Attention to the Debentures

[54] Beginning on August 25, 2000, Billiton and Nesbitt Burns received correspondence and calls from Debentureholders inquiring about Billiton's intentions in relation to the Debentures. Deutsche Bank Canada ("DBC"), the largest single holder of Debentures demanded to be paid

$108 per $100 ("based on repaying par and pre-paying the coupon"), plus an amount "to compensate for the value of the warrant".

[55] At the end of August and in early September 2000, Billiton received written advice about the Debentures from its legal and financial advisors.

[56] In an August 31, 2000 memo to Billiton, Nesbitt Burns valued the Debentures in a range from $101 to $103.75, with a mid-point of $102.50.

[57] In the same memo, in suggesting that Billiton seek to acquire the Debentures "at approximately par", Nesbitt Burns said:

> "Billiton's pressure point with the CD holders are that we can de-list the common shares of Rio Algom and the indenture provides for redemption at par (breach of non-financial covenant).
>
> …
>
> We recommend a bid for the debentures as the cleanest way to deal with the CD holders. It is our expectation that this can be done reasonably at approximately par. This view is supported by:
>
> - the opinion of Blakes that we have an ability to cause a default on the bonds through de-listing Rio Algom and redeem the CDs at par.
>
> …
>
> The initial approach should be made for a takeout at par value based on the premise that under the worst case scenario from Billiton's perspective, Billiton can cause an event of default to triggered with a redemption at par. If the combination of the default scenario once more closely analyzed is judged to be too unpalatable, in order to reach an agreement, Billiton should be prepared to settle in the range of fundamental value between $101 and $103.75."

[58] In a memo to Billiton dated August 31, 2000, Blakes referred to the Nesbitt Burns memo of the same date and expressed "agreement with the Nesbitt analysis of the alternatives available to Billiton as part of this process."

[59] An internal Nesbitt Burns memo dated September 7, 2000, "summarized" the results of an internal strategy session on the Debentures. Billiton's lead investment banker at Nesbitt Burns, Geoffrey Belsher ("Belsher"), is a recipient of the memo. The memo identified three

options, a bid for the Debentures (option 1), an amendment to the terms of the Trust Indenture (option 2) or the "Status Quo" (option 3):

> "3. Status Quo
>
> - Take up and pay for Rio Algom common shares and de-list Rio Algom common shares, which causes a breach of covenant
> - If a Notice of Default is delivered to Billiton, Billiton repays the CDs at par
> - If a Notice of Default is not received, Billiton calls the CDs in February 2002
> - If Billiton acquires 25% of the CDs in the market it can instruct the trustee to deliver the Notice of Default and accelerate payment
>
> The pricing of options 1 and 2 are driven by our ability to achieve par through the 3rd scenario.
>
> …
>
> If we can credibly begin the negotiations below par and define our worst case as a redemption at par, we can expect to be able to purchase the CDs at approximately par."

[60] After settling on its "par or default" approach, Billiton caused a review to be undertaken of "cross-default" provisions to ensure that a default under the Trust Indenture did not give rise to other defaults for Billiton or Rio Algom. From this review it was determined that a default under the Trust Indenture would not have unacceptable consequences for Billiton or Rio Algom.

[61] Billiton did not disclose its intentions to Debentureholders until after the expiry of its bid on October 6, 2000.

[62] In late September or early October, Brian Ramsay of Casurina spoke with Dave Talbot, a senior trader on the bond desk at Nesbitt Burns, who said that in his view $108 to $112 (mid-point $110) was a fair price for the Debentures. This price was based upon par, plus the dollar value of interest payments to January 31, 2002 (after which the Debentures were redeemable), plus a few points to compensate for the loss of the conversion option. Talbot told Ramsay that he had shared this opinion with the investment bankers representing Billiton.

[63] Talbot had a similar conversation with a representative of DBC, Greg Sullivan ("Sullivan"). On August 25, 2000, Sullivan was told by Talbot that approximately $110 was a fair price for the Debentures. Talbot told Sullivan that he had conveyed this opinion to the investment bankers representing Billiton.

[64] The "bond desk" view was supported by the evidence of Fowler of Scotia Capital. In his affidavit, Fowler deposed:

> "On a takeover it is common for professional investors to value convertible debentures using a formula of par, plus interest to the

> first call date plus some consideration to compensation for the loss of the conversion option. Using this formula, at that time I concluded that Billiton should pay at least $110 to $112 per $100 of face value."

October 6, 2000: The Compulsory Acquisition

[65] On October 3, 2000, Noranda said that it would not top Billiton's offer, leaving no obstacle to completion of Billiton's bid. As contemplated by the Support Agreement, on October 6, 2000, Rio Algom's directors waived the application of its shareholder rights plan to Billiton's bid. Rio Algom then issued a press release dated October 6, 2000 announcing that it had waived the application of its shareholder rights plan to Billiton's offer "to purchase all of the outstanding common shares of Rio Algom Limited."

[66] On October 6, 2000, Billiton announced that 95% of Rio Algom's common shares had been deposited to its bid, that it would forthwith take up and pay for the shares deposited, and that it was extending its bid to midnight on October 16, 2000, to provide remaining shareholders time to tender to the bid. The press release stated that Billiton intended to acquire all Rio Algom shares not so deposited pursuant to the compulsory acquisition provisions of applicable legislation or by way of a "going private" transaction.

Dealings With the Debentureholders

[67] A meeting between representatives of Billiton and Rio Algom was held on October 11, 2000. In discussing the Debentures, it was observed that the Debentures "could go into default and redeem at par".

[68] On October 11 or 12, 2000, Norval and Belsher of Nesbitt Burns met with Sullivan of DBC. Sullivan advanced an argument for $113 based on par, interest to first call date (8 points), plus 5 points to compensate for loss of the conversion option.

[69] Belsher made a note of the meeting with Sullivan which was produced. Under the heading "position of Billiton", he recorded Norval's response as follows:

> "- basis – if we can't come to a transaction, we are looking at redeeming at par in March plus accrued and unpaid
>
> - par in April/March is not same as par today
>
> - are prepared to start working a formula from that basis
>
> - we want a lock-up and 2/3 locked-up –
>
> - is there flexibility to do a deal above par?

- practical position – redemption @ par is where we will get to"

[70] In an internal e-mail dated October 25, 2000, copied to Belsher and Blakes, Norval told a colleague "the bondholders will receive par in about April next year if they do not accept our offer on the table of receiving this end November". Norval acknowledged that payment in April in this e-mail was premised upon acceleration of the debt following an event of default arising out of the de-listing of Rio Algom's common shares.

[71] Norval said that he was authorized to offer DBC below par for its Debentures. He was not able to reach an agreement with DBC until the following day, after he received authority from his superiors to offer to redeem the Debentures at par.

[72] On October 12 or 13, 2000, Billiton and DBC reached agreement for immediate redemption at par (conditional upon the agreement receiving two-thirds support of holders). DBC then assisted in efforts to obtain the assent of other Debentureholders to redemption on this basis.

[73] In a press release issued by Billiton on October 17, 2000, Billiton announced that upon the expiry of its bid on October 16, 2000, approximately 95.7% of the outstanding common shares of Rio Algom had been deposited to its bid. Billiton said it intended to take up and pay for additional common shares deposited during the extension of the bid.

[74] After Billiton secured DBC's agreement to redeem at par, Billiton and Nesbitt Burns sought to secure the agreement of certain large Debentureholders. Since the redemption was to be accomplished through an amendment to the Trust Indenture, acceptance by holders holding two-thirds of the Debentures was required. A deadline for acceptance was set for October 31, 2000.

[75] In a conversation in late October with Ramsay, Belsher went on to indicate that if two-thirds of Debentureholders did not agree to the amendment, Rio Algom would commit an event of default and holders would get par in any event, since par is payable upon an event of default.

[76] Ultimately, only DBC and RBC Dominion Securities ("RBC DS") were prepared to be redeemed at par. RBC DS was the financial advisor to Rio Algom on Billiton's takeover. After Billiton took control of Rio Algom, RBC DS was engaged to assist in the sale to Billiton of Rio Algom's North American metals distribution business, NAMD Inc. ("NAMD. The investment bankers at RBC DS on the Rio Algom mandate intervened in RBC DS's decision to accept Billiton's proposal.

[77] On November 1, 2000 Rio Algom announced that its proposal to redeem the Debentures at par did not receive requisite support.

[78] At no time after November 1, 2000 did Billiton make an offer generally to Debentureholders to redeem their Debentures at par or on any other basis.

Compulsory Acquisition and De-Listing of Common Shares

[79] By notice dated October 30, 2000, Holdings informed holders of Rio Algom's common shares of its intention to exercise compulsory acquisition rights under Part XV of the *OBCA*.

[80] Pursuant to a press release dated November 29, 2000, Rio Algom announced that Billiton had completed the compulsory acquisition of the balance of Rio Algom's outstanding common shares, to hold 100% of the shares. In the same press release, Rio Algom announced that from November 29, 2000, Rio Algom's common shares would no longer be listed on the TSE or the NYSE. The common shares were de-listed as of that date.

[81] Debentureholders have not directed the trustee under the Trust Indenture to initiate default proceedings.

Transfer of Rio Algom Subsidiaries to Billiton

[82] On December 15, 2000, Rio Algom announced that it would transfer its interest in two wholly-owned subsidiaries, NAMD and Atlas Ideal Metals Inc. ("AIM"), to wholly-owned subsidiaries of Billiton. Of the U.S. $410 million purchase price, U.S. $350 million would be loaned by Rio Algom to Billiton. The press release referred to the establishment of an independent committee and to receipt of valuation advice from RBC DS.

[83] The following developments then occurred with the independent committee:

(a) the U.S. $350 million loan to Billiton had a coupon bearing interest at LIBOR (London InterBank Offered Rate) plus 0.75%;

(b) although the independent committee was established on November 23, 2000, its mandate was not settled until after the committee's work was completed;

(c) the committee's counsel, Osler Hoskin & Harcourt, advised the committee that the sale was a related party transaction within the meaning of OSC Policy 61.501, which brought with it more formal valuation requirements;

(d) Billiton's counsel Blakes disagreed with the opinion received from Osler, Hoskin & Harcourt;

(e) Billiton refused to authorize the committee to undertake an OSC Policy 61.501 valuation;

(f) to resolve the matter, Billiton moved its shares in Rio Algom to a jurisdiction outside of Ontario to avoid OSC Policy 61.501 and the attendant valuation requirement;

(g) Billiton refused to settle the committee's mandate until it was agreed that, by removing the shares from Ontario, OSC Policy 61.501 did not apply to the transaction;

(h) the committee requested that Billiton (i) provide a letter of credit to secure its guarantee of the U.S. $350 million loan and (ii) enter into a unanimous shareholder agreement for the purpose of approving the transaction (so as to make Billiton and not Rio Algom's directors responsible for approving the transaction);

(i) Billiton's counsel Blakes sent a letter to the committee's counsel "indicating that it was not Billiton's intention to comply with either request"; and

(j) the committee ultimately required Billiton to approve the transaction through a unanimous shareholder resolution.

[84] NAMD and AIM accounted for approximately one quarter of Rio Algom's assets. In return for these operating assets, Rio Algom received US $60 million cash and a U.S. $350 million debt instrument.

[85] A November 8, 2001 Nesbitt Burns research report on BHP Billiton was marked as an exhibit on Belsher's cross-examination. The report commented favourably on NAMD:

> "The North American Metals Distribution and Richards Bay titanium are reported in Other Activities, where revenues and EBIT increased 157% and 2%, respectively. The positive impact of the profits from the NAMD group was partially offset by increased losses from the Columbus Steel JV, as well as lower sales volumes at Richards Bay."

Valuation Evidence

[86] In the period from February 1, 2000 to January 31, 2002, the Debentures are redeemable at the instance of Rio Algom only if Rio Algom's common shares are trading at a 25% premium to the conversion price. This provision would permit holders, in response to a redemption notice, to convert Debentures into common shares and sell the Debentures at a 25% premium to par.

[87] In his affidavit, Fowler of Scotia Capital has deposed that, based on simple extrapolations in the trading prices of comparable stocks and stock indices, there is every reason to believe that Rio Algom's common shares would have traded above the conversion price prior to the February1, 2002 first call date. For example, in October 2000, the average trading price of Billiton's common shares on the London Stock Exchange was approximately £2.50. By early May 2001 (after Billiton acquired Rio Algom's NAMD and AIM operating units), Billiton's common shares traded over £3.57, an increase of approximately 43% over seven months. Applying Billiton's 43% increase over seven months to Rio Algom's October 2000 $27 share

price would result in a Rio Algom share price of $38.61. Extrapolated for the nine months to February 2002, Rio Algom's stock price would be over $59. At this price, each $100 par value debenture could be converted for Rio Algom stock worth approximately $149.90.

The November 10, 2000 Nesbitt Burns "Draft Valuation"

[88] As indicated above, Nesbitt Burns gave valuation advice to Billiton on August 31, 2000 which valued the Debentures with a mid range of $102.50. After Debentureholders refused to agree to be redeemed at par, Nesbitt Burns prepared a "draft" valuation memo dated November 10, 2000. Unlike previous valuations which were addressed to Billiton, this draft valuation was addressed to Billiton's counsel, Blakes. The conclusion in the draft opinion is that the maximum value of the Debentures is $100 or par.

Comparables

[89] According to Mr. Hunt, to be comparable, convertible debentures must be taken out for cash or a cash equivalent during the time period in which the debentures were protected from call and where there is no change of control clause that permits call where there is a bid. Based on these criteria, the takeovers of Cadillac Fairview Corporation ("Cadillac Fairview"), CFCF Inc. ("CFCF"), Oxford Properties Group Inc. ("Oxford Properties") and Rainy River Forest Products Inc. ("Rainy River") are most comparable to Rio Algom.

[90] In those takeovers where convertible debentures were taken out for cash or a cash equivalent during a time period when the debentures were not callable, and where there was no change of control clause prescribing the terms of redemption, following negotiation Debentureholders received $110 (Cadillac Fairview), $113 (Oxford Properties), $120 (CFCF) and $147.60 (Rainy River). Where these circumstances existed, in no instance were Debentureholders required to accept par or less than par in return for the redemption of their debentures.

[91] The applicants provided a "Table 1" listing the premiums paid in takeovers for Canadian convertible debentures. As set out in that schedule, in only one instance, Ivanhoe's takeover of Cambridge, were Debentureholders offered an amount less than par in return for their debentures. As described in Hunt's affidavit, approximately one-half of the outstanding debentures were not tendered to Ivanhoe's bid, with the result that the debentures continued to be outstanding.

[92] Billiton put forward an affidavit from Paul Hand ("Hand"), the Managing Director of Institutional Equity at RBC DS. Hand was personally involved in the takeover engagement. RBC DS received almost U.S. $8 million for its work for Rio Algom before and after the Billiton take over.

[93] In his affidavit, Hand deposed that:

(a) there is no custom in the Canadian market whereby bidders for the common shares of the takeover target negotiate with the holders of convertible debentures for the early redemption of the convertible debentures at a price above par;

(b) where convertible debentures are well out of the money, there is no rationale for a bid for the convertible debentures at a premium to par;

(c) a bid for the Debentures at $112 per $100 principal amount would have had a substantial adverse financial impact on Billiton;

(d) Hand could find no instance of a premium being paid for out of the money convertible debentures where such a premium would have resulted in a substantial adverse financial impact on the bidder; and

(e) conclusions could be drawn from the Luscar/Sherritt Coal and Cadillac Fairview/Teachers' takeover bids.

[94] The respondents offered a number of reports from Professor Gomper of Harvard Business School.

Law

The Oppression Remedy and Its Scope

[95] Subsections 248(1) and (2) of the *OBCA* provide:

1) A complainant and, in the case of an offering corporation, the Commission may apply to the court for an order under this section.

2) Where, upon an application under subsection (1), the court is satisfied that in respect of a corporation or any of its affiliates,

(a) any act or omission of the corporation or any of its affiliates effects or threatens to effect a result;

(b) the business or affairs of the corporation or any of its affiliates are, have been or are threatened to be carried on or conducted in a manner; or

(c) the powers of the directors of the corporation or any of its affiliates are, have been or are threatened to be exercised in a manner,

that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of any security holder, creditor, director or officer of the corporation, the court may make an order to rectify the matters complained of.

[96] A "complainant" is defined to include "a registered holder or beneficial owner, and a former registered holder or beneficial owner, of a security of a corporation or any of its affiliates". A security of a corporation includes a debt obligation of the corporation.

[97] The oppression remedy provides courts with extremely broad sources of authority to protect the rights and interests of minority stakeholders, including the holders of debt securities.

[98] The oppression remedy is an equitable remedy, intended to defend against wrongs done to security holders. Given the equitable nature of the remedy, the court has jurisdiction to find an action is oppressive, unfairly prejudicial or unfairly taken in disregard of the interests of a security holder if it is wrongful, even if the action is not actually unlawful.

[99] The availability of another remedy does not preclude a complainant from proceeding under the oppression remedy so long as the matter being complained of is, in substance, one of oppression relating to the complainant's rights or interests *qua* security holder: *Levy-Russel Ltd.* v. *Shieldings Inc.* (1998), 165 D.L.R. (4th) 183 (Ont. Gen. Div.) at 191.

[100] In *Deutsche Bank Canada v. Oxford Properties Group Inc.* (1998), 40 B.L.R. (2d) 302 (Ont. Gen. Div.) at 310 to 313, Blair, J. granted the applicant, Deutsche Bank Canada, the holder of convertible debentures, a judgment declaring that a special dividend paid by Oxford to its common shareholders was an event entitling the Debentureholders to an adjustment in the conversion price of the debentures pursuant to the governing trust indenture or, in the alternative, damages under the oppression remedy. The contractual remedy provided for in the trust indenture did not preclude alternative relief being granted under the oppression remedy.

[101] In this case, pursuant to the Trust Indenture, the Applicants say that the delisting of Rio Algom's common shares constitutes an Event of Default. The contractual remedy available to the applicants under section 7.3 is to require the trustee to issue a notice of acceleration such that the principal value of the Debentures plus all accrued interest becomes immediately payable.

[102] If the applicants are restricted to contractual remedies, they contend that an injustice will result. They say Billiton sought to coerce Debentureholders to agree to immediate redemption of the Debentures at par by threatening to create an Event of Default. Accordingly, sanctioning Billiton's "par or default" scheme would permit the respondents to effectively circumvent the limitations on redemption in the Prospectus and the Trust Indenture without regard for the rights

and interests of the Debentureholders. They say the oppression remedy was intended to remedy inequitable conduct of this very nature.

Application of Oppression Remedy To Billiton, Holdings and the Billiton Directors

[103] Subsection 248(2) of the *OBCA* permits a complainant to apply to the court for relief in respect of acts or omissions of a corporation *or any of its affiliates* where the acts or omissions complained of effect or threaten to effect a result that is oppressive or unfairly prejudicial to or unfairly disregards the interests of the complainant.

[104] One corporation is an affiliate of another corporation if one is the subsidiary of the other or both are controlled by the same person or each of them is controlled by the same person: Subsections 1(1) and 1(4), *OBCA*.

[105] After Billiton acquired 95% of Rio Algom's common shares on October 6, 2000, it became an affiliate of Rio Algom within the meaning of subsection 1(4) and for the purposes of section 248 of the *OBCA*. Billiton now owns 100% of the common shares of Rio Algom. As Holdings is also a wholly-owned subsidiary of Billiton, Holdings too is an affiliate of Rio Algom: Subsections 1(1), 1(2) and 1(4), *OBCA*.

[106] The oppression remedy may be used by complainants to seek redress for the oppressive acts of a corporation's affiliate, so long as the oppressive conduct complained of affects the interests of the complainant in the *OBCA* company.

The Applicants' Argument Based on Reasonable Expectations

[107] The Applicants advance the following agreement with respect to their reasonable expectations.

[108] The reasonable expectations the oppression remedy is aimed at protecting are those which could be said to have been (or ought to have been considered as) part of the compact of the shareholders. Whether an expectation is a reasonable expectation or merely wishful thinking on the part of the complainant is a question of fact to be decided by the court.

[109] As observed by the Ontario Court of Appeal in *Re Themadel Foundation and Third General Investment Trust Ltd*. (1988), 38 O.R. (3d) 749 (Ont. C.A.) "(t)he public pronouncements of corporations, particularly those that are publicly traded, become its commitments to shareholders within the range of reasonable expectations that are objectively aroused". The same is true with respect to the reasonable expectations of any security holder, including the holders of debt securities.

[110] In determining the reasonable expectations of a security holder "… *all* the words and deeds of the parties are relevant to an assessment of reasonable expectations, not necessarily only

those consigned to paper, and not necessarily only those made when the relationship first arose.": *Westfair Foods Ltd*. v. *Watt* (1991), 79 D.L.R. (4th) 48 (Alta. C.A.) at 54.

[111] Both the Trust Indenture and the Prospectus provide that (a) Rio Algom's common shares would remain listed on the TSE or another nationally recognized stock exchange so long as the Debentures are outstanding; and (b) Rio Algom could not redeem the Debentures before February 1, 2002 unless holders were in a position to receive at least a 25% premium to par. In addition, pursuant to section 9.1 of the Trust Indenture, Rio Algom was prohibited from entering into a merger or acquisition unless the rights of Debentureholders were substantially preserved and not impaired.

[112] These public pronouncements constitute rights of the Debentureholders or, at the very least, reasonable expectations. These rights and reasonable expectations were completely disregarded by the respondents in favour of the common shareholders and in their own self-interest.

[113] The very essence of a privilege to convert debentures into participating shares is to be able to eventually realize an additional gain due to the potential appreciation of the security. As a result of the actions of the respondents, the applicants have lost a fundamental part of the bargain represented by the Debentures.

CFCF Inc., 3242722 Canada Inc., Le Groupe Videotron Ltee, Sunrise Partners LP International Fund Limited and American Lane Partners LLC, Quebec Securities Commission Dec. No. 96-C-0329, QSCB XXVII, no. 36, p. 5, as translated.

[114] It is disingenuous for the respondents to suggest that had Rio Algom's common shares continued to be listed, the common share price would not have exceeded the conversion price prior to February 1, 2002, given that Billiton itself denuded Rio Algom of profitable assets and the common shares no longer trade as a result of the respondents' conduct. The rights and interests of minority stakeholders cannot be expropriated or materially altered by virtue of a merger and acquisition without their consent.

Palmer v. *Carling O'Keefe Breweries of Canada Ltd.* (1989), 67 O.R. (2d) 161 (H.C.J.) at 171-172.

[115] The respondents should not be permitted through a deliberate and self-induced Event of Default to put themselves in a better position than if they had caused Rio Algom to honour its lawful and equitable obligations to the applicants. The applicants should therefore receive at least a 25% premium to par as contemplated by both the Prospectus and the Trust Indenture.

[116] It is irrelevant that some of the debentures were purchased by the applicants after Billiton's bid was announced. The debentures are marketable securities. Debentureholders purchasing before the announcement of Billiton's bid and those purchasing after cannot be

treated differently. If any relief is granted, it will mean the applicants correctly appreciated the Debentureholders' legal rights.

Deutsche Bank Canada, supra at 310 and 312.
Palmer v. *Carling O'Keefe Breweries of Canada Ltd., supra* at 169.

The Applicants' Argument as to the Valuation Evidence

[117] The Applicants submit that neither Mr. Hand nor Professor Gompers is properly qualified as an expert witness and their evidence should be disregarded, for the following reasons.

As stated by the Supreme Court of Canada in *R.* v. *Mohan*:
"Admission of expert evidence depends on the application of the following criteria:

(a) relevance;

(b) necessity in assisting the trier of fact;

(c) the absence of any exclusionary rule;

(d) a properly qualified expert."

R. v. Mohan (1994), 114 D.L.R. (4th) 419 (S.C.C.) as cited by Farley, J. in *Pente Investment Management Ltd.* v. *Schneider Corp*., [1998] O.J. No. 6387 (Gen. Div.) (QL) at 2.

> A properly qualified expert is one "who is shown to have acquired special or peculiar knowledge through study or experience in respect of the matters on which he or she undertakes to testify."

R. v. Mohan, supra as cited in *Pente, supra* at 3.

> A skilled person is "one who has, by dint of training and practice, acquired a good knowledge of the science or art concerning which his opinion is sought, and the practical ability to use his judgment in that science". Absent demonstration of a special skill or experience in the relevant field, a witness will not be qualified as an expert.

Catholic Children's Aid Society of Hamilton-Wentworth v. *S.* (1986), 9 C.P.C. (2d) 265 at 270-271 citing *R.* v. *Bunniss*, [1965] 3 C.C.C. 236 (B.C.).

Bank of Montreal v. *Citak*, [2001] O.J. No. 1096 (S.C.J.) (QL) at 3.

> *Olympia & York Developments Ltd. (Trustee of)* v. *Olympia & York Realty Corp.* [2000], O.J. No. 3708 (S.C.J.) (QL) at 3-4.

[118] The applicants say Mr. Hand does not meet the test to qualify as an expert witness. He had little or no understanding of convertible debentures and little or no understanding of comparable transactions. To the extent a purported expert relies on others, and merely assembles components, the proffered opinion will not be of assistance to the court.

Toronto-Dominion Bank v. *E. Goldberger Holdings Ltd.*, [1999] O.J. No. 5324 (S.C.J.) (QL) at 3.

[119] In any event, as he acted as the financial advisor to Rio Algom, Hand is not neutral and objective and is therefore not properly qualified to give an expert opinion.

> *Fellowes, McNeil* v. *Kansa General International Insurance Co.* (1998), 40 O.R. (3d) 456 (Gen. Div.) at 460.
>
> *Bank of Montreal* v. *Citak, supra* at 2.

[120] The applicants say that Professor Gompers too cannot be qualified as an expert on matters relevant to this proceeding. He has no practical experience with the valuation of derivatives or convertible debentures, including Canadian convertible debentures. His use of models that can be employed in valuing convertible debentures is confined to a few case studies and some classroom use. He has no special skill or knowledge in respect of which his evidence is proffered and his evidence should, therefore, be disregarded.

Part 2

Analysis: The Interests of the Debentureholders in the Context of the Take-Over Bid: Preliminary Considerations

[121] The applicants have a proper interest in receiving the benefit of the securities they purchased. Those securities are debentures, not shares. They are constituted by a contract, in the form of a trust indenture, between the issuer and the trustee for the holders, so the holders have a proper interest in receiving the benefit of that contract in accordance with its terms and conditions. Under those terms and conditions the holders are given certain rights which are made exercisable in specified ways.

[122] The applicants submit that the covenant of Rio Algom in the Trust Indenture would keep the common shares listed has been breached and this failure constitutes an Event of Default under the Trust Indenture. This is so, as discussed further below. Section 7.3 of the Indenture provides that, on the occurrence of such an event, if it is not remedied as provided for, the Debentures become immediately callable. Had this provision been activated by the holders following the delisting, the shares would have become callable by the Trustee for the holders.

[123] The Indenture does not provide for any other rights on the occurrence of such an event of default. Neither does the Indenture provide that the right in s.7.3 is the only right or remedy that the holders may have in the event of a breach of the listing covenant.

[124] The Indenture permits as exceptions certain changes by way of merger or amalgamation or arrangement, as set out in s. 9.1. The Indenture makes no provision of the kind set out on that section in respect of the occurrence of a take-over bid followed by a forced acquisition. The transactions contemplated by s. 9.1 involve the participation of the issuer, Rio Algom in the transaction. An acquisition of all of the outstanding shares of Rio Algom, such as has occurred here is different; it is effectively carried out solely between the acquiror and the shareholders, and does not involve the issuer corporation as a party.

[125] The applicants rely on the breach constituted by the delisting, and the consequent Event of Default, but they do not seek an order that the Debentures have become callable, which is the order that the Trust Indenture provides for if the precedent conditions for the order are satisfied. Such an order could not meet the objectives of the applicants.

[126] These considerations prompt the following line of enquiry. If the Debentureholders could assert such a contractual claim pursuant to the Trust Indenture provided they meet certain conditions, should they not be left to pursue the remedy that is afforded to them under the Indenture? If they can also assert an oppression remedy claim, does this not mean that the oppression remedy is available to obtain a supplement to contractual terms previously settled by the bargain made between the parties?

[127] In *Highfields Capital I LP v Telesystem International Wireless Inc.*, [2002] O.J. No. 384, (Sup.Ct.) the decision was that the unit holders could assert a claim under the oppression remedy to enjoin an issuer bid for units of one company which were exchangeable into shares of another company. The claim was based on alleged oppressive conduct in the form of a special arrangement with 55% of the unit holders which, in the circumstances, was bound to have an unfairly coercive effect upon the remainder of the unit holders. The case provides an example of a situation where the oppression remedy may afford relief which is based on conduct in respect of which no provision is made in the terms of the securities in question.

The Indenture; the "No-action" clause

[128] As noted the interests of the Debentureholders arise from the Debenture and the Indenture, which sets out the terms and conditions of the Debenture. The Indenture is, in effect, the contract between Rio Algom and the Trustee for the Debentureholders.

[129] The importance of attending to the provisions of the contract in respect of a claim asserted by a person whose rights are established by way of contract is self-evident. The question whether contractual provisions can preclude resort to the oppression remedy was considered in *Armstrong v Northern Eyes*. [2001] O.J. No. 1085 (CA.) affirming (2000) 48 O.R. (3d) 442 (Div.Ct.) For the Court of Appeal, Catzman J.A. effectively held that the appellant

could not resort to court on the basis of the oppression remedy because he had entered into an agreement to arbitrate which effectively precluded him from doing so.

[130] The parties dispute whether s.7.6 of the Indenture precludes the applicants from resorting to the oppression remedy.

[131] Sections 7.5 and 7.6 of the Trust Indenture provide in part as follows:

7.5 Enforcement by the Trustee

> If an Event of Default shall have occurred, but subject to section 7.4 and to the provisions of any Extraordinary Resolution that may be passed by the Debentureholders as hereinafter provided and subject to section 12.3:
>
> (a) The Trustee (either in its own name or as trustee of an express trust, or as attorney-in-fact for the Debentureholders, or in any one or more of such capacities), may in its discretion proceed to enforce the rights of the Trustee and of the Debentureholders by any action, suit, remedy a proceeding authorized or permitted by this Indenture or by law or equity; and may file such proof of debt, amendment of proof of debt, claim, petition or other papers or documents as may be necessary or advisable in order to have the claims of the Trustee and of the Debentureholders filed in any bankruptcy, insolvency, winding-up or other judicial proceedings relating to the Corporation or its creditors or relating to or affecting its property; (emphasis added)
>
> (b) the Trustee is hereby irrevocably appointed (and the successive Holders of Debentures by taking and holding the same shall be conclusively deemed to have so appointed the Trustee) the true and lawful attorney-in-fact of the respective Debentureholders with authority to make and file in the respective names of the Debentureholders or on behalf of the Debentureholders as a class, subject to deduction from any such claims of the amounts of any claims filed by any of the Debentureholders themselves, any proof of debt, amendment of proof of debt, claim, petition or other papers or documents in any such proceedings and to receive payment of any sums becoming distributable on account thereof, and to execute any such other papers and documents and to do and perform any and all such acts and things for and on behalf of such Debentureholders, as may be necessary or advisable in the opinion of the Trustee, in order to have the respective claims of the Trustee and of the Debentureholders against the Corporation or its property

allowed in any such proceeding, and to receive payment of or on account of such claims; provided, however, that nothing contained in this Indenture shall be deemed to give to the Trustee, unless so authorized by Extraordinary Resolution, any right to accept or consent to any plan of reorganization or otherwise by action of any character in such proceeding to waive or change in any way any right of any Debentureholder; (Emphasis added)

(c) no such remedy for the enforcement of the rights of the Trustee or the Debentureholderes shall be exclusive of or dependent on an other such remedy but any one or more of such remedies may from time to time be exercised independently or in combination;

(d) all rights of action hereunder may be enforced by the Trustee without the possession of any of the Debentures, or the production thereof on the trial or other proceedings relating thereto; and may in its discretion proceed to enforce the rights of the Trustee and of the Debentureholders by any action, suit, remedy or proceeding authorized or permitted by this Indenture or by law or equity;

(e) Upon receipt of a Debentureholders' Request, the Trustee shall exercise or take such one or more of such remedies as the Debentureholders' Request may direct provided that if any such Debentureholders' Request directs the Trustee to take proceedings out of court the Trustee may in its discretion take judicial proceedings in lieu thereof.

7.6. Debentureholders May Not Sue

No Debentureholder shall have the right to institute any action, suit or proceeding or to exercise any other remedy authorized or permitted by this Indenture or by law or by equity for the purpose of enforcing payment of principal or interest owing on any Debenture or for the execution of any trust or power hereunder, unless:

(a) such Holder shall previously have given to the Trustee written notice of the occurrence of an Event of default;

(b) the Debentureholders, by Extraordinary Resolution, shall have made a request to the Trustee to take action hereunder or the Debentureholders' Request referred to in section 7.3 shall have been delivered to the Trustee, and the Trustee shall have been offered a reasonable opportunity either itself to proceed to exercise the powers hereinbefore granted or to institute an action, sit or proceeding in its name for such purpose;

(c) the Debentureholders or any of them shall have furnished to the Trustee, when requested by the Trustee, sufficient funds and an indemnity in accordance with subsection 12.3(2); and

the Trustee shall have failed to act within a reasonable time thereafter.

> In such event but not otherwise, any Debentureholder acting on behalf of himself and all other Debentureholders, shall be entitled to take proceedings in any court of competent jurisdiction such as the Trustee might have taken under section 7.5, but in no event shall any Debentureholder or combination of Debentureholders have any right to take any other remedy or proceedings out of court; it being understood and intended that no one or more of the Debentureholders shall have any right in any manner whatsoever to enforce any right hereunder or under any Debenture except subject to the conditions and in the manner herein provided, and that all powers and trusts hereunder shall be exercised and all proceedings at law shall be instituted, had and maintained by the Trustee, except only as herein provided, and in any event for the equal benefit of all Holders of outstanding Debentures.

Preliminary Analysis of Section 7.5 and 7.6

[132] The proper interpretation of the Trust Indenture is considered more fully and definitively below in connection with the conduct of Billiton. Where the subsequent treatment might suggest a different view on the proper interpretation it is the subsequent treatment that governs for purposes of this decision. In any event, the preliminary analysis results in the view that the Applicants are not entitled to assert a claim against Rio Algom and the subsequent definitive treatment does not change that result.

[133] S.7.5 authorizes the Trustee to sue where an Event of Default has occurred, but not otherwise. In such circumstances the Trustee may "enforce the rights of the Debentureholders by any action suit, remedy or proceeding authorized or permitted by this Indenture or by law or equity". So, the Trustee could exercise the oppression remedy if an Event of Default has occurred so as to give rise to a proper claim for the remedy.

[134] Under the provision set out in s.7.6, sometimes referred to as a "no-action" clause, the Debentureholders themselves are precluded from bringing any such proceeding for the purpose of enforcing payment of principal or interest owing on any Debenture or for the execution of any trust or power under the Indenture unless the requirements of subsections (a) to (d) are satisfied. If they are, a Debentureholder, acting on behalf of all Debentureholders may take any court proceedings that the Trustee could take under s.7.5.

[135] The text continues as follows: "but in no event shall any Debentureholder … have any right to take any other remedy or proceedings out of court". Having regard to the use in s.7.5.(e) of the phrase "proceeding out of court", the words "out of court" in s.7.6 should be understood to modify "proceeding" but there is no reason to consider that they also modify the words "remedy".

[136] It was suggested for the applicants that the words "in no event" relate back to the words "in such event", ie. the circumstances in which a Debentureholder may take proceedings that the Trustee could take under s.7.5. On this basis, it was suggested that these provisions of s.7.6 have a very limited effect: they mean only that a Debentureholder may not take proceedings to enforce "contract rights" (ie. "payment of principal or interest … or the execution of any trust or power hereunder" unless the four requirements of sub-sections (a) to(d) are satisfied but not otherwise. So understood, the clause is not an obstacle to the assertions of the extra-contractual "right" afforded by the oppression remedy

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[137] The proposed reading would in effect change the words "in no event" to "in no such event". No basis is shown for such a change.

[138] Also the distinction proposed about contractual rights is not clear in the clauses in the way suggested. The opening words of s.7.6 preclude a Debentureholder from taking proceedings to enforce what may fairly be considered contractual rights but the enabling clause ("in such event…") authorize a Debentureholder to take any court proceedings the Trustee could have taken under s.7.5, which would include, in a proper case, the exercise of the oppression remedy where an Event of Default has occurred.

[139] On the wording of the clauses of s.7.5 and s.7.6 considered so far, a Debentureholder may take proceedings, if the requirements of s.7.6(a) to (d) are met, to enforce the rights of Debentureholders, including the oppression remedy, if an Event of Default has occurred, but "in no event" may a Debentureholder "take any other remedy".

[140] S.7.6 continues with the clause that begins "it being understood and intended …". The clause has two parts. The first is that no Debentureholder may enforce rights under the Indenture or a Debenture" except subject to the conditions and in the manner herein provided". It was submitted that this provision reinforces the reading of s.7.6 that would limit its scope to contractual rights. It is true that the provision deals only with contractual rights ("rights under the Indenture"). But the provision is a limiting one not an enabling one, and the limitation it imposes is one that is properly referable to contractual rights and would not seem to have any application to extra-contractual rights. As well, the clause in its second and final part provides "and that all powers and trusts hereunder shall be exercised and proceedings at law shall be instituted, had and maintained by the Trustee, except only as herein provided, and in any event for the equal benefit of all Holders to outstanding Debentures". This provision, with its words "all proceedings at law" is not restricted to contractual rights only and is consistent with the interpretation developed above and reinforces it. On this basis, the above interpretation gives effect properly to the provisions and their constituent elements.

[141] On this interpretation, if an Event of Default has occurred so as to give rise to a proper claim for the oppression remedy, the Trustee may exercise the oppression remedy or, if the requirements in s.7.6(a) to (d) are met, but not otherwise, a Debentureholder may do so, for the benefit of all Debentureholders.

[142] Nothing in this arrangement of rights, by itself, appears commercially unreasonable and nothing in the submissions of counsel leads to a different view. So there is no reason not to give effect to the interpretation set out above.

[143] The applicants' position about the effect under the Indenture of the delisting is that it is an Event of Default or, if it is not, it is of such a character that, in either case, it has led to a deprivation of their reasonable expectations. The respondents' position is that the delisting is not an Event of Default and it has not led to such a deprivation.

[144] It was submitted by Rio Algom that having regard to the precise wording of the covenant for listing, which refers only to the shares to be issued on the exercise of the conversion rights, the delisting of the shares did not constitute a default because no conversions have occurred so far. Against this, it was submitted that, since the Toronto Stock Exchange rules required a public distribution of 30,000 shares for a listing, Rio Algom had ceased to be in a position to list and accordingly, in the event of conversions, the default would operate, and that should be sufficient to constitute a default. This reasoning is sound enough.

[145] In *Millgate Financial Corp. v. B.F. Realty Holdings Ltd.* (1994), 15 B.L.R. (2d) 212 (Ont.Gen.Div.), Farley J. considered a no-action or precondition clause similar to s.7.6. In the case the claims of the Debentureholders were brought against the issuer company, certain other related companies and individuals, and the indenture trustee itself. The claim included a claim for the exercise of the oppression remedy as well as a claim for breach of the Indenture. Farley J. decided at p.225 that only the issuer corporation but not the other defendants could rely on the precondition clause and then only to the extent that Millgate was alleging that the issuer was in breach of its contractual obligations pursuant to the payment of principal and interest on the debentures being in default.

[146] The no-action clause that the court considered is set out at p.21 of the decision, in paragraph 7. The clause is, for present purposes, materially the same as the first part of s.7.6., i.e. down to the end of paragraph (d). The provision that would compare to s.7.5 is not referred to. There is no indication that the no-action clause contained any further provision, as does s.7.6. The interpretation approved above in this decision turns on that further provision, and takes s.7.5 into account contextually, so there is no reason to consider that the limitations to contractual obligations which Farley J. asserted should apply in the present case.

[147] The *Millgate* decision does not elaborate on the determination that only the issuer company and not the other defendants may rely on the no-action clause. The clause set out in the decision refers only to proceedings to enforce payment on the debentures or the rights and

remedies under the indenture. The clause does not contain broader language such as is contained in the present case, in s.7.5 (“enforce the rights…of the Debentureholders by any…remedy…) and in the further provision of s.7.6 (“any other proceeding “and” all proceedings at law shall be instituted…by the Trustee”).

[148] The question whether a defendant other than the issuer may rely on the no-action clause was considered in the United States in *Feldman v McCrory Corp*. 1992 Del. Ch. LEXIS 113 at paragraph 25 of the decision, Chancellor Allen addressed the matter as follows:

> I rather conclude only that, absent circumstances making application of a no-action clause inappropriate such as those described above, courts systematically conclude that, in consenting to no-action clauses by purchasing bonds, Plaintiffs waive their rights to bring claims that are common to all bondholders, and thus can be prosecuted by the trustee, unless they first comply with the procedures set forth in the clause or their claims are for the payment of past-due amounts.
>
> Courts have implicitly concluded that this waiver by a bondholder applies equally to claims against non-issuer Defendants as to claims against issuers. See Norte & Co. v. Manor Healthcare Corp., Del. Ch., C.A. Nos. 6827, 6831, Berger, V.C. (Nov. 21, 1985) (dismissing for failure to comply with a no-action clause breach of indenture claims against issuer and codefendants); *Levy v. Paramount Publix Corp., N.Y. Supr., 266 N.Y.S. 271,* aff'd, *N.Y. App. Divl., 269 N.Y.S. 2d 997 (1934)* (dismissing for failure to comply with no-action clause breach of fiduciary duty claims against issuer's directors in connection with issuer's alleged fraudulent conveyance); *Relmar Holding,* 262 *N.Y.S. 776[*26]* (dismissing for failure to comply with no-action clause fraudulent conveyance claim against recipient of transferred assets).
>
> The policy favoring the channeling of bondholder suits through trustees mandates the dismissal of individual bondholder actions no matter whom the bondholders sue. So long as the suits to be dismissed seek to enforce rights shared ratably by all bondholders, they should be prosecuted by the trustee. Moreover, like other no-action clauses, the clauses at issue here explicitly make their scope depend on the nature of the claims brought, not on the identity of the Defendant. For example, the E-II clauses quoted earlier begin: "A Securityholder may not pursue any remedy with respect to this Indenture of the Securities unless …."

[149] There is much in this line of reasoning to commend it. However, counsel made submissions that were not disputed that American corporate law does not include an oppression remedy. Moreover, Farley J.'s decision in *Millgate* is arguably authority to the contrary of the position in the *Feldman* decision. The matter was not canvassed in submissions otherwise than by reference to the above considerations. The issue is considered further below.

[150] The applicants have named as respondents persons who were directors and/or officers of Rio Algom. There were no submissions as to whether, if the no-action clause precludes proceedings against Rio Algom, the claim against the officers and directors should also fail. It was not argued that the directors and officers of Rio Algom had any separate interest that would support their being regarded as acting for their own interest rather than that of Rio Algom. Mr. Gray received compensation relating to the securing of the more favourable offer from Billiton but it was not his actions but the decisions of the special committee and the board, each acting as such, that constituted the actions taken and not taken by Rio Algom. A case has not been made for any separate potential liability on the part of the Rio Algom directors and officers.

[151] Accordingly, whether or not there has been an Event of Default, the applicants are precluded by s.7.6 of the Trust Indenture from bringing the present application against Rio Algom and it must fail on that ground alone as against Rio Algom and consequentially as against its directors and officers. The application of s.7.6 to Billiton is addressed below.

Whether Oppressive Conduct Occurred in respect of the Take Over Bid

[152] Despite the conclusions reached above and also below about the effect of s.7.6, it is appropriate to address the question whether oppressive conduct occurred on the part of either Rio Algom or Billiton or both, in order to ensure that the analysis of the issues raised is complete.

[166] In the present case, the applicants say that they are relying, not on the contractual rights that arise under the Trust Indenture by reason of the occurrence of an Event of Default, but on the oppressive conduct constituted by the occasioning of the delisting. They say that the delisting is oppressive in two respects. One is that it creates an Event of Default under the Indenture. The second is that it effectively deprives the conversion right of its value.

[167] The occurrence of the event of default had the effect of potentially making the debentures callable at the instance of the Trustee. Billiton appears to have proceeded in its planning on the expectation or assumption that following the occurrence of the event of default, the debentures would become callable and would be called. It was always within the power of the Debentureholders only, not Billiton, to determine whether that would happen, and it did not happen.

[168] The occurrence of the delisting has *prima facie* harmed the value of the conversion right in two related ways. The delisting has made it impossible to make a reliable determination of the value of the right. The delisting also adversely affects the market for the sale of any shares acquired through acquisition. These results do not come about because of the delisting as such.

If, to give an unlikely scenario, there had been no take-over and the shares had been delisted but continued to trade in the over-the-counter market, the conversion right would still have a value determinable in the market place. What has caused the particular detriment to the value of the conversion right that has occurred in this case is that Billiton has acquired all of the outstanding common shares.

[169] If Billiton had made this acquisition in one step, e.g. through 100% acceptance of its take-over bid, then the oppression remedy provision in s. 248 would have no potential application to it because Billiton was not an affiliate of Rio Algom at the time it made the take-over bid. When it made the bid, Billiton stated that its intention was to acquire 100% of the shares and, depending on the success of the bid, it would adopt one or another means to do so.

[170] Rio Algom entered into a Support Agreement with Billiton in respect of the take-over bid. So even if Billiton's making of the bid would not engage the oppression remedy, Rio Algom's support of the bid could potentially do so, because it is the very company whose Debentureholders are asserting this complaint.

[171] Various possible positions arise from these considerations. One is that if the claim of the applicants is sound, it necessarily implies that Rio Algom could not properly give support to the Billiton bid without ensuring either that a public market would remain for the shares or that an offer was made to the Debentureholders that was acceptable to them.

[172] It was mentioned in the course of submissions that some trust indentures contain a provision for the protection of convertible debentureholders on the occurrence of a change in control of the issuer such as upon a take-over. There is no provision of this kind in the Indenture except s. 9.1, as mentioned above. To say that Rio Algom had an obligation to ensure that an acceptable offer was made to the holders seems at least to border on adding a provision to the Trust Indenture that was not part of the deal that was made when the debentures were issued.

[173] The applicants indeed say that Rio Algom had an obligation to see that an acceptable offer was made to them because otherwise they were going to be left without a public market for the shares as a result of the change of control. A provision to provide protection to them in this circumstance could have been negotiated as part of the original issue of the debentures, but it was not. This protection is not a right that was included in the Indenture.

[174] Assuming for the moment that it is correct to say that in supporting the Billiton bid, Rio Algom disregarded the interests of the Debentureholders in having a public market for the shares, it must still be asked whether this act of disregard was done "unfairly" within the meaning of s. 248. The argument on that point must take into account the fact that the Trust Indenture could have provided a protective feature and it did not.

[175] In the fact situation in *Highfields supra,* the impugned conduct took the form of dealings between the issuer and certain unit holders as to the exchange of their units and not with respect

to a matter that would inherently be properly addressed in the instrument governing the attributes of the units and the relations between the issuer and all holders.

[176] In *Deutsche Bank v. Oxford Properties supra*, the Court applied the oppression remedy provision to grant relief where it found that the Trust Indenture failed to reflect properly the representations that were made to the purchasers of the convertible debentures in the Prospectus relating to their issue. In the present case there is no such discrepancy between the Prospectus and the Trust Indenture. There is nothing in the Rio Algom Prospectus or the Trust Indenture to suggest a delisting of the shares would result in any other result in addition to a right of acceleration.

[177] *Highfields* and *Deutsche Bank* dealt with events that were not provided for in the trust indentures. In the present case, the Trust Indenture makes provision in respect of the event that occurred, the delisting. The Trust Indenture makes that occurrence an Event of Default. The Trust Indenture employs the concept of an "Event of Default" to identify the occurrences that will allow acceleration. No provision is made in the Trust Indenture for an Event of Default to have any other consequence. It is difficult to see why in principle it is unfair to leave the applicants to rely on the relief provided for in the Indenture for an event that is made objectionable only by a provision in the Trust Indenture referred to in the Prospectus.

[178] Since the Indenture makes provision both for the listing of the shares and for the consequences of a delisting, the onus must be on the applicants to show why it was unfair for the take-over and forced acquisition to have been carried out without care being taken for their interests other than simply leaving the Indenture to operate according to its terms and conditions. Otherwise, it would seem that the applicants are simply trying to pick and choose those provisions of the Indenture that are favourable to their case while ignoring other related provisions that detract from it, which would not be a reasonable way to proceed. This line of reasoning provides a cogent basis for considering that, having regard to the provisions of the Indenture, the delisting was not oppressive.

[179] It was suggested that the Prospectus provides support to the Applicants' case. The issued common shares were listed at the time of the issue of the Debentures. The Prospectus makes specific reference to this fact. The Prospectus also states that the Toronto and Montreal Stock Exchanges have conditionally approved the listing of the common shares offered by the Prospectus. These statements say nothing about an obligation to maintain the listing or the consequences of a delisting. The Prospectus does not address those matters.

[180] The Prospectus refers in a number of places to the section entitled "Details of the Offering". That section makes reference to the Trust Indenture. The specific statement in the Prospectus is as follows:

> The Debentures will be issued under a trust indenture (the "Indenture") to be dated as of the date of closing of the offering and made between the Corporation and Montreal Trust Company

> of Canada (the "Trustee"), as trustee. The following is a summary of the material attributes and characteristics of the Debentures which does not purport to be complete. Reference is made to the Indenture for the full text of the attributes and characteristics of the Debentures. A copy of the Indenture will be available for inspection (in draft form before closing and in executed form thereafter) at the principal office of the Trustee in Toronto.

[181] In view of this statement and the lack of any statement in the Prospectus dealing with the maintenance of the listing and the consequences of a delisting it is hard to see how a purchaser could rely on the Prospectus to say that its reasonable expectation in respect of the listing of the shares could disregard the provisions of the Indenture dealing with that subject.

[182] Some subsidiary considerations may be noted. First, it is not apparent how the holders could say that they had a reasonable expectation based on their dealing with Rio Algom as the issuer that the shares would be kept listed despite a take-over bid by a third party resulting in the acquisition of 100% of the outstanding shares. The holders' deal was only with Rio Algom and not with any other party.

[183] A further reason for concluding that the Debentureholders could not have had a reasonable expectation that a delisting would not be allowed to occur is provided by the reference in the Prospectus to the Shareholder Protection Rights Plan.

[184] The Prospectus provides as follows:

> In 1993, the shareholders of Rio Algom approved a Shareholder Protection Rights Plan (the "Plan:") authorizing the issue of one Right in respect of each outstanding Common Share. The Rights remain attached to the Common Shares and are not exercisable until the occurrence of certain designated events. Upon the occurrence of these events (including the acquisition by a person or group of persons of 20% or more of the voting shares of Rio Algom in a transaction not approved by the Board of Directors), the Rights entitle the holders, other than the acquiring person or group, to acquire Common Shares of Rio Algom at a 50% discount to the market price. The Plan permits a takeover of Rio Algom by means of a "Permitted Bid", which is a bid made to all holders of voting shares outstanding on identical terms. A Permitted Bid must be made in compliance with applicable Canadian and United States securities laws and must comply with certain other conditions. A Permitted Bid must also be

> accepted by holders of more than 50% of voting shares outstanding …

[185] From this information it ought to have been within the contemplation of Debentureholders that a takeover bid for all the outstanding common shares might be made and be permitted to proceed and that, if the takeover bid were successful, the shares would be delisted by the exchanges. While the text of the Prospectus does not state the latter point, it cannot justifiably be supposed that a reasonably informed intending purchaser of the Debentureholders would reasonably hold a different expectation.

[186] Taking the Prospectus and the Trust Indenture together, it can be concluded that the Convertible Debentureholders had a proper interest in being allowed to enjoy their rights under the Indenture in the event of an Event of Default by reason of a delisting. No basis is shown for a reasonable expectation that would go further. There has been no impairment of their rights under the Indenture, so no case of unfairness is made out.

[187] On the facts, the Rio Algom board did not know of the Billiton plan to acquire the remaining shares by compulsory acquisition under Part XV of the OBCA until after Billiton announced its plan to do either that or a going private transaction on October 6, 2000. Up to the time in late August that the Rio Algom board approved the Support Agreement, it knew of Billiton's stated intention to acquire 100% of the shares in one or another of the ways available for that purpose. Soon after that, the Rio Algom board was advised by Billiton that it would deal with the Debentures in a manner that was appropriate.

[188] At a meeting between representatives of Billiton and Rio Algom on October 11, 2000, it was observed that the Debentures "could go into default and redeem at par". It does not appear that this comment was more than an observation about one possibility among others.

[189] Billiton subsequently made a proposal to Debentureholders to redeem the Debentures at par but it did not receive the necessary two-thirds approval. It is not submitted that this proposal involved oppressive conduct on the part of Rio Algom.

[190] Billiton announced its plan for a compulsory acquisition under Part XV of the OBCA on October 7, 2000. Rio Algom had no involvement in that acquisition. Delisting was the inevitable result of the successful completion of the acquisition.

[191] On these facts, it could not be concluded that Rio Algom acted in a manner that unfairly disregarded the interests of the Debentureholders as characterized above. The same conclusion applies in respect to Billiton.

[192] In the case of Billiton, there are certain additional considerations. By the time of its compulsory acquisition, Billiton had become an affiliate of Rio Algom, so its conduct could properly found a complaint under s. 248 if it satisfied the other requirements of the section.

[193] A problem here is this. The basis for the complaint is the making of the compulsory acquisition and the causing of the event of default. Assuming for the moment that this conduct disregarded the interests of the Debentureholders, why was it unfair on the part of Billiton to act in this way? Although it had become an affiliate of Rio Algom, it was not acting in a manner that causes action to be taken by Rio Algom. Billiton was dealing directly with the shareholders of Rio Algom based on statutory rights acquired earlier by reason of Billiton's offer to them.

Billiton never had any relationship with the Debentureholders that would have provided a basis for assessing its conduct towards them as fair or unfair. It was a third party and it was exercising rights which it acquired as a result of actions it took while it was a third party.

[194] So there are two particular problems with the contention that Billiton has acted with unfair disregard for the interests of the Debentureholders and both of these problems arise from the fact that the conduct in which Billiton has engaged is that of a third party to Rio Algom and does not involve it in dealing with Rio Algom: (i) the difficulty in seeing how the holders could properly be said to have had a reasonable expectation about a third party's actions in buying the shares of Rio Algom, and (ii) the difficulty in seeing how Billiton as a third party buying those shares can be said to be acting unfairly in disregarding the interests of the Debentureholders.

[195] For the above reasons it cannot be concluded that Billiton's conduct in acquiring the shares constituted unfair disregard by it of the interests of the Debentureholders.

The Conduct of Billiton: The Transfer of the Subsidiaries

[196] It was not submitted that the transfer of the subsidiaries contravened any provision of the Trust Indenture or any statement in the Prospectus.

[197] The complaint of the applicants about the transaction is that, as it is put in their factum, "denuding Rio Algom of profitable assets was one of two ways by which Billiton ensured that the trading price of Rio Algom's common shares could not exceed the conversion price". (The other way was said to be the delisting of the shares.) The applicants advanced this contention at the hearing. The respondents' factums did not deal with this complaint. Counsel for Billiton made submissions about the complaint of the applicants after I raised the matter in the course of the Billiton submissions. There was no submission that the matter is not properly before the court.

[198] If Rio Algom common shares had still remained outstanding in the hands of public investors at the time of the transaction and had been listed, it would not have been possible for Billiton to have authorized the transaction by way of a unanimous shareholders resolution. It would have required Rio Algom board approval and the board might well have considered it necessary to use an independent committee, which might well have insisted on the same things as the independent committee in fact requested here, and possibly other protections as well. Moreover, all decisions would have had to be taken in the awareness that the market would make

its assessment of the advisability of the transaction for Rio Algom. With the shares having been acquired and delisted, the discipline of the prospect of assessment by the market was eliminated.

[199] A similar discipline might have been supplied by obtaining a valuation in compliance with the related party transaction requirements of the O.S.C. Counsel for Rio Algom and Billiton did not agree on whether those requirements applied. In any event, Billiton took steps, by transferring the jurisdiction of incorporation of Rio Algom, to make those requirements inapplicable.

[200] The independent committee requested Billiton to provide a letter of credit to secure its guarantee of the U.S. $350 loan. Billiton advised it would not comply with the request.

[201] In the result, Billiton carried out the transaction in such a way that it was done without the approval of the Rio Algom board or independent committee and without the safeguard requested by the independent committee and without the protective discipline that the valuation contemplated by O.S.C. requirements might have afforded in the absence of a public market for the shares. These features of the transaction arguably raise an issue whether Billiton was acting in a manner that disregarded the interests of the holders of the Debentures having regard to their conversion feature, as explained below.

[202] The argument in support of the above position is as follows. Immediately before the transaction (and whether or not the Debentureholders had been put in a position to complain under the oppression remedy provision by reason of the take-over and the delisting), the Debentureholders still had conversion rights, even though those rights had been adversely affected by the elimination of the public market and the delisting. No one can say whether, if Rio Algom had not transferred the subsidiaries to Billiton, the share value of Rio Algom would not have risen to a level that would have made it worthwhile for a holder of convertible Debentures to convert in the event Rio Algom called them for redemption. The prospect of such a situation perhaps seems difficult to credit but that is because of the loss of the public market and the delisting and not because of any information available about the actual and prospective value of the shares. Although exercise of the conversion rights had been made impracticable, the conversion rights continued to exist and therefore had some value and in the absence of evidence to the contrary, it must be taken that those rights and that value could be adversely affected by the transaction.

[203] On the other hand, there is arguably an air of unreality about this analysis. While it is the case that the Debentures continued to have conversion rights, the loss of the public market (as noted above) made conversion an impracticable course, as the applicants themselves say. Indeed the contention of the applicants is that the acquisition and delisting rendered the conversion rights virtually worthless and this is not disputed.

[204] It might also be argued that, as is discussed further in connection with valuation, taking into account their earlier trading price of $79, the Debentures likely did not have a value in excess of par at the time of the acquisition of the shares at a $27 share price even allowing for an

exercisable conversion right of unimpaired value at that time. The Debentures might have had a greater value at the time of the acquisition if the acquisition had triggered oppression remedy rights, but it did not so, for the reasons given above.

[205] This second consideration is not helpful by itself because even if the Debentures did not have a value above par at the time that would not excuse conduct that would damage their possible growth in value in the future. The first consideration, the impracticability of exercising the conversion rights, has some *prima facie* force. There is no evidence before the court on how, if at all, one could fairly value the common shares at a time when there is only one holder of them, Billiton. In the absence of evidence, considering the matter in principle, the value of the common shares would be solely dependent on the price which the only real prospective buyer, Billiton, would be prepared to pay for them. There is nothing to show how a reasonable expectation as to that price could be determined. In particular, there is nothing to show that the price Billiton would be prepared to pay would be affected materially by the transfer of the subsidiaries. However, for the reasons set out below, these considerations are inconclusive.

[206] The contention that the sale has prevented the Convertible Debentureholders from enjoying the increase in value in their securities that would have been possible if the assets had been retained gives rise to two important questions. If the assets had been retained, how would they have fared and how would the value of the shares of Rio Algom have been affected as a result? There is some evidence as to how the assets performed under the ownership of Billiton but there is no evidence as to the extent to which those results would have been replicated if the assets had instead been retained by Rio Algom. Moreover there is no evidence as to how, if at all, the sale of the assets affected the value of the Debentures at the time, ie. before the transaction and after.

[207] It is to be remembered that the position of the applicants is that the conversion option had been rendered virtually valueless by Billiton's acquisition of the shares and their delisting. There is no evidence to the contrary. The Gompers valuation of $0.76 for the option is post-acquisition but nothing is said in his report to suggest that it reflects the negative factor of the acquisition and delisting except to the extent the delisting gives rise to an Event of Default under the Indenture (and thereby allows a "put" to be made by the Debentureholders) and eliminates a public market. Paragraph 53 of Professor Gompers report indicates he is employing the assumption of shares of "private" firms for which there is a market although there is no listing. He doesn't say he is valuing for a case where all the outstanding shares of the company are owned by one person. There is no suggestion he is applying any discount for this consideration. As a matter of common sense, it may be hard to see (in the absence of helpful materials on the point) why anyone would pay to acquire an option to purchase at $40 a share in a class of shares recently valued at only $27 per share that is now owned entirely by the controlling shareholder and is not listed, otherwise than for a nuisance-type of value. On the other hand, "nuisance" is a misnomer here. Since the Convertible Debentures continue to have conversion rights, the arguable position is that Billiton must not unfairly disregard those rights. (This point is considered further below) What the value of the option on the above basis might be, and what effect the subsequent transaction would have had on that value, cannot be discerned.

[208] With respect to the other elements in the value of the Convertible Debentures, ie the debt obligation, there is no basis for a conclusion that the transaction negatively affected the ability of Rio Algom to repay the debt.

[209] Billiton obtained a valuation of the assets for the transaction and paid the amount indicated by the valuation with an interest-bearing debt obligation. Billiton did not provide the letter of credit that the Rio Algom board had requested, but that fact does not by itself allow a conclusion to be drawn that the sale was made for an amount less than value. Indeed, no submission was made to that effect.

[210] So, it cannot be said that the sale was made for less than value and it is not known how the value of the Debentures was affected by the transaction at the time and it cannot be known how the transaction ultimately affected the value of Rio Algom.

[211] However, it is not clear that considering only the present value of the Debentures at the time of the transaction meets the contentions of the applicants that their interests have been unfairly disregarded. The Debentureholders as holders of securities of Rio Algom have a reasonable expectation that decisions of Rio Algom would be taken in the best interests of the company as a whole. If the independent committee of the board had approved the transaction, the applicants would have had the onus, at least practically if not also legally, of showing that this requirement is not satisfied. But the committee did not approve the transaction, and the transaction was done without the letter of credit that the committee requested. The transaction was done on the approval of Billiton, the purchaser, so it is obviously a case of self-dealing and there must therefore be an onus on Billiton to show that the transaction was in the best interests of the company as a whole. This onus is a critical factor. It is especially critical because Billiton is not the only party interested in the equity value of Rio Algom; the Convertible Debentureholders hold rights to convert into the shares of Rio Algom. Billiton obtained a valuation but there is no way to determine the quality of the valuation since Billiton took steps to ensure the valuation requirements of the O.S.C. could not apply. So Billiton is not able to discharge its onus.

[212] Moreover, even if the conversion right of the Debentureholders was of negligible value at the time of the transaction, that does not mean that their interests in respect of that right were not adversely affected. By reason of the transaction, Rio Algom lost the potential benefit of the potential growth in the value of the transferred businesses, a potential benefit that would potentially enhance the value of the conversion right.

[213] Billiton submits that this line of reasoning is merely speculative. It does involve speculation. But that does not answer the complaint. The Debentureholders had a proper interest in enjoying the effect of speculative increases in the value of Rio Algom on the value of their conversion right. They have now lost the full benefit of that interest through action by Billiton which Billiton cannot show to have been in the best interests of Rio Algom as a whole. So it could properly be concluded that Billiton has unfairly disregarded the interests of the

Debentureholders. No basis for a claim against any of the other Billiton respondents was established.

Application of s7.6 to the claims against Billiton

[214] S.7.5 of the Trust Debenture authorizes the Trustee to enforce the rights of the Debentureholders in an Event of Default. S.7.6 precludes the Debentureholders from seeking remedies on their own rather than via the Trustee. The Trust Indenture is made between the Trustee and the issuer, here Rio Algom, for the benefit of all the Debentureholders, who are given certain rights on and subject to certain terms and conditions. Nothing in the terms of s.7.5 purports to limit the scope of the claims the Trustee may assert on behalf of the Debentureholders to claims against the issuer. Nor do the terms of s.7.6 purport to limit the scope of the claims that are precluded for the Debentureholders to claims against the issuer. If the Indenture were instead a direct contract between the issuer and one Debentureholder only it would be understandable to interpret the provisions of s.7.5 and 7.6 as applying only to claims against the issuer. But it is much less apparent that that interpretation is appropriate in respect of a trust instrument intended for the benefit of many persons.

[215] In the case of the Debentures, their terms, and therefore the rights of the Debentureholders, are constituted in and by the Trust Indenture. It is not only a contract but also a trust instrument. and the trust instrument constitutes a trust for many beneficiaries, the persons who are the Debentureholders from time to time. So viewed, there is no reason to regard s.7.6 as preventive of individual Debentureholder claims against the issuer only. The terms of s.7.6 are not specifically limited in that way and neither is the authority given to the Trustee in s.7.5. If it were held that s.7.6 applied only to claims against the issuer, the interpretation of s.7.5 that would seem to follow is that the authority granted to the Trustee is also so limited, and there is no evident reason to limit s.7.5 in that way. From the point of view of the Debentureholders, it makes sense that s.7.5 would not be interpreted in such a restrictive way.

[216] Moreover the result of such an interpretation is not to deprive the Debentureholders of the benefit of the oppression remedy. S.7.5 empowers the Trustee to assert a claim for the oppression remedy. And s.7.6 would allow a Debentureholder to assert the claim where the s.7.6 requirements in that regard are satisfied. In either case, the claim would be asserted for the benefit of all Debentureholders, which is not so in the present case.

[217] Nor is it evident that the present case is one in which it would impose an undue hardship on the Debentureholders to comply with the requirements set out in s.7.6 for the bringing of individual claims. In any event, there is no request here to vary the terms of the Trust Indenture.

[218] For these reasons, the better interpretation of s.7.6 is arguably that it applies to prevent the applicants from asserting their claim against Billiton as well as against Rio Algom.

[219] Arguably a difficulty is presented for this interpretation of s.7.6 by reason of the last two clauses of the last sentence of that section. If the words from “in no event” to the end of

sentence are taken to preclude a Debentureholder from asserting the oppression remedy, that result would apply even though by reason of the formulation of the terms of s.7.5, the Trustee is not given the power to make a claim for the oppression remedy in the particular case. To be more precise, if the conduct that is alleged to constitute oppression is not also an Event of Default under the Indenture, then the concluding clauses of s.7.6 could preclude a Debentureholder from asserting the claim even though the Trustee could not itself assert the claim because it would not qualify under s.7.5 for the Trustee's power because of the absence of an Event of Default. This asymmetrical outcome (ie. disempowering the Debentureholders in circumstances where the Trustee is not empowered) would be troubling.

[220] This disabling outcome, precluding the Debentureholders from taking action in a situation even where the Trustee is not empowered to do so, might suggest that this strong interpretation of the concluding clauses of s.7.6 needs further consideration.
[221] A possible alternative would be to read the concluding clauses as widening the power of the Trustee from that conferred by s.7.5, through the words, "all proceedings at law shall be instituted, had and maintained by the Trustee for the equal benefit of all holders of outstanding Debentureholders".

[222] As will be made clear below, it is not necessary to pursue these particular considerations further. The reason is that when s.7.5 and 7.6 are interpreted in the context of the other relevant provisions of the Indenture, the apparent problem of potential asymmetry disappears.

The Proper Interpretation of the Trust Indenture

[223] The submissions about the effect of s.7.5 and s.7.6 of the Indenture concentrated only on the specific terms of these sections. To understand correctly how s.7.5 and s.7.6 of the Indenture affect the question of the rights of the Debentureholders to exercise the oppression remedy, it is necessary to consider those sections in the context of the other relevant provisions of the Indenture.

[224] Section 7.5 grants authority to the Trustee to assert claims for the Debentureholders in the specific circumstances of that section. But s.7.5 does not purport to limit the power of the Trustee to proceedings authorized by that section.

[225] The Trustee has a general power to take legal proceedings. That power is set out as follows in s.12.11:

> Action by Trustee to Protect Interests
>
> The Trustee shall have the power to institute and maintain all and any such actions, suits or proceedings as it may consider necessary or expedient to preserve, protect or enforce its interests and the interests of the Debentureholders.

[226] In the context of the present case, it is to be noted that this power is not limited to the assertion of rights arising under the terms of the Indenture. Nor is the power limited to proceedings against the issuer only. The power is a broad general power to take legal proceedings to "enforce … the interests of the Debentureholders". This power, by its terms, is sufficiently broad to enable the Trustee to exercise the oppression remedy on behalf of the Debentureholders and to do so not only against the issuer Rio Algom, but also against Billiton. This provision is key to the interpretation issue and to the determination of the issues in this case.

[227] Section 10.11 sets out the power which the Debentureholders may exercise by way of an Extraordinary Resolution. Section 10.11(c) includes in those powers:

> Power to direct or authorize the Trustee to exercise any power, right, remedy or authority given to it by this Indenture or the Debentures in any manner specified in such Extraordinary Resolution or to refrain from exercising any such power, right, remedy or authority.

[228] The formulation of this power is compatible with the breadth of the power given to the Trustee in Section 12.11.

[229] Article 7 deals with "Default and Enforcement". More specifically, it defines Events of Default and provides for the enforcement of rights upon the occurrence of such events, as set out in sections 7.5 and 7.6. These sections must be read in their context. Their context includes the provisions considered above. Their context also includes, within Article 7 itself, s.7.11, which provides as follows:

> Remedies Cumulative
>
> No remedy herein conferred upon or reserved to the Trustee or the Debentureholders is intended to be exclusive of any other remedy, but each and every such remedy shall be cumulative and shall be in addition to every other remedy given hereunder or now or hereafter existing by law or by statute.

[230] Now, viewed within this context, it is possible to understand correctly the scope and limits of Section 7.5 and Section 7.6.

[231] Section 7.5 grants to the Trustee certain specific powers of enforcement when an Event of Default has occurred. By s.7.11 these powers do not exclude the other powers of the Trustee, including the broad power under s.12.11.

[232] The first part of section 7.6 (down to the words "as the Trustee might have taken under section 7.5", imposes a prohibition on the Debentureholders from taking certain proceedings

unless the requirements of section 7.6 (a) to (d) are satisfied, in which case a Debentureholder may take any court proceedings which the Trustee might have taken under s.7.5.

[233] Section 7.6 then continues with further provisions. The first is that "in no event shall any Debentureholder … have any right to take any other remedy or proceedings out of court". This disabling provision by its terms appears to be very broad. It was submitted that the provision ought to be understood to mean no more than "in no event in which a Debentureholder may take proceedings which the Trustee may take under s.7.5 may a Debentureholder take any other remedy or proceeding out of court." The section could have been worded in that way, so as to have that effect, but it was not worded that way, which supports the view that it was not meant to have that limited effect. The words "in no event" would most naturally mean "either in the above circumstances or in any other".

[234] But the paragraph does not end there. It continues with the clauses that commence with the words "it being understood and intended". These words suggest that what is to follow is a statement of a rule or principle of general application that is to govern the interpretation of the preceding provisions.

[235] The first of the two clauses relates to the Debentureholders. It is consistent with a reading of the "in no event" clause which does not limit that clause to an event or situation described in s.7.6 (a) to (d). On the other hand, it is not as broad as the literal reading given above to the "in no event" clause, because its scope is addressed only to "rights hereunder or under any Debenture", which would not include the oppression remedy.

[236] However, the clause relating to Debentureholders is coupled with a final clause, relating to the exercise of powers by the Trustee, and so must be read in that context. The final clause is as follows:

> and that all powers and trusts hereunder shall be exercised and all proceedings at law shall be instituted, had and maintained by the Trustee, except only as herein provided, and in any event for the equal benefit of all Holders of outstanding Debentures.

[237] The first part of the clause refers to "all powers and trusts hereunder". These include the power given to the Trustee under s.12.11 to take "all … proceedings … necessary … to … enforce … the interests of the Debentureholders", as discussed above.

[238] The final part of the clause provides that "all proceedings at law shall be instituted, had and maintained, by the Trustee, except only as herein provided, and in any event for the equal benefit of the Holders …". The scope of this clause, by its wording, is very broad. That breadth is consistent with the provisions that precede it and the other relevant provisions of the Indenture noted above. The clause includes reference to its implicit rationale: the power is to be exercised by the Trustee so that such exercise will be "for the equal benefit of all Holders". This rationale evokes the reasoning of Chancellor Allen in *Feldman, supra*. No reference was made in

Millgate, supra to any clause to this effect. Accordingly there is a good reason to follow *Feldman* and no reason to the contrary is shown.

Conclusion from the Interpretation

[239] For the above reasons s.7.6 must be taken to mean the broad proposition that it states. The effect of that proposition is that, except for a s.7.6 (a) to (d) claim against the issuer in respect of an Event of Default, only the Trustee may exercise the oppression remedy. Accordingly the claim of the applicants fails against Billiton as well as against Rio Algom.

Other Issues

[240] In view of the conclusion reached above it is not strictly necessary to address certain other matters that were addressed in the materials and submissions. However it may be helpful to do so, both for the parties in this case and for other prospective litigants in other cases. I acknowledge that the comments made below on the other matters may well be regarded as *obiter* (as may also some earlier parts of these reasons not dealing with the interpretation of the Trust Indenture.)

Valuation

[241] At the time of its acquisition of 100% of the shares, Billiton made a proposal to the Convertible Debentureholders which would have allowed them to receive par plus accrued interest without waiting until 2002. The respondents' position is that the fair value of the Debentures was not more than the amount this proposal would have yielded. The applicants dispute this and say the fair value of the Debentures was materially greater.

[242] There is a question as to what is the relevant time at which the valuation should be made. Before the Billiton offer the shares were trading at around $18 and the Debentures were trading at $79. The Billiton offer was $27 per share. It would seem that the appropriate time for the valuation would be after the making of the $27 offer for the shares and before giving effect to the impugned event of the delisting except as an Event of Default. (There is a question here whether this approach would introduce an element of artificiality, because the offer at the higher value of $27 also initiates the process which eliminates the listing and the public market. This question is considered further below).

[243] The applicants proffered evidence from two of their principals and from Mr. Fowler, an official of Scotiabank, a holder of Debentures, relating to the valuation of the Debentures. The evidence was tendered as opinion evidence and would therefore have to come from qualified experts with the requisite independence. The individuals in question cannot be considered adequately independent: their organizations all have a direct interest in the outcome. So their evidence is not admissible. This concern does not apply to the evidence of Mr. Hand that was given on behalf of the respondents.

[244] The respondents offered as expert evidence the opinion of Professor Gompers, which is addressed below. The applicants offered no evidence from an independent expert with reference to the valuation made by Professor Gompers, although they had employed their own expert with respect to that evidence. I accept the submission that that failure to lead evidence warrants an adverse inference against the applicants in regard to the valuation prepared by Professor Gompers.

[245] It remains at least interesting and possibly instructive that Nesbitt Burns, on the first request to them for a valuation of the post-bid value, provided advice that the value range was $101 to $104, with a mid-point of $102.50 which they considered acceptable as the value. Later evidence was given by a Nesbitt Burns representative that this valuation was not "beat up" as was the later and lower one given in November of 2000. However there was no evidence that made it plausible that Nesbitt Burns would have offered a valuation at the earlier time that they might have regarded as less than adequately assessed. For this reason, the value of $102.50 has some *prima facie* credibility.

[246] Despite the submissions of the applicants, it is in order to accept Professor Gompers of the Harvard Business School as an expert, based on his academic background and experience and his consulting experience, for purposes of expressing an opinion on the valuation of the Convertible Debentures.

[247] However, based on the submissions, it would be difficult to accept certain of the conclusions reached Professor Gompers report without significant qualification. Professor Gompers properly valued the Convertible Debentures on a post-bid basis, appropriately, after giving effect to the 100% acquisition and delisting. He did so by using an effective maturity of February 1, 2002 and regarding the Convertible Debentureholders as having acquired a put on their Debentures exercisable from the time of the delisting forward. He appears, appropriately, not to have discounted for the adverse effect of the delisting itself on the value of the conversion right.

[248] Where problems arise and remain, are in the determinations reflected in certain components in Table 2 in Professor Gompers report. It is not clear why the value the report attributes to Rio Algom's "call" on the Debentures in 2002 (ie. $10.19) is different from the value attributed to the (assumed) immediately exercisable "put" held by the Debentureholders (ie. $7.50). The applicants seemed to submit that, if any use is to be made of the report at all, which they dispute, the two amounts should be the same. That would result in a post-bid value of about $98.00. But difficulties remain.

[249] It is understandable that a value of $96.27 would be attributable to the bond portion of the Debenture based on a 2002 maturity, but it is not apparent why there would then be a deduction from that amount to reflect Rio Algom's "call" on the Debentures in 2002 when they are already treated as maturing at that time. But if that deduction is not made the resulting total value for the bond portion of the Debenture is $103.77 (ie. $96.27 + 7.50).

[250] Without some basis for a different view, I do not see why the "put" would have a different effect on the value than simply regarding them as demand instruments, in which case one would suppose that their value might well be higher than $96.27, but how it would exceed $100 is not apparent.

[251] Professor Gompers post-bid valuation, aggregates the "put" feature and the conversion right. It is not evident how the holder can enjoy both the right of early redemption and the alternative right of conversion; a Debentureholder can do only one or the other, not both. If so, one would think the value of the instrument would be the higher of its redemption value or its conversion value.

[252] Counsel made a genial admonition that a judge would fairly want to approach expert matters of this sort with appropriate modesty and I cannot disagree. Still, I am not able to dispel my perplexity about the above aspects of the valuation.

[253] It can reasonably be taken from the report that the post-bid components of the value of the Debentures would be the bond portion, valued to reflect relevant factors, plus a factor for the "put" now assumed to be held by the Debentureholders, for a total value equal to or approaching, but in any event not exceeding, $100, or, if valued instead for its conversion right plus an amount for the conversion feature for which Professor Gompers' value of $1.91 seems acceptable, a total of $98.18. On this analysis, the resulting value would be a maximum of par, presumably plus accrued interest.

[254] Further comments on valuation issues are given below. As will be apparent, the valuation issue remains unresolved.

Remedy

[255] The applicants say that it is not necessary to address valuation considerations in order to fashion the appropriate remedy. By reason of the redemption provisions in the Indenture, Rio Algom could redeem the Debentures after February 1, 2000 and up to February 1, 2002 only where the shares were trading at a 25% premium to the conversion price. The Applicants say that the interests of the Debentureholders have been unfairly disregarded in a material way such that they should be granted an oppression remedy, and that remedy should take the form of requiring the redemption or repurchase of their Debentures at a corresponding 25% premium to par. Otherwise, they say, if a lower price is to be paid, the companies will have obtained through unfair disregard a benefit they would not have received if they had acted properly, and this result would be unfair.

[256] The contrary position is that the most that the holders should receive is the fair value and the fair value is to be determined without reference to the 25% premium provision, by looking to what, on the evidence, would be the price reasonably to be expected in the event of a redemption or repurchase of Debentures in comparable circumstances. This position leads to two different approaches. One approach looks to the fact that the shares pre-offer were trading at $18 and the Debentures at $79 and contends that, at an indicated value for the shares of $27 (the take-over

price) the Debentures could not have risen to a fair value greater than par by the time of the conduct which is the basis for the remedy. The other approach looks to the prices paid in actual redemptions or repurchases in other cases where take-overs have occurred. The question on the latter approach is: which transactions can properly be regarded as comparable.

[257] The problem with this position, in either of its approaches, may be shown by referring to the difficulties that arise in deciding, on the second approach, what is a proper comparable. For example, one view advanced is that a debenture repurchase following a take-over is only comparable if the take-over occurred when the debenture was non-callable by the issuer. Another factor noted in one case (CFCF) cited by counsel is that the Quebec Securities Commission in effect gave the debentureholders a veto over the share acquisition. In at least one of the cases proposed as a comparable, there was a "change of control" clause in the trust indenture that gave the debentureholders special rights in the event of a proposed change in control. The difficulty stated in simple terms is how to say that two cases are comparable unless it is known that the legal rights, including oppression "rights", are comparable.

[258] The underlying difficulty here manifests itself in the conflicting evidence about the approach that is taken to valuing convertible debentures where they are to be redeemed in circumstances where a take-over has resulted in the effective loss of the conversion option. The evidence of Mr. Fowler was that it is common to use "a formula of par, plus interest to the first call date plus some consideration to compensate for the loss of the conversion option". However, Mr. Hand said there is no custom in the Canadian market whereby bidders for the common shares of the take-over target negotiate with the holders of convertible debentures for the early redemption of the convertible debentures at a price above par. Where the debenture is well out of the money (i.e. the conversion price is well above the current share price) there is no immediately obvious rationale for a price at a premium to par. The position reflected in Mr. Hand's evidence would seem to make perfectly good sense where the issuer proceeds on the basis (rightly or wrongly) that it has no legal liability beyond the making of an offer at face value. Following the Billiton acquisition, the conversion right attaching to the Debentures cannot be said to have had material value. The Debentures by their terms would not be redeemable by the issuer until 2002, when they would be redeemable at par. The occurrence of the delisting put the Indenture Trustee in a position, if authorized by the Debentureholders, to call for their immediate redemption at par. There is nothing to suggest that a third party considering a purchase of the Debentures either before or after the take-over would have had any good reason to pay more than par for the Debentures. After all, a third party purchaser could only look forward to getting par for the Debentures, so why would that purchaser pay more?

[259] Here of course the question is not what an unrelated third party would pay, but what Billiton should pay. It is apparent from material filed by the applicants and set out in their Table 1 that issuers have paid premiums over par to redeem debentures in take-over situations. But the information available does not provide a reliable base for determining something in the nature of a customary premium paid over the pre-existing debenture price for the loss of a conversion right that was well out of the money at the time of the take-over. In particular, I am not satisfied that the information shows a premium level that would be inconsistent with whatever premium level

would be implicit in an offer of par for debentures which were trading at $79 when the shares were at $18 and taking into account that the take-over price for the shares was $27. The information is not adequately grounded or detailed.

[260] If the proper way to determine the amount to be paid for the Debentures is to look either to their fair value on a third party purchase or to a price reflecting some customary premium for loss of the conversion option, I do not see a basis for concluding that the amount would be greater than par.

[261] A consideration in favour of a greater price is this. On the analysis set out above the continued existence of the conversion rights is a factor that adversely affects Billiton's ability to deal with Rio Algom as it sees fit. It would be understandable if this factor had additional value for the Convertible Debentureholders.

[262] The contention of the applicants is not that they should be paid an amount determined on the basis discussed above. They say that the proper approach is for Rio Algom and/or Billiton to pay them, not some amount that would be determined from such considerations, but rather the amount that they would have been able to receive if there had been no delisting, no Event of Default and no transfer of assets and Rio Algom had instead become entitled to redeem them in accordance with the terms of the Indenture and had decided to do so.

[263] Holders of the Debentures have a proper interest in being allowed to enjoy the benefits of the securities they hold, without conduct that unfairly disregards their interest. Where such conduct occurs, the question as to the proper relief may be put as follows: what relief most adequately compensates the holders for the unfair disregard to their interests. Here the choices that have been presented are as follows:

> (i) do nothing and leave the Debentures to be redeemed in the ordinarily course – this would simply ignore the oppressive conduct;
>
> (ii) redeem or repurchase the Debentures at an amount equal to their fair value in the market in the fall of November 2000, which would not have exceeded par – this would not recognize the reasonable expectation that the holders would have had that, if the debentures had been redeemed at that time, it could only have been because they would be able to receive a 25% premium on them through the exercise of their conversion rights;
>
> (iii)redeem or repurchase at 125%, which is what the holders could reasonably have expected to realize if they had been redeemed at that time.

[264] It certainly appears that, of these three options, only the last option fulfills the objective of providing adequate compensation for oppressive conduct.

[265] It is important to take into account in this regard that the oppressive conduct in this case is not located in the delisting but in the course of conduct which has resulted, through the transfer of subsidiaries, in the interests of the holders having been improperly disregarded in the conduct of that transaction. This is another reason why the reference to the premiums paid in respect of other take-overs does not help to resolve the matter.

[266] One possible objection to the above analysis is as follows. If some common shares of Rio Algom had remained outstanding in the hands of minority shareholders, and the sale transaction had been carried out in a way determined to have involved an unfair disregard of their interests such that they were entitled to an oppression remedy, it is reasonable to suppose that the remedy would have been an order to buy out their shares at the fair value of their shares before the impugned transaction. It might appear, on the 125% basis discussed above, that Convertible Debentureholders would receive an unfairly greater amount. The best answer to that objection may be that the terms of the Debentures give the holders a reasonable expectation that they will not be redeemed in the period without being able to realize a 25% premium. This expectation is special to the Debentures. It reflects the special characteristic that is fundamental to the conversion right, which is that the benefit it is designed to afford cannot be assured unless the conversion right remains in effect for the period designated in its terms.

A Note on Reasonable Expectations

[267] As mentioned earlier, the oppression remedy is addressed to interests. Giving consideration to the reasonable expectations of security holders is a way to assess what their proper interests are. For that purpose, it ought not to be necessary for the security holder to have had the expectation as a matter of conscious experience. The exercise to be undertaken by the Court is not one of psychological reconstruction. Conversely, the fact that a particular security holder actually held (or purports to have held) a particular expectation relating to the security does not necessarily assist in determining whether the expectation was reasonable.

[268] In submissions, the issue was raised whether the applicants could be said to have had the requisite reasonable expectations about the Debentures when in fact they purchased almost al of their Debentures after the acquisition by Billiton of the controlling position in Rio Algom. The *Palmer, supra* case was cited as authority for the proposition that a subsequent purchaser of the Debentures may in effect rely upon the interests of the previous holder from whom they were acquired.

[269] The applicants in the present case acquired their Debentures before the sale of the subsidiaries to Billiton. So the timing issue does not arise in respect of any claims they might have in respect of that sale.

Summary and Conclusions

[270] By reason of s.7.6 of the Trust Indenture the applicants are precluded from asserting their claim against Rio Algom. In any event the applicants have not shown that they have any basis for a claim for the oppression remedy against any of the respondents except for a claim against Billiton by reason of the sale transaction which it carried out subsequent to the takeover. However by reason of the proper interpretation of s.7.6 in the full context of the Trust Indenture, the applicants are also precluded from asserting their claim against Billiton.

[271] Accordingly the application is dismissed. Counsel may consult me about costs.

_____

SPENCE J.

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DATE: 20020822

ONTARIO

SUPERIOR COURT OF JUSTICE
Commercial List

B E T W E E N:

CASURINA LIMITED PARTNERSHIP, FIRST WAVE INC. and JMM TRADING LLP

Applicants

- and -

RIO ALGOM LIMITED, ET AL

Respondents

REASONS FOR JUDGMENT

SPENCE J.

Released: August 22, 2002

ICLR: Appeal Cases/2000/Volume 1/JAMESON AND ANOTHER RESPONDENT AND CENTRAL ELECTRICITY GENERATING BOARD APPELLANT - [2000] 1 A.C. 455

[2000] 1 A.C. 455

[HOUSE OF LORDS]

JAMESON AND ANOTHER RESPONDENT AND CENTRAL ELECTRICITY GENERATING BOARD APPELLANT

1998 Oct. 27, 28, 29;

Lord Browne-Wilkinson, Lord Lloyd of Berwick,

Lord Hoffmann, Lord Hope of Craighead

and Lord Clyde

Joint Tortfeasors - Concurrent tortfeasors - Contribution - Plaintiff agreeing "full and final" settlement of personal injury claim against one tortfeasor - Settlement less than full value of claim - Plaintiff's widow bringing dependency claim against concurrent tortfeasor - Whether settlement satisfying claim against concurrent tortfeasor - Whether bar to dependency claim - Fatal Accidents Act 1976 (c. 30), s. 1(1) (as substituted by Administration of Justice Act 1982 (c. 53), s. 3(1))

A few days before his death in 1988 from malignant mesothelioma J. agreed to accept £80,000 from his former employer in "full and final settlement and satisfaction of all the causes of action in respect of which the plaintiff claimed in the statement of claim" which were for negligence and/or breach of statutory duty in causing the disease by exposing him to asbestos at various premises at which he had been employed, including those of the defendant, for which his employer had undertaken work. By the time payment of the settlement sum was made by the employer J. had died. The £80,000 was significantly less than the full liability value of his claim. The fatal disease might have been caused by the negligence or breach of statutory duty of either or both of the employer and the defendant. The settlement of the action divested J. of his cause of action against his former employer and barred his widow from making a claim against it pursuant to section 1(1) of the Fatal Accidents Act 1976.1The

1 Fatal Accidents Act 1976, s. 1(1), as substituted: see post, p. **470F-G**.

plaintiffs, J.'s executors, issued proceedings against the defendant on behalf of J.'s widow for loss of dependency in respect of the same exposure to asbestos as for part of the claim in the settled action against the employer alleging similar, but not identical, negligence and breach of statutory duty. The defendant denied responsibility for J.'s illness, but maintained that in any event it could not be liable because of J.'s settlement of his claim with his former employer, which it joined as third party claiming a contribution pursuant to section 1 of the Civil Liability (Contribution) Act 1978 should it be held liable in damages to the plaintiffs. On preliminary issues assuming both parties liable as concurrent and not joint tortfeasors, the judge held that J.'s acceptance of the payment in settlement of his claim for personal injury did not bar the plaintiffs from proceeding with the dependency claim against the defendant and that in the event of that claim succeeding the defendant would be entitled to maintain proceedings against the third party for a contribution. The Court of Appeal dismissed appeals by the defendant and third party.

On appeal by the defendant:-

Held, allowing the appeal (Lord Lloyd of Berwick dissenting), (1) that as a matter of principle, once a plaintiff's claim had been satisfied by one of several tortfeasors his cause of action for damages was extinguished against all of them; that the effect of a compromise was to fix the amount of a plaintiff's claim in just the same way as if the plaintiff had obtained judgment after a trial; that (*per* Lord Clyde) the words used in the settlement were not readily open to a construction which resolved the issue of the parties' intentions regarding a concurrent tortfeasor; and that, accordingly, since the settlement agreement could not be construed as meaning that the sum which the deceased had agreed to accept was only in partial satisfaction of his claim of damages, the terms of the settlement with the employer were such as to extinguish the deceased's claim of damages against any other tortfeasor (post, pp. **465B**, **468H-469A**, **472A-B**, **474E-G**, **476D-F**, **482D**, **483A-C**).

(2) That the date from which the claim was to be treated as having been satisfied by reason of the settlement was the date when it was entered into subject only to a resolutive condition which would deprive the settlement of that effect if the deceased were unable to recover the payment due; that, as the settlement was implemented in full by the employer after the deceased's death, nothing which it

had agreed to pay having been left unpaid, its effect was to discharge the claim of damages against the other tortfeasors with effect from the date of the settlement; and that, accordingly, the plaintiffs could not satisfy the requirements of section 1(1) of the Fatal Accidents Act 1976 as the defendant would not have been liable, if death had not ensued, to an action of damages brought by the deceased in respect of the cause of action (post, pp. **465B**, **468H-469A**, **477G-478F**).

Reg. v. Turner [1974] A.C. 357 applied.

Decision of the Court of Appeal [1998] Q.B. 323; [1997] 3 W.L.R. 151; [1997] 4 All E.R. 38 reversed.

The following cases are referred to in their Lordships' opinions:

Arrow Chemicals Ltd. v. Guild, 1978 S.L.T. 206

Balfour v. Baird & Sons, 1959 S.C. 64

Bird v. Randall (1762) 3 Burr. 1345

Boyle v. State Rail Authority (1997) 14 N.S.W.C.C.R. 374

Brinsmead v. Harrison (1872) L.R. 7 C.P. 547

British Electric Railway Co. Ltd. v. Gentile [1914] A.C. 1034, P.C.

British Russian Gazette and Trade Outlook Ltd. v. Associated Newspapers Ltd. [1933] 2 K.B. 616, C.A.

Brown v. Wootton (1604) Cro.Jac. 73

Bryanston Finance Ltd. v. de Vries [1975] Q.B. 703; [1975] 2 W.L.R. 718; [1975] 2 All E.R. 609, C.A.

Carrigan v. Duncan, 1971 S.L.T. (Sh.Ct.) 33

Clark v. Urquhart [1930] A.C. 28, H.L.(N.I.)

Crawford v. Springfield Steel Co. Ltd. (unreported), 18 July 1958, Lord Cameron

Deanplan Ltd. v. Mahmoud [1993] Ch. 151; [1992] 3 W.L.R. 467; [1992] 3 All E.R. 945

Dillon v. Napier, Shanks & Bell (1893) 30 S.L.R. 685

Kohnke v. Karger [1951] 2 K.B. 670; [1951] 2 All E.R. 179

Latham v. Des Moines Electric Light Co. (1942) 6 N.W.2d 853

Liverpool City Council v. Irwin [1977] A.C. 239; [1976] 2 W.L.R. 562; [1976] 2 All E.R. 39, H.L.(E.)

Morris v. Baron and Co. [1918] A.C. 1, H.L.(E.)

Reg. v. Turner [1974] A.C. 357; [1973] 3 W.L.R. 352; [1973] 3 All E.R. 124, H.L.(E.)

Ruffino v. Grace Brothers Pty. Ltd. [1980] 1 N.S.W.L.R. 732

Steven v. Broady Norman & Co. Ltd., 1928 S.C. 351

Tang Man Sit (Personal Representatives of) v. Capacious Investments Ltd. [1996] A.C. 514; [1996] 2 W.L.R. 192; [1996] 1 All E.R. 193, P.C.

Townsend v. Stone Toms & Partners [1981] 1 W.L.R. 1153; [1981] 2 All E.R. 690, C.A.

Townsend v. Stone Toms & Partners (No. 2) (1984) 27 B.L.R. 26, C.A.

United Australia Ltd. v. Barclays Bank Ltd. [1941] A.C. 1; [1940] 4 All E.R. 20, H.L.(E.)

Watts v. Aldington, The Times, 16 December 1993; Court of Appeal (Civil Division) Transcript No. 1578 of 1993, C.A.

The following additional cases were cited in argument:

Ashmore v. British Coal Corporation [1990] 2 Q.B. 338; [1990] 2 W.L.R. 1437; [1990] 2 All E.R. 981, C.A.

Bell v. Galynski [1974] 2 Lloyd's Rep. 13, C.A.

Bryce v. Swan Hunter Group Plc. [1988] 1 All E.R. 659

Castellan v. Electric Power Transmission Pty. Ltd. (1967) 69 S.R.(N.S.W.) 159

Cumper v. Pothecary [1941] 2 K.B. 58; [1941] 2 All E.R. 516, C.A.

Gammell v. Wilson [1982] A.C. 27; [1981] 2 W.L.R. 248; [1981] 1 All E.R. 578, H.L.(E.)

Gardiner v. Moore [1969] 1 Q.B. 55; [1966] 3 W.L.R. 786; [1966] 1 All E.R. 365

Gleeson v. J. Wippell & Co. Ltd. [1977] 1 W.L.R. 510; [1977] 3 All E.R. 54

Henderson v. Henderson (1843) 3 Hare 100

Koursk, The [1924] P. 140, C.A.

Logan v. Uttlesford District Council (unreported), 14 June 1984; Court of Appeal (Civil Division) Transcript No. 263 of 1984, C.A.

M.C.C. Proceeds Inc. v. Lehman Brothers International (Europe) [1998] 4 All E.R. 675, C.A.

Martin French (A.) v. Kingswood Hill Ltd. [1961] 1 Q.B. 96; [1960] 2 W.L.R. 947; [1960] 2 All E.R. 251, C.A.

Morris v. Wentworth-Stanley [1999] Q.B. 1004; [1999] 2 W.L.R. 470, C.A.

Peto v. Checy (1611) 2 Brownl. & Golds 128

Phipps v. Brooks Dry Cleaning Service Ltd. [1996] P.I.Q.R. Q100, C.A.

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Pickett v. British Rail Engineering Ltd. [1980] A.C. 136; [1978] 3 W.L.R. 955; [1979] 1 All E.R. 774, H.L.(E.)

Pidduck v. Eastern Scottish Omnibuses Ltd. [1990] 1 W.L.R. 993; [1990] 2 All E.R. 69, C.A.

Scania (Great Britain) Ltd. v. Andrews [1992] 1 W.L.R. 578; [1992] 3 All E.R. 143, C.A.

Stanley v. Saddique (Mohammed) [1992] Q.B. 1; [1991] 2 W.L.R. 459; [1991] 1 All E.R. 529, C.A.

Talbot v. Berkshire County Council [1994] Q.B. 290; [1993] 3 W.L.R. 708; [1993] 4 All E.R. 9, C.A.

Thompson v. Australian Capital Television Pty. Ltd. (1996) 186 C.L.R. 574

Wah Tat Bank Ltd. v. Chan Cheng Kum [1975] A.C. 507; [1975] 2 W.L.R. 475; [1975] 2 All E.R. 257, P.C.

APPEAL from the Court of Appeal.

This was an appeal by the defendants, the Central Electricity Generating Board, by leave of the House of Lords (Lord Browne-Wilkinson, Lord Nicholls of Birkenhead and Lord Hope of Craighead) on 30 June 1997 from the decision of the Court of Appeal (Nourse and Auld L.JJ. and Sir Patrick Russell) on 13 February 1997 dismissing their appeal against a decision of Sir Haydn Tudor Evans sitting as a judge of the Queen's Bench Division at

Southampton on 31 March 1995 in determining a preliminary issue before issues of liability were decided that, inter alia, the plaintiffs, Elizabeth Ann Jameson and Alan William Wyatt, who were the executors of David Allen Jameson, deceased, were entitled to maintain their action on behalf of the deceased's widow and first named plaintiff under the Fatal Accidents Act 1976 and that the quantum of the claim was £142,000.

The facts are stated in the opinions of Lord Hope of Craighead and Lord Clyde.

Ian McLaren Q.C. and ***Simon Beard*** for the defendant. The settlement by a plaintiff of his action against a concurrent tortfeasor for an agreed sum stated to be in full and final settlement and satisfaction, without any express or implied reservation, discharges any other concurrent tortfeasor.

Full and final settlement should be just that for the tort rather than the individual cause of action. The Court of Appeal took the view that one should consider the value of the claim and if the settlement does not amount to 100 per cent. of the claim there has not been full and final settlement of the tort. However, the parties are likely to be the best judge of the settlement value of the case. The policy question is whether it is permissible for the parties to agree the figure of satisfaction. There is no reason in principle why a plaintiff should not fix the price of his own satisfaction.

Exactly the same allegations are raised against the defendant in the second action as were raised in the settled action. No explanation has been given as to why the defendant in the second action was not joined as second defendant in the first action. If both had been joined there would probably have been the same figure agreed in settlement against both of them jointly. Consequently, the instant action is an abuse of process and unfair.

The policy reasons for allowing the appeal include the following-(i) There should be finality in litigation: see *Tang Man Sit (Personal Representatives of) v. Capacious Investments Ltd*. [1996] A.C. 514 and *Morris v. Wentworth-Stanley* [1999] Q.B. 1004. (ii) A defendant who has settled on a full and final basis should not be at risk of being troubled again in contribution proceedings. (iii) A plaintiff should be free to fix the value of his own satisfaction. Some value has to be given to the fact that a defendant has given up his chance of success in the action. (iv) Settlement should be encouraged-a reservation can be made, and in any event would be implied, where plainly required. (v) A defendant should not be obliged to require a plaintiff to issue proceedings and have a consent judgment in order to achieve finality, this would add to costs and pressure on the courts. (vi) It would avoid double recovery; (vii) it would avoid delayed second actions.

At common law a mere judgment against one of a number of joint tortfeasors operated as a bar to any further action against any of the others even though the judgment remained unsatisfied: see

Wah Tat Bank Ltd. v. Chan Cheng Kum [1975] A.C. 507, 515-516. Release of one joint tortfeasor, whether under seal or by way of an accord and satisfaction released all others, but a mere covenant not to sue one joint tortfeasor had no such effect. Provided that the earlier judgment had not been satisfied a plaintiff could sue each concurrent tortfeasor to judgment, notwithstanding the prior judgment.

Satisfaction of a judgment given by an English court discharges the tort and prevents further action: see *United Australia Ltd. v. Barclays Bank Ltd*. [1941] A.C. 1, 20 and *Kohnke v. Karger* [1951] 2 K.B. 670, 674-676. A tort requires breach of duty, damage and loss. There is no loss if somebody else has satisfied the loss for the same damage.

Section 4 of the Civil Liability (Contribution) Act 1978 is permissive but that gives no ground for ignoring *Henderson v. Henderson* (1843) 3 Hare 100. The right to join an extra tortfeasor does not do away with the basic rule that all defendants should be joined in one action.

Satisfaction of a consent judgment for the sum agreed in favour of the deceased prior to his death would have discharged the tort. However, he settled by way of a Tomlin Order. The different methods should not be permitted to produce a totally different result.. The principle of satisfaction is said to be founded upon equitable principles: see *Bird v. Randall* (1762) 3 Burr. 1345; *Balfour v. Baird & Sons*, 1959 S.C. 64; *Arrow Chemicals Ltd. v. Guild*, 1978 S.L.T. 206 and *Joyce, The Law and Practice of Injunctions in Equity and at Common Law*, (1872), vol. 1, p. 62.

Clark v. Urquhart [1930] A.C. 28 decides no more than that payment of the full amount discharges the tort. It does not establish the converse: that less than 100 per cent. recovery is not satisfaction under an agreement between the parties.

There is no reason in principle why a plaintiff who agreed to a settlement should be in a worse position than if he had gone to court and had damages assessed in a judgment: see *Glanville Williams, Joint Torts and Contributory Negligence*, (1951), p. 33, para. 9 and *Peto v. Checy* (1611) 2 Brownl. & Golds 128.

Carrigan v. Duncan, 1971 S.L.T. (Sh.Ct.) 33 is a Scottish authority showing that it is possible for parties to agree a full and final settlement. The Court of Appeal [1998] Q.B. 323, 339 misconstrued that case. There is little English authority on the point. *Bell v. Galynski* [1974] 2 Lloyd's Rep. 13 is not decisive.

Ireland has taken the same approach (see section 16 of the Civil Liability Act 1961) as has Australia

(see *Balkin and Davis, Law of Torts,* 2nd. ed. (1996), p. 843; *Castellan v. Electric Power Transmission Pty. Ltd.* (1967) 69 S.R. (N.S.W.) 159; *Ruffino v. Grace Brothers Pty. Ltd.* [1980] 1 N.S.W.L.R. 732 and *Thompson v. Australian Capital Television Pty. Ltd.* (1996) 186 C.L.R. 574). The *American Law Institute, Restatement of the Law,* 2d, Torts, 2d (1969), p. 333, para. 885 also accepts the validity of the proposed principle. See also *Latham v. Des Moines Electric Light Co.* (1942) 6 N.W. 2d. 853.

Bryanston Finance Ltd. v. de Vries [1975] Q.B. 703 is of no assistance. It was a majority decision in which the majority were of differing views. Consequently, there is no discernible ratio. Moreover, the case can be distinguished as the agreement was not meant to be in full and final settlement. Similarly, *Townsend v. Stone Toms & Partners* [1981] 1 W.L.R. 1153 and *Townsend v. Stone Toms & Partners (No. 2)* (1984) 27 B.L.R. 26 do not take the matter forward, as the claims were not against concurrent tortfeasors liable for precisely the same damage, neither does *Watts v. Aldington,* The Times, 16 December 1993; Court of Appeal (Civil Division) Transcript No. 1578 of 1993.

The timing of the deceased's death gives rise to complications. However, the date of the settlement agreement should be held to be the effective date of the discharge, by satisfaction, of the tort: see *Morris v. Baron and Co.* [1918] A.C. 1, 35; *British Russian Gazette and Trade Outlook Ltd. v. Associated Newspapers Ltd.* [1933] 2 K.B. 616, 643 and *Arrow Chemicals Ltd. v. Guild,* 1978 S.L.T. 206. This would be on the same basis as the law deals with repudiation of a contract or acceptance of a cheque: see *Reg. v. Turner* [1974] A.C. 357. There is no reason why precisely the same doctrine should not be used in relation to discharging torts. Alternatively, if satisfaction occurred after death then the plaintiff is caught by the rule in *Bird v. Randall,* 3 Burr. 1345.

The issue of abuse of process only arises if the defendant fails on the issue of satisfaction. If it were to be decided that the claim was not satisfied only by reason of the non-payment prior to the death of the deceased, it is still open to the court to conclude that for the purposes of section 1 of the Fatal Accidents Act 1976 an injured person who has accepted a sum of money in full and final settlement of the claim but who dies before receipt of that sum, which is in fact paid to his estate, is not a person who is entitled "to maintain an action and recover damages in respect thereof" against any concurrent tortfeasor. A person cannot be in that position if it were ever likely that an action commenced by him would, upon payment of the agreed sum, be struck out as an abuse of process. The relevant words are "maintain" and "recover," not simply "commence."

Auld L.J. [1998] Q.B. 323, 344D, looked only at "entitlement" as at the date of death and decided it did not matter what the position would have

little justification for it. It is equally valid to ask whether the deceased would have been able to

issue a writ just before payment was made, knowing payment was coming. Although he would have had a right to issue a writ it would have been the subject of an abuse of process challenge. If the deceased could not have maintained an action in such circumstances there is no justification for allowing his widow to do so. This case is different from other windfall cases as it is a self-manoeuvred windfall.

The court can look at the reality of the situation rather than be constrained to reach an unjust result by reason of an over-rigid reliance upon the punctum temporis argument. Earlier authorities such as *British Electric Railway Co. Ltd. v. Gentile* [1914] A.C. 1034 did not require examination of any time other than the date of death to reach an appropriate result. They were perfectly adequate for their day but are not decisive of the issue in this case. Abuse of process is a wide doctrine which has been developed over the years as a flexible tool: see *Ashmore v. British Coal Corporation* [1990] 2 Q.B. 338.

The purpose of the Fatal Accidents Act 1976 is to enable dependants to bring an action if the deceased has failed to do so within his own lifetime: see *Talbot v. Berkshire County Council* [1994] Q.B. 290 and *Pickett v. British Rail Engineering Ltd*. [1980] A.C. 136. It is not its purpose to give a cause of action where the deceased has gained a settlement in his lifetime.

Although there is a statutory recognition of the right to sue another tortfeasor in a second action that right is subject to the *Henderson v. Henderson*, 3 Hare 100 principle. *M.C.C. Proceeds Inc. v. Lehman Brothers International (Europe)* [1998] 4 All E.R. 675 is the first case where the Court of Appeal has said that the *Henderson* principle applies not just to those who have been joined but also to those who could have been joined.

If all prior submissions fail the issue of the appropriate quantum of damages arises. Under section 3(1) of the Act of 1976 the damages due are not what the deceased would have recovered by way of his own action but what the defendants have lost by reason of the death. In the case of a person who has taken proceedings in his lifetime it is fair, in considering what has been lost on his death, to consider whether he could (or would) have brought another action himself if he were still alive. Where such further action is merely speculative no sum can be awarded in respect of that prospect. The only entitlement is bereavement damages and interest.

Ronald J. Walker Q.C. and ***Anthony Coleman*** for the plaintiffs. If necessary, the deceased's settlement should be construed as a covenant not to sue rather than a release by way of accord and satisfaction: see *Glanville Williams, Joint Torts and Contributory Negligence*, (1951), p. 46 and *Gardiner v. Moore* [1969] 1 Q.B. 55.

For an example of the difficulties of establishing liability in negligence or breach of statutory duty against an employer for exposure to asbestos going back to the 1950s giving rise to mesothelioma, see *Bryce v. Swan Hunter Group Plc.* [1988] 1 All E.R. 659.

The defendant's submissions below on satisfaction confused the common law defences of "satisfaction" (payment) and release by way of "accord and satisfaction" (settlement). The latter defence originally required executed consideration since the common law did not recognise executory consideration. This rule was changed by *British Russian Gazette and Trade Outlook Ltd. v. Associated Newspapers Ltd.* [1933] 2 K.B. 616 since when executory consideration has been considered sufficient "satisfaction" for the purposes of this doctrine, i.e., where there is a contract of settlement the right of action is extinguished and replaced by the right to sue on the contract. However, this has nothing to do with the common law defence of satisfaction.

If payment sufficient to satisfy the whole of the loss occasioned by the tort has been received, the plaintiff's claim has been satisfied and no further action lies. However, this principle can only apply when, on the facts, the amount recovered equals or exceeds the full amount of the plaintiff's damage. It makes no difference whether the money is recovered by consent judgment, acceptance of money paid into court or settlement: see *Bryanston Finance Ltd. v. de Vries* [1975] Q.B. 703; *Watts v. Aldington*, The Times, 16 December 1993; *Logan v. Uttlesford District Council* (unreported), 14 June 1984; Court of Appeal (Civil Division) Transcript No. 263 of 1984 and *Balfour v. Baird & Sons*, 1959 S.C. 64.

The decision in *Clark v. Urquhart* [1930] A.C. 28 depended upon a finding on the facts that the sum recovered by the plaintiff was full satisfaction so that no further damages could be recovered. The ratio on this point in *Bryanston Finance Ltd. v. de Vries* [1975] Q.B. 703 was based upon the fact that the sum which the plaintiff had already received in settlement exceeded any damages that could be awarded.

Partial satisfaction does not preclude a further action against another tortfeasor: see *The Koursk* [1924] P. 140 and *Townsend v. Stone Toms & Partners (No. 2)*, 27 B.L.R. 26. Therefore, even if the settlement money had been received by the deceased before his death it would not have amounted to satisfaction because the sum was less than the full liability value of his claim. The defendant's apparent assertion that every settlement is deemed to constitute satisfaction of the whole of the plaintiff's damage is wrong. It is inconsistent with the authorities, which show that where there are two torts and two tortfeasors settlement with one does not satisfy the claim against the other for reasons of privity of contract. If the deceased had brought a further action against the defendant he could not have obtained in total more than the damages his condition warranted. In such an action, as the Court of Appeal stated [1998] Q.B. 323, 340, the court might legitimately have either confined the judgment sum to the unrecovered amount of the deceased's total loss or given

judgment for the full amount of the claim, whereupon the deceased would not have been entitled to enforce that judgment save in relation to the amount by which damages and interest exceeded the sum already recovered.

Bird v. Randall, 3 Burr. 1345 is a case of satisfaction properly so called and is not authority for the defendant's proposition. Scottish authorities are not of persuasive authority. In any event, *Carrigan v. Duncan*, 1971 S.L.T. (Sh.Ct.) 33 may be justifiable on its facts. *Castellan v. Electric Power*

Transmission Pty. Ltd., 69 S.R. (N.S.W.) 159 and *Boyle v. State Rail Authority* (1997) 14 N.S.W.C.C.R. 374 are favourable to the plaintiff's case.

Further, the money was not paid until after the deceased's death. Satisfaction depends upon payment. This was the crucial point in *Bryanston Finance Ltd. v. de Vries* [1975] Q.B. 703. A promise to pay did not constitute satisfaction.

The plaintiff is simply attempting to enforce her legal right to damages. The fact that she does not have to give credit for indirect receipt of the deceased's settlement is the will of Parliament. If Parliament permits a windfall it is not for the courts to prohibit it. Were it so the actions in *Pidduck v. Eastern Scottish Omnibuses Ltd.* [1990] 1 W.L.R. 993; *Stanley v. Saddique (Mohammed)* [1992] Q.B. 1 and *Gammell v. Wilson* [1982] A.C. 27 would have been abuses of process as would many other cases which followed the *Gammell* case prior to the change in law effected by section 4(2) of the Administration of Justice Act 1982. Consequently, the widow's action is plainly not itself an abuse of process.

The Fatal Accidents Act 1976 gives the widow a claim which bears no relation to the claim the deceased might have had if he had lived. It is potentially a more valuable claim: see *Phipps v. Brooks Dry Cleaning Service Ltd.* [1996] P.I.Q.R. Q100.

Given that the whole amount of the deceased's loss was not compensated in the first action, a second action by the deceased, if he had lived, could only be an abuse of process if there were some principle that a plaintiff is bound to sue all possible defendants in one action. There is no such principle and the authorities are to contrary effect: see *United Australia Ltd. v. Barclays Bank Ltd.* [1941] A.C. 1; *Logan v. Uttlesford District Council*, 14 June 1984; *Watts v. Aldington*, The Times, 16 December 1993 and *Gleeson v. J. Wippell & Co. Ltd.* [1977] 1 W.L.R. 510. The only party prejudiced is the defendant in the first action who, having settled with the plaintiff, could be asked for a contribution if the defendant in the present action were to be sued and lose.

The terms of the settlement agreement can only be seen as an agreement to accept the payment as full and final settlement of the claim against that particular defendant as outlined in the statement of claim. Although the defendant has not relied on the point, there is no room for implying a term that the deceased would refrain from suing any other defendant. Whether the deceased intended to do so or not was irrelevant to the agreement. If the converse is true then every settlement with a concurrent tortfeasor for whatever value prevents an action against any other tortfeasor unless the agreement contains an express reservation. However, the defendant has relied throughout on satisfaction rather than an implied term.

If the deceased and his wife had deliberately planned that he would settle the claim in the first action for less than its full value so as to enable her to bring a Fatal Accidents Act claim after his death that would be a possible abuse of process. However, the findings of fact preclude abuse in this case so that if abuse is to be found it must exist in every case of this sort by virtue of section 4 of the Act. *M.C.C. Proceeds Inc. v. Lehman*

Brothers International (Europe) Ltd., 19 December 1997 is not relevant. That action was found to be an attempt to litigate the same point twice.

[LORD BROWNE-WILKINSON. Their Lordships do not need to hear argument on the issue of damages under the Fatal Accidents Act 1976.]

McLaren Q.C. in reply. It is incorrect that the defendant should have specifically pleaded an implied term. That was unnecessary. The task is to construe the settlement agreement against the factual matrix. The agreement evinces an intention that the payment was common law satisfaction of the damage resulting from the concurrent tort, thereby discharging the tort and precluding any further claim. Alternatively, the defendant's case has always been that the agreement should be treated as one where common law satisfaction and finality were objectively intended. In order to see what was objectively intended one necessarily considers both express and implied terms. The Tomlin order could hardly have been in fuller language. That order cannot be ignored since it is strong evidence of the intention of the parties.

There is no justification for treating a consent judgment, when satisfied, in any different way from a judgment entered following a trial. An unqualified consent judgment is conclusive evidence of an intention to accept the judgment sum as satisfaction of the damage resulting from the tort. Satisfaction of a consent judgment, as with any other judgment, discharges the tort: see *Bryanston Finance Ltd. v. de Vries* [1975] Q.B. 703.

A payment into court and acceptance thereof are subject to strict procedural rules under R.S.C.,

Ord. 22 and, in relation to defamation, Ord. 82, r. 4. It is a wholly procedural matter and has no true analogy to a settlement arranged between the parties out of court: *per* Goddard L.J. in *Cumper v. Pothecary* [1941] 2 K.B. 58, 67. However, once the court has ceased to exercise its controlling powers in relation to a payment in, there is no reason why the consequences cannot be determined as a matter of fact in the same way as if the money had been paid pursuant to an accord and satisfaction.

The difference between the instant case and a mere payment in is that the parties have drafted their own terms as distinct from relying on the terms provided in the Rules. See also *A. Martin French v. Kingswood Hill Ltd.* [1961] 1 Q.B. 96.

The principles as to what may constitute satisfaction (discharge) of a tort at common law are more complex where other defendants are involved on the pleadings but can be made clear by the terms of any order. Thus, even where joint tortfeasors are sued in the same action and normally acceptance of money paid into court by one operates as a stay against the others, it seems that the plaintiff might apply for the stay to be lifted if he is not satisfied with the amount recovered from the defendant paying in: *per* Stuart-Smith L.J. in *Scania (Great Britain) Ltd. v. Andrews* [1992] 1 W.L.R. 578, 582H-583A.

There are no special rules as to acceptance of payments in in cases involving concurrent tortfeasors sued either separately or together or in respect of joint tortfeasors if sued separately. Whilst each case must depend upon its own facts, acceptance of a payment in in these cases could amount to discharge of the tort if an intention to treat the payment in as full satisfaction is demonstrated.

The principle in *Henderson v. Henderson,* 3 Hare 100 can be invoked in appropriate circumstances where the plaintiff brings a second action against a defendant who could have been sued in the first action. Extension of the rule to such a situation is in accordance with *M.C.C. Proceeds Inc. v. Lehman Brothers International (Europe)* [1998] 4 All E.R. 675 and *Morris v. Wentworth-Stanley* [1999] Q.B. 1004.

Their Lordships took time for consideration.

16 December. LORD BROWNE-WILKINSON . My Lords, I have had the advantage of reading in draft the speech of my noble and learned friend, Lord Hope of Craighead. I agree with it and for the reasons which he gives, I would allow the appeal.

LORD LLOYD OF BERWICK . My Lords, David Allen Jameson was employed by Babcock

Energy Ltd. ("Babcock") between October 1953 and October 1958. In the course of his employment he worked at (among other places) two power stations owned and occupied by the defendants, the Central Electricity Generating Board ("the C.E.G.B."). In February 1987 Mr. Jameson developed symptoms of malignant mesothelioma. On 24 April 1988 he died. Shortly before his death, he brought proceedings against his employers. The value of his claim as found by the judge, Sir Haydn Tudor Evans, and as now agreed between the parties, was £130,000. On 19 April the claim was settled for £80,000 plus costs. The settlement was later embodied in a Tomlin order dated 29 April 1988.

On 2 April 1989 the executors of Mr. Jameson's estate brought these proceedings against the C.E.G.B. pursuant to the Fatal Accidents Act 1976, as amended, alleging negligence and breach of statutory duty. According to the particulars of negligence Mr. Jameson was exposed to substantial quantities of asbestos dust while working at Battersea Power Station between October 1953 and April 1954, and again at Castle Donnington Power Station between October 1957 and October 1958. The value of Mrs. Jameson's dependency, assessed on a conventional basis, has been agreed by the parties at £142,000. It is argued on behalf of the C.E.G.B. that the claim under the Fatal Accidents Act ("the widow's claim") is now barred on the ground that Mr. Jameson's claim against Babcock was settled before his death, even though that claim was settled for less than two-thirds of Mr. Jameson's loss. If that is the law, then I would regard the result as most unjust.

However a judge with unrivalled experience in personal injuries litigation has held that it is not the law. In a careful judgment in which he dealt with all the authorities, including the decision of Sheriff Sir Allan Walker Q.C. in *Carrigan v. Duncan*, 1971 S.L.T. (Sh.Ct.) 33 (the authority on which the C.E.G.B. chiefly rely) he has held that the widow's claim is not barred, because Mr. Jameson did not, on the agreed facts, recover the whole of his loss. The decision of the judge has been upheld by the Court of Appeal in an equally impressive judgment. I can find no error in either judgment, and would be content to adopt Auld L.J.'s judgment as my own. But it is right that I should spell out my reasons briefly in my own words.

There are two questions for decision, and it is best to keep them separate. The first is whether Mr. Jameson would himself have been able to maintain an action against the C.E.G.B. if he had not died. If not, then clearly the widow's claim under the Fatal Accidents Act 1976 must fail.

The second question is whether if the widow is entitled to bring her claim under the Fatal Accidents Act 1976 it makes any difference that she is the beneficiary under her husband's will. It is said that if she receives the dependency of £142,000 in full she will be recovering £80,000, or thereabouts, twice over; once as part of her husband's estate, and once as part of the dependency. But as against that, section 4 of the Fatal Accidents Act 1976 specifically provides that benefits accruing to any person from the estate of the deceased are to be disregarded in assessing damages under the Act.

As to the first question, the starting point is to distinguish between joint torts and concurrent torts. It is agreed between the parties that we are here concerned with concurrent torts, and not joint torts; that is to say, the claim against Babcock and the claim against the C.E.G.B. give rise to separate causes of action, each contributing to the same damage.

On the face of it, it would seem strange and unjust that a plaintiff who settles a claim against A in respect of one cause of action should be unable to pursue a claim in respect of a separate cause of action against B. Of course if the plaintiff recovers the whole of his loss from A, then he will have nothing left to recover against B. The payment received from A will have "satisfied" his loss, though I would for my part prefer not to use the term "satisfy" in this context, in order to avoid confusion with the quite different concept of accord and satisfaction. In the present case Mr. Jameson agreed to accept £80,000 plus costs in settlement of his claim against Babcock. If during his lifetime he had started a fresh action against Babcock he would have been met with the defence of accord and satisfaction, the satisfaction being the £80,000 which he agreed to accept in settlement of his claim against Babcock. But there would have been nothing whatever to stop him claiming against the C.E.G.B. during his lifetime, unless, of course, £80,000 had been the full amount of his loss. But it was not. On the agreed facts it was less than two-thirds of his loss.

It is a matter of every day occurrence in personal injury litigation that a plaintiff will begin an action against two concurrent tortfeasors. He may have a strong case against the first defendant, and a weak case against the second. In those circumstances he may be well advised to accept a payment into court made by the second defendant, and continue against the first.

Thus in *Townsend v. Stone Toms & Partners* [1981] 1 W.L.R. 1153 (a case in contract, but the same principle applies) the plaintiffs brought proceedings against a builder for defective work, and against the architect for negligence in supervising the work. The builder made a payment into court of £30,000 "in satisfaction of all the causes of action in respect of which the plaintiffs claim." It was argued that the claim against the architect should be stayed by virtue of R.S.C., Ord. 22, r. 3(4). The argument was rejected. Eveleigh L.J. said at p. 1161F: "where there are two separate causes of action, satisfaction of the one should not be a bar to proceedings on the other." So the case against the architect continued.

But when the case came on for trial, it was found as a fact that the £30,000 paid into court was more than sufficient to cover the whole of the loss suffered by the plaintiffs in respect of the overlapping claims. So the plaintiffs' claim against the architect in respect of the overlapping claims was dismissed, and the judge's decision to that effect was upheld by the Court of Appeal in *Townsend v. Stone Toms & Partners (No. 2)* (1984) 27 B.L.R. 26.

So the acceptance by a plaintiff of payment into court by one concurrent tortfeasor does not operate as a bar to proceedings against other concurrent tortfeasors, unless the plaintiff has recovered the whole of his loss. Exactly the same applies where judgment has been entered in respect of the amount paid into court (as happened in *Townsend v. Stone Toms*), or where a claim is settled without any payment into court; and exactly the same applies whether the claims against the other tortfeasors are made in the same set of proceedings or in subsequent proceedings.

It follows that Mr. Jameson would in my opinion have been entitled to commence proceedings against the C.E.G.B. during his lifetime for the whole of his loss, but he would have had to give credit for the £80,000 recovered from Babcock.

It is said that if Mr. Jameson had proceeded to judgment against Babcock and recovered £120,000, then he would not have been able to challenge that figure in other proceedings before another judge. The same ought to be true, so it is said, where Mr. Jameson has accepted £80,000 "in full and final settlement and satisfaction in all the causes of action in respect of which the plaintiff claims." The agreement stands in place of the judgment. But the two cases are entirely different. The £80,000 is not an agreed figure of the plaintiff's loss, corresponding to the judge's award of £120,000. It is a figure which reflects the plaintiff's chances of success in the action. By the time the judge comes to make his award, the action has, ex hypothesi, succeeded. So there is no room for any discount. Like Auld L.J. I can see no basis in law or common sense why the settlement of a claim in respect of one cause of action at 50 per cent. of the plaintiff's loss, so as to reflect the chances of success against that defendant, should impose a ceiling on the damages recoverable in respect of a separate cause of action against a different defendant.

A part of the difficulty may lie in the use of the word "value" in this connection. When it is said that a claim has an agreed value of £80,000 it may mean one of two things; it may mean that the plaintiff's loss is agreed at £80,000. Or it may mean that his claim is worth £80,000 after taking account of the chances of success. In personal injury cases it frequently happens that quantum is agreed subject to liability. But since very few claims are settled at 100 per cent., I would take a great deal of persuading that in agreeing a figure of £80,000 the parties were agreeing a figure for Mr. Jameson's loss, which agreement would then somehow enure to the benefit of concurrent tortfeasors. Nor can I see any reason for implying a term in the settlement agreement that Mr. Jameson would not proceed against other tortfeasors who might or might not bring contribution proceedings against Babcock. Babcock were professionally advised. If they had reason to fear contribution proceedings by a concurrent tortfeasor they could have protected themselves by an express term in the settlement

agreement. But they did not. On the other hand if the appellants are right, it will mean that in every case plaintiffs will have to insist on an express term reserving the right to proceed against other

concurrent tortfeasors, even though there might be no other tortfeasors in mind at the time. The requirement for such a term would be to reintroduce a trap of just the kind which Parliament and the courts have consistently tried to eradicate in the field of joint and several torts over many years: See the passage quoted in the court below from the judgment of Steyn L.J. in *Watts v. Aldington*, The Times, 16 December 1993; Court of Appeal (Civil Division) Transcript No. 1578 of 1993, and the illuminating judgment, Neill L.J. in the same case.

It is said that policy favours finality. So it does. But I do not see how it can make the settlement agreement mean something which it does not say, and on one view could not say.

As for *Carrigan v. Duncan* the explanation must be that the pursuer had recovered the whole of his loss in the earlier proceedings. As Auld L.J. pointed out at p. 339, there was no evidence in that case that the amount of the payment accepted by the pursuer was less than his loss. If that is not the explanation, then the case cannot stand against the great weight of English authorities cited by Sir Haydn Tudor Evans and the Court of Appeal.

For the above reasons, I would not for my part doubt that Mr. Jameson would have been entitled to commence proceedings against C.E.G.B. during his lifetime for the whole of his loss, but he would have been bound to give credit for the £80,000 received from Babcock.

I turn to the second question. Again it seems to admit of a straightforward answer. Section 4 of the Fatal Accidents Act 1976 provides that benefits accruing to a person from the estate of the deceased are to be disregarded. Parliament must therefore have contemplated that in a case where the person who would benefit under the Fatal Accidents Act 1976 is also the beneficiary under the will, that person may be entitled to a double recovery. It is unnecessary to consider why Parliament should have so provided. The language of the section is precise and clear. On the face of it, therefore, Mrs. Jameson is entitled to recover £142,000 in respect of her dependency, and to keep the £80,000 from her late husband's estate. It may be that a decision to that effect would work hardly on Babcock; but not so hardly as a decision the other way would work on Mrs. Jameson. Section 4 of the Act does not permit a halfway house.

It hardly needs saying that the answer to the second question cannot throw any light on the answer to the first question.

Conscious, perhaps, of the weakness of their argument on this part of the case, the C.E.G.B. allege that the current proceedings are an abuse of process. But the judge heard the witnesses over a period of 10 days. He expressly acquitted Mr. Jameson, and his advisers, of having a "secret reservation" when they entered into the settlement agreement, or of planning any procedural device. In the face

of those findings the allegation of abuse of process should have been abandoned.

For the above reasons, and the reasons given by Sir Haydn Tudor Evans and Auld L.J. in the Court of Appeal, with which I agree, I would dismiss the appeal.

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LORD HOFFMANN . My Lords, I have had the advantage of reading in draft the speech of my noble and learned friend, Lord Hope of Craighead. I agree with it and for the reasons which he gives, I would allow the appeal.

LORD HOPE OF CRAIGHEAD . My Lords, the dispute which has arisen in this case concerns the effect of the settlement of an action of damages for personal injury where the injured party has sued only one of two or more tortfeasors who by their separate acts have caused the same harm. In such circumstances each tortfeasor is liable to the injured party jointly and severally with the other tortfeasors for the whole amount of his loss. The injured party, having brought his action against only one of them, has agreed to accept a sum of money from that tortfeasor in full and final settlement and satisfaction of all the causes of action in his claim against him. But it is said that there is a shortfall between the amount which he has agreed to accept under the settlement and the full value of the claim. Is he able then to maintain and recover damages from the other tortfeasors in order to make up this shortfall, or is he disabled from doing so by his settlement with the first tortfeasor? And, if the effect of the settlement is to discharge the liability of the other tortfeasors, does it have this effect as soon as the agreement is made, or is this effect suspended until the settlement has been performed by payment to the injured party of the full amount of the agreed sum?

These questions have not been the subject of decision in any of the relevant English authorities-no doubt because the practice is for concurrent tortfeasors to be sued in the same action where by their separate acts they have caused the same harm. They have arisen as preliminary issues in this case, where the second action was commenced after the injured party's death.

The plaintiffs, who are the deceased's executors, brought the action by writ against the defendant, the Central Electricity Generating Board ("the C.E.G.B.") on behalf of his widow under the Fatal Accidents Act 1976 for damages for her loss of dependency. The deceased had brought a separate action before he died against his employer, Babcock Energy Ltd. ("Babcock"), for damages for personal injury due to asbestos exposure at various places where he was required to work during his employment, including the defendant's premises. On 30 March 1988 Babcock paid the sum of £75,000 into court. On 19 April 1988 the deceased's solicitors agreed to accept Babcock's offer of £80,000 in settlement of the claim. On the following day they sent to Babcock's solicitors a draft

Tomlin order which stated that it had been agreed that that sum was to be paid "in full and final settlement and satisfaction of all the causes of action in respect of which the plaintiff claims in the statement of claim." On 21 April 1988 Babcock's solicitors returned the draft order to the deceased's solicitors endorsed with their consent. The sum which was still due to be paid to the deceased under the settlement was £5,000, plus costs in the sum of £15,750. On 24 April 1988 the deceased died. On 29 April 1988 the action was stayed by way of the Tomlin order. On the same date Babcock's solicitors sent to the deceased's solicitors a cheque in settlement of their costs, and a further cheque for the remainder of the money payable to the deceased in

full and final settlement and satisfaction of the claim. So, although the settlement had been agreed to before the deceased died, performance of it was not completed until after his death.

The action which is the subject of this appeal was commenced on 2 April 1989. Pursuant to an order which was made on 7 April 1993 Babcock were joined as a third party. On 31 March 1995 Sir Haydn Tudor Evans, sitting as a judge of the Queen's Bench Division, gave judgment on a number of preliminary issues. He held that the plaintiffs were entitled to maintain the present action on behalf of the first named plaintiff under the Fatal Accidents Act 1976. He also held that the C.E.G.B. was entitled to maintain proceedings against Babcock for contribution under the Civil Liability (Contribution) Act 1978. Appeals against that decision by both the C.E.G.B. and Babcock were dismissed by the Court of Appeal (Nourse and Auld L.JJ. and Sir Patrick Russell) on 13 February 1997. Babcock did not seek leave to appeal against that decision, so no question now arises as to the entitlement of the C.E.G.B. to maintain contribution proceedings against Babcock. The principal issue in this appeal is whether the plaintiffs are entitled to maintain these proceedings against the C.E.G.B. It has been assumed that during the periods when he worked at their premises the deceased was exposed to asbestos as a result of breach of duty both on the part of Babcock and the C.E.G.B., and the trial of the preliminary issues proceeded on the basis that the C.E.G.B. and Babcock were concurrent tortfeasors. We are concerned in this case not with an accord and satisfaction which extinguishes the liability in tort of joint tortfeasors, but with the question whether the liability of concurrent tortfeasors for the same harm is discharged by a settlement which has been entered into with one of them.

The questions which arise as to the effect of a settlement with one tortfeasor in a question with the other concurrent tortfeasors are relevant to this case because, in order to succeed in their claim against the defendant under the Fatal Accidents Act 1976, the plaintiffs must satisfy the requirements of section 1(1) of that Act, as substituted by section 3(1) of the Administration of Justice Act 1982. The substituted section 1(1) provides:

> "If death is caused by any wrongful act, neglect or default which is such as would (if death had not ensued) have entitled the person injured to maintain an action and recover damages in respect thereof, the person who would have been liable if death had not

ensued shall be liable to an action for damages, notwithstanding the death of the person injured."

The plaintiffs must show (a) that the death was caused by a wrongful act, neglect or default which would, if death had not ensued, have entitled the deceased to maintain an action and recover damages in respect thereof and (b) that the defendant is a person who would have been liable, if death had not ensued, to the deceased's action of damages. It is the second of these two points which is in issue in this case.

In the ordinary case, where the deceased has died without having first brought an action of damages, the application of this provision will produce a fair result and ought not to give rise to any difficulty. But the

question whether the plaintiffs can satisfy its requirements has an additional significance in this case. This is because section 4 of the Act of 1976, as substituted by section 3(1) of the Administration of Justice Act 1982, provides that in assessing damages in respect of a person's death in an action under that Act the benefits which have accrued to any person from his estate or otherwise as a result of his death shall be disregarded. The first named plaintiff has inherited the whole of the sum of £80,000 which was received from Babcock under the settlement of the deceased's claim together with the remainder of the deceased's estate. As this is a benefit which accrued to her as a result of the death it must be disregarded. So the C.E.G.B. cannot take into credit, by way of set off against any liability to the plaintiffs in this action, the amount which was paid to the deceased in order to settle his claim against Babcock.

The situation which has arisen here may be summarised in this way. If the deceased would have been entitled to maintain an action and to recover damages from the C.E.G.B. notwithstanding his settlement with Babcock, the plaintiffs will be entitled not only to recover damages from the C.E.G.B. but to do so to the extent of the full amount of their claim without any set off for the damages which the deceased has already received under the settlement. The C.E.G.B. for its part will be entitled to maintain proceedings under section 1(1) of the Civil Liability (Contribution) Act 1978 against Babcock for a contribution towards the sum it paid to the plaintiffs in this action, notwithstanding the fact that Babcock has already entered into a full and final settlement of the deceased's claim against it. Thus Babcock, having agreed to a full and final settlement of the deceased's claim of damages and having implemented that settlement, will be exposed to a claim for a contribution towards a further payment in respect of the same claim which will be calculated as if that settlement had not been entered into. And the plaintiffs will be able to achieve full recovery for the first named plaintiff in respect of her claim of damages for loss of dependency, despite the fact that her loss has already been reduced by the amount which she has inherited from the deceased's estate which was paid in full and final settlement of his claim of damages for personal injury.

The trial judge said that he had reached this result with regret because it might work an injustice on Babcock. I agree. It seems unjust that Babcock should be exposed to the risk of having to pay damages twice for the same harm and that the plaintiffs should be able to obtain for the first named plaintiff what, in the circumstances, would amount to double recovery in respect of the same loss. It seems unlikely that, when the substituted section 4 of the Fatal Accidents Act 1976 was enacted, Parliament contemplated that a person could become entitled to a double recovery in these circumstances.

Did the settlement with one tortfeasor discharge the other tortfeasor?

The basic rule is that a plaintiff cannot recover more by way of damages than the amount of his loss. The object of an award of damages is to place the injured party as nearly as possible in the same financial position as he or she would have been in but for the accident. The liability

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which is in issue in this case is that of concurrent tortfeasors, because the acts of negligence and breach of statutory duty which are alleged against Babcock and the defendant respectively are not the same. So the plaintiff has a separate cause of action against each of them for the same loss. But the existence of damage is an essential part of the cause of action in any claim for damages. It would seem to follow, as a matter of principle, that once the plaintiff's claim has been satisfied by any one of several tortfeasors, his cause of action for damages is extinguished against all of them. As Lord Atkin said in *Clark v. Urquhart* [1930] A.C. 28, 66, "damage is an essential part of the cause of action and if already satisfied by one of the alleged tortfeasors the cause of action is destroyed." In that case the plaintiff had received in satisfaction of his claim against one defendant the full amount of damages which he could have received on any of the causes of action against the rest. It was held that his acceptance of the money paid into court was a satisfaction of all the claims in the action and that his damage, in a question with the other defendants, had been satisfied. In *Tang Man Sit (Personal Repres entatives of) v. Capacious Investments Ltd.* [1996] A.C. 514, 522 Lord Nicholls of Birkenhead discussed the limitations on a plaintiff's freedom to sue successively two or more persons who are liable to him concurrently. He explained the point in this way:

> "A third limitation is that a plaintiff cannot recover in the aggregate from one or more defendants an amount in excess of his loss. Part satisfaction of a judgment against one person does not operate as a bar to the plaintiff thereafter bringing an action against another who is also liable, but it does operate to reduce the amount recoverable in the second action. However, once a plaintiff has fully recouped his loss, of necessity he cannot thereafter pursue any other remedy he might have and which he might have pursued earlier. Having recouped the whole of his loss, any further proceedings would lack a subject matter. The principle of full satisfaction prevents double recovery."

So the first question which arises on the facts of this case is whether satisfaction for this purpose is achieved where the plaintiff agrees to accept a sum from one of the alleged concurrent tortfeasors which is expressed to be in full and final settlement of his claim against that tortfeasor, if that sum is

less than the amount which a judge would have held to be the amount of the damages which were due to him if the case had gone to trial and the defendant had been found liable.

In the Court of Appeal [1998] Q.B. 323, 341-342 Auld L.J., in a careful and impressive judgment, said that he could "see no basis in law or in common sense why an agreement expressed to be 'in full and final settlement and satisfaction' between a claimant and one tortfeasor should be regarded as full satisfaction in respect of any claims that he may have against a concurrent tortfeasor who was not a party to [the settlement]." This was because the causes of action against each of the concurrent tortfeasors are separate, not single and indivisible as is the case with joint tortfeasors. He said that satisfaction, as between concurrent tortfeasors, must depend not upon an agreement with one of them but on whether or

not the claim against the second tortfeasor has in fact been satisfied. So the judge in the second action was not bound to equate full satisfaction with a figure acceptable to both parties representing their assessment of the risks of litigation.

I follow that reasoning as far as it goes but I do not think, with great respect, that it goes quite far enough. The causes of action are indeed separate. And it is clear that an agreement reached between the plaintiff and one concurrent tortfeasor cannot extinguish the plaintiff's claim against the other concurrent tortfeasor if his claim for damages has still not been satisfied. The critical question, as Auld L.J. was right to point out, at p. 342B, is whether the claim has in fact been satisfied. I think that the answer to it will be found by examining the terms of the agreement and comparing it with what has been claimed. The significance of the agreement is to be found in the effect which the parties intended to give to it. The fact that it has been entered into by way of a compromise in order to conclude a settlement forms part of the background. But the extent of the element of compromise will vary from case to case. The scope for litigation may have been reduced by agreement, for example on the question of liability. There may be little room for dispute as to the amount which a judge would award as damages. So one cannot assume that the figure which the parties are willing to accept is simply their assessment of the risks of litigation. The essential point is that the meaning which is to be given to the agreement will determine its effect.

I take as my starting point the fact that a claim of damages in tort is a claim for unliquidated damages. It remains unliquidated until the amount has been fixed either by the judgment of the court or by an agreement as to the amount which must be paid to satisfy the claim. It cannot be doubted that, once the amount of the damages has been fixed by a judgment against any one of several concurrent tortfeasors, full satisfaction will have been achieved when the judgment is satisfied. The law used to be that the judgment against one joint tortfeasor was itself, without satisfaction, a sufficient bar to an action against another joint tortfeasor for the same cause: *Brown v. Wootton* (1604) Cro.Jac. 73; *Brinsmead v. Harrison* (1872) L.R. 7 C.P. 547: *Bryanston Finance*

Ltd. v. de Vries [1975] Q.B. 703, 721E-H and 730B-C, *per* Lord Denning M.R. and Lord Diplock. In the case of concurrent tortfeasors, a judgment recovered against one of them did not put an end to the cause of action against any of the other tortfeasors until it had been satisfied: *Bryanston Finance Ltd. v. de Vries*, p. 730E-F, *per* Lord Diplock. Section 6(1)(*a*) of the Law Reform (Married Women and Tortfeasors) Act 1935, which was replaced and extended by section 6 of the Civil Liability (Contribution) Act 1978, altered the common law on these matters. As the law now stands, a plaintiff is barred from going on with a separate action against another tortfeasor if the judgment which he has obtained in the first action has been satisfied.

What then is the effect if the amount of the claim is fixed by agreement? Is the figure which the plaintiff has agreed to accept in full and final satisfaction of his claim from one concurrent tortfeasor open to review by the judge in a second action against the other concurrent tortfeasor on the ground that, despite the terms of his agreement, he has

not in fact received the full value of his claim? Or is the fact that that figure was agreed to as the amount to be paid in full and final settlement of the first action to be taken as having fixed the amount of the claim in just the same way as if it had been fixed by a judgment, so that the claim must be held to have been extinguished as against all other concurrent tortfeasors?

As I have said, a claim of damages is a claim for a sum of money, the amount of which must necessarily remain unliquidated until something has been done to fix the amount. Where the claim is adjudicated upon by the court, the amount of the damages is fixed by the judgment which the court makes as to the sum required to make good to the plaintiff the full value of his loss. But it is well known that many claims are settled without the amount due as damages having been adjudicated by the court. They are settled by agreement between the parties. Were it not for the fact that most claims of damages are settled in this way, the parties would be exposed to greater expense and uncertainty and the burden of work on the courts would be intolerable. There is a strong element of public interest in facilitating the disposal of cases in this way.

In the typical case the plaintiff agrees to accept the sum which the defendant is willing to pay in full and final settlement of his claim. Such a settlement normally involves an element of compromise on both sides. Each side will have made concessions of one kind or another to reflect its assessment of the prospects of success if the case were to go to trial. The plaintiff will normally have made a discount from the amount which he regards as full compensation for his loss. He may have withdrawn some elements of his claim, reduced the amounts sought in settlement of others or accepted an overall reduction in the amount claimed. But, whatever the nature and extent of the compromise, one thing is common to all these cases. This is that the agreement brings to an end the plaintiff's cause of action against the defendant for the payment of damages. The agreed sum is a liquidated amount which replaces the claim for an illiquid sum. The effect of the compromise is to

fix the amount of his claim in just the same way as if the case had gone to trial and he had obtained judgment. Once the agreed sum has been paid, his claim against the defendant will have been satisfied. Satisfaction discharges the tort and is a bar to any further action in respect of it: *United Australia Ltd. v. Barclays Bank Ltd.* [1941] A.C. 1, 21, *per* Viscount Simon L.C.; *Kohnke v. Karger* [1951] 2 K.B. 670, 675, *per* Lynskey J. I think that it follows that, if the claim was for the whole amount of the loss for which the defendant as one of the concurrent tortfeasors is liable to him in damages, satisfaction of the claim against him will have the effect of extinguishing the claim against the other concurrent tortfeasors.

There may be cases where the terms of the settlement, or the extent of the claim made against the tortfeasor with whom the plaintiff has entered into the settlement, will show that the parties have not treated the settlement as satisfaction for the full amount of the claim of damages. In the same way a judge, in awarding damages to the plaintiff in his action against one concurrent tortfeasor, may make it clear that he has restricted his award to a part only of the full value of the claim. That was the point which the sheriff, Sir Allan G. Walker Q.C., had to examine in *Carrigan v.*

Duncan, 1971 S.L.T. (Sh.Ct.) 33. In that case the pursuer who had accepted a sum from one wrongdoer in full satisfaction of his claim for loss and injury resulting from a road accident raised a fresh action against another alleged wrongdoer in an attempt to recover further damages. Auld L.J. said, at p. 339B, that this case did not support the submission that the answer to the question whether the claimant had received full satisfaction is to be found in the words of the settlement. I think that, on closer examination, it provides direct support for this submission on grounds which do not appear to be in conflict with any relevant English authority. It has been referred to and accepted as good authority in Australia: *Ruffino v. Grace Brothers Pty. Ltd.* [1980] 1 N.S.W.L.R. 732; *Boyle v. State Rail Authority* (1997) 14 N.S.W.C.C.R. 374.

In holding that the second action was incompetent the sheriff distinguished two previous cases where a second action to recover further damages had been held to be competent. The first was *Dillon v. Napier, Shanks & Bell* (1893) 30 S.L.R. 685, where the court examined the terms of the receipt and the correspondence regarding the settlement which showed that the pursuer's claim against the second wrongdoer was expressly reserved and the payment made was not a payment in full satisfaction of all possible claims for the injury. The second was *Crawford v. Springfield Steel Co. Ltd.* (unreported), 18 July 1958, where Lord Cameron held that the obtaining of a decree against one employer did not debar a later claim against another employer because the judge in the first action had made it clear in his judgment that he had granted a decree for only 10 per cent. of the pursuer's total loss due to the disease which he had contracted on the footing that the defenders in that action were only 10 per cent. to blame for the pursuer's incapacity. In *Carrigan v. Duncan* on the other hand the pursuer had brought his action against the defender in the first action on the basis that that defender was entirely to blame for the accident. It was said on his behalf that he did not

intend the settlement of the earlier action to be in full satisfaction of his claim for loss and injury arising from the accident. But the pleadings and the terms of the settlement, looked at objectively, showed that the sum which he obtained under it had been accepted in full satisfaction of his claim.

In these circumstances the sheriff applied the decision of the Court of Session in *Balfour v. Baird & Sons*, 1959 S.C. 64, where the judgment which the pursuer had obtained against one employer in the first action made it clear that the award of damages was for the whole of the damage which he had suffered as the result of his pneumoconiosis and the second action which had been raised against another employer was dismissed as incompetent. Relying on the principle which was explained in that case that the claim is extinguished against all the wrongdoers once the damages have been satisfied in an action against any one of them, the sheriff held that the claim had been satisfied by the settlement of the first action and that in this case also the second action was incompetent. He did not, as Auld L.J. noted, at p. 339D, hear any evidence that the sum which had been accepted in settlement was less than the full amount of his loss. But it is clear from the sheriff's judgment that he would have held that evidence to that effect was excluded by the terms of the settlement.

I think that these cases demonstrate the limits of the inquiry which the judge may undertake in the event of a subsequent action being raised against another alleged concurrent tortfeasor. He may examine the statement of claim in the first action and the terms of the settlement in order to identify the subject matter of the claim and the extent to which the causes of action which were comprised in it have been included within the settlement. The purpose of doing so will be to see that all the plaintiff's claims were included in the settlement and that nothing was excluded from it which could properly form the basis for a further claim for damages against the other tortfeasors. The intention of the parties is to be found in the words of the settlement. The question is one as to the objective meaning of the words used by them in the context of what has been claimed.

What the judge may not do is allow the plaintiff to open up the question whether the amount which he has agreed to accept from the first concurrent tortfeasor under the settlement represents full value for what has been claimed. That kind of inquiry, if it were to be permitted, could lead to endless litigation as one concurrent tortfeasor after another was sued on the basis that the sums received by the plaintiff in his settlements with those previously sued were open to review by a judge in order to see whether or not the plaintiff had yet received full satisfaction for his loss. Different judges might arrive at different assessments of the amount of the damages. The court would then have to decide which of them was to be preferred as the basis for the apportionment between the various tortfeasors. I do not think that this can be regarded as acceptable. The principle of finality requires that there must be an end to litigation.

The question therefore is, as Mr. McLaren for the C.E.G.B. put it, not whether the plaintiff has received the full value of his claim but whether the sum which he has received in settlement of it

was intended to be in full satisfaction of the tort. In this case the words used cannot be construed as meaning that the sum which the deceased agreed to accept was in partial satisfaction only of his claim of damages. It was expressly accepted in full and final settlement and satisfaction of all his causes of action in the statement of claim. I would hold that the terms of his settlement with Babcock extinguished his claim of damages against the other tortfeasors.

Was the effect of the settlement suspended until payment?

This is the second question which arises on the facts of this case, because the sum due under the settlement which the deceased entered into before he died on 21 April 1988 was not paid until 29 April 1988. When he died the debt which was due under the settlement had not been satisfied. Section 1 of the Act of 1976 requires that the question whether the defendant would have been liable to the deceased in damages if death had not ensued must be addressed as at the date of the deceased's death. As Lord Dunedin said in *British Electric Railway Co. Ltd. v. Gentile* [1914] A.C. 1034, 1041, the punctum temporis at which the test is to be taken is at the moment of death, with the idea fictionally that death has not taken place. But the problem in this case is not due to any failure on Babcock's

part to perform its obligations under the settlement. It is simply one of timing.

The argument for the C.E.G.B. was that the date of the settlement agreement should be held to be the effective date for the discharge of the tort. I do not think that it would be right to regard what the deceased accepted in settlement of his claim for damages as no more than a promise by Babcock that it would perform its obligations under the settlement. What he agreed to do in satisfaction of his claim was to accept payment of the sum which Babcock had agreed to pay to him. So it was open to him to say that until that sum had been paid to him his claim of damages had not been satisfied. As Lord Diplock explained in *Bryanston Finance Ltd. v. de Vries* [1975] Q.B. 703, 730E-G, that is the rule which applied at common law where the plaintiff had recovered a judgment against one of two or more concurrent tortfeasors. The judgment did not put an end to the cause of action until it had been satisfied. So long as it remained unsatisfied it was not a bar at common law to a subsequent action against any other of the tortfeasors.

Examples of the application of a similar rule can be found in the Scottish authorities. In *Steven v. Broady Norman & Co. Ltd.*, 1928 S.C. 351 it was held that the fact that a decree had been obtained against one of a number of joint and several obligants did not preclude a fresh action being brought against the others, if satisfaction had not been got under the decree. In *Arrow Chemicals Ltd. v. Guild*, 1978 S.L.T. 206 Lord McDonald applied the same rule in a case where the first action had been settled by the pursuer's acceptance of a sum which had been tendered to him in full of the

conclusions of the summons. He held that the pursuer would be precluded from proceeding against the defender in the second action if he had already received full reparation of his loss from the first, but that he would be able to proceed with the second action if he had been able to recover nothing under the decree which he had obtained in the first action or had recovered less than his full loss under it. We were not referred to any English case in which this question had arisen in a case where the plaintiff had entered into a settlement in his action against the first concurrent tortfeasor. But it seems to me that it would have to be answered in the same way. To do otherwise would clearly produce hardship and inequity.

But the question of timing which arises in this case raises a different problem. A further analysis of the terms and effect of the settlement is needed in order to resolve it. The issue, it seems to me, is whether the settlement was subject to a condition which suspended its effect for any purpose until the sum due to be paid under it had been fully paid up by Babcock, or whether it was subject to a resolutive condition that the discharge of the plaintiff's claim was to be treated as void ab initio if the sum due under it was not paid.

The settlement itself was silent on these matters, but I think that the correct view of its nature was that it was to take effect as soon as the agreement was made as having discharged the deceased's claim of damages, subject to an implied resolutive condition which would render it void ab initio if the debt which was due under it was not satisfied. In *Liverpool City Council v. Irwin* [1977] A.C. 239, Lord Wilberforce had

regard to what the nature of the contract itself implicitly required in the search for the obligation which should be read into the contract, as essentials of the tenancy. Lord Fraser of Tullybelton said, at p. 270, that the obligation was to be implied as a legal incident of the kind of contract which those landlords and those tenants had entered into. I think that the nature of a settlement of the kind which was entered into in this case requires that terms be read into it, subject only to a resolutive condition in the event of the debt not being satisfied, to the effect that the settlement puts an end to any further proceedings between the parties to it except those which are needed to enable the action to be stayed and the case taken out of court, and that the deceased's claim of damages are to be treated as satisfied so that the defendant is not exposed to the risk of contribution proceedings by any other concurrent tortfeasor. The same view would be taken if the plaintiff's claim had been dealt with by means of a judgment. The issuing of the judgment would be a bar to any further proceedings for damages for the same tort against the defendant or any other concurrent tortfeasor as from the date of the judgment, subject only to a resolutive condition in the event that the judgment was not satisfied.

In *Reg. v. Turner* [1974] A.C. 357, 367-368 Lord Reid said that, where a person takes a cheque in discharge of a debt, the discharge is presumed to be subject to a resolutive condition that if the

cheque is dishonoured the discharge is void ab initio and the debt revives in its original form. That also was a case where the nature of the transaction required of necessity that an implied resolutive condition should be read into it. I would apply the same reasoning here and hold that the date as from which the claim of damages is to be treated as having been satisfied by reason of the settlement with the first concurrent tortfeasor is the date when the settlement was entered into, subject only to a resolutive condition which would deprive the settlement of that effect if the plaintiff was unable to recover the payment due under the settlement.

So I would hold that, as the settlement which the deceased entered into before his death was implemented in full by Babcock, nothing which it had agreed to pay having been left unpaid, its effect was to discharge the claim of damages against the other concurrent tortfeasors with effect from the date of the settlement. The plaintiffs cannot therefore satisfy the requirements of section 1(1) of the Fatal Accidents Act 1976, because the C.E.G.B would not have been liable, if death had not ensued, to an action of damages brought by the deceased in respect of the same tort. I would allow the appeal.

LORD CLYDE . My Lords, the respondents are the executors of the late David Alan Jameson ("the deceased"), who died on 24 April 1988 as a result of a malignant mesothelioma. Before he died he had commenced proceedings against his former employers, Babcock Energy Ltd. ("Babcock"). In those proceedings he had claimed damages for the mesothelioma which he averred he had developed through the negligence of Babcock as a result of contact with asbestos in the course of his employment with them during four periods between 1953 and 1958. These periods related respectively to work at Battersea Power Station, at Dewrance & Co.'s factory in South London, at Babcock's welding school

in Birmingham, and at Castle Donnington Power Station in Derbyshire. On 30 March 1988 Babcock's solicitors paid £75,000 into court. The notice recording this which was sent to the deceased's solicitor stated that that sum, which included interest, was "in satisfaction of all the causes of action in respect of which the plaintiff claims." On 19 April 1988 his solicitors negotiated an oral agreement to settle the action for £80,000 plus costs. They sent a letter, without prejudice, to Babcock's solicitors by fax on that day, including a statement of their costs. On 20 April 1988 Babcock's solicitor wrote confirming the settlement at £80,000 plus costs at the stated sum which they also agreed. They enclosed a draft order for consent and return. That draft provided for the staying of all further proceedings (save for enforcing the terms of the order) upon certain terms including the payment of £80,000 in 14 days "in full and final settlement and satisfaction of all the causes of action in respect of which the plaintiff claims in the statement of claim." Four days later the deceased died. After that, payment was made of the balance of the settlement sum of the cost.

Thereafter his executors commenced proceedings against the Central Electricity Generating Board

("the C.E.G.B."). The claim was for damages suffered by his widow in respect of loss of dependency and for bereavement. The case was based on the development by the deceased of mesothelioma as a result of the negligence of the C.E.G.B. during the periods between 1953 and 1954 when he worked at Battersea Power Station and between 1957 and 1958 when he worked at Castle Donnington Power Station, both of which power stations had been owned or occupied by the C.E.G.B. These places and periods were the same as two of the places and periods referred to in the proceedings against Babcock. The proceedings initially included a claim under the Law Reform (Miscellaneous Provisions) Act 1934, but that was later abandoned as it was more than balanced by the money which had been received in the settlement and that sum had to be taken into account. There remained a claim under the Fatal Accidents Act 1976. Babcock was joined as a third party in the action. It was accepted that by virtue of section 4 of that Act (as amended by section 3(1) of the Administration of Justice Act 1982) no credit needed to be given for the money received in the settlement from Babcock. This feature in the case makes it a remarkably unattractive one from the point of view of the defendants. If the plaintiffs are correct in their submission the widow stands to gain not only the damages obtained by the deceased from Babcock but in addition the whole damages he could have recovered from the C.E.G.B. without any deduction in respect of the settlement with Babcock. It was suggested that if the result was inequitable an allowance might be made for the inheritance, but in strict law there seems to be no obligation to do so. It was not suggested that the terms of section 4 of the Act of 1976 should be so construed as to exclude the settlement sum. It was argued that for the executors now to proceed against the C.E.G.B. would be an abuse of process. But it seems to me too difficult to maintain such an argument. If the deceased would have been entitled to sue the circumstance that the settlement sum has passed to his widow where Parliament has provided that no deduction is to be made on that account does not in my view render the executors' claim an abuse of process. But this peculiarity of double recovery in the present case should

not distract one from the critical issue of the entitlement of the deceased to have commenced proceedings against the C.E.G.B. Had he so disposed of his estate that the widow did not inherit the sum precisely the same issue would remain. Accordingly I approach the matter without regard to this special feature.

Section 1(1) of the Act of 1976 imposes a liability to an action for damages for a wrongful act, neglect or default where the deceased if he had not died would have been entitled to maintain an action and recover damages in respect of that wrongful act, neglect or default against the person who would have been liable. It thus becomes critical for the executors that the deceased would have been entitled to take these proceedings against the C.E.G.B. at the moment of his death.

But here a second special feature of the case arises. By the time of his death there had been agreement to settle the case, but there had not been payment of the agreed sum. Whether an accord

does or does not have the effect of achieving a discharge depends upon the terms of the agreement. The position in a case of contract was explained by Lord Atkinson in *Morris v. Baron and Co.* [1918] A.C. 1, 35:

> "There is no doubt that the general principle is that an accord without satisfaction has no legal effect, and that the original cause of action is not discharged as long as the satisfaction agreed upon remains executory. That was decided so long ago as 1611 in *Peytoe's case* ((1611) 9 Rep. 77b, 79b). If, however, it can be shown that what a creditor accepts in satisfaction is merely his debtor's promise and not the performance of that promise, the original cause of action is discharged from the date when the promise is made."

It is open to the creditor to insist upon performance by the other party before the discharge is to be effective and in such a case the liability of the other will remain until performance has been made. On the other hand if the creditor has accepted in satisfaction the debtor's promise, as distinct from the performance of his promise, the original cause of action will be discharged from the date when the promise is made. Thus in *British Russian Gazette and Trade Outlook Ltd. v. Associated Newspapers Ltd.* [1933] 2 K.B. 616, the agreement there made was seen as one where the consideration was an executory promise and was enforceable at least by way of counterclaim. Scrutton L.J. observed, at p. 644: "The accord is the agreement by which the obligation is discharged. The satisfaction is the consideration which makes the agreement operative." As Greer L.J. recognised, at p. 654, the promise is valuable consideration and the agreement is enforceable at law. Looking at the exchange of letters in the present case I consider that the agreement reached by the time of the deceased's death was legally effective to achieve a discharge.

The significance of the accord in such a case as the present where the promise serves as consideration is the substitution of a contractual obligation for the original debt, illiquid in the case of a claim in tort. After the agreement for settlement has been concluded the original claim is superseded and a contractual claim put in its place. What the parties have done is to agree to the substitution for the original right and liability, contingent as they may have been, of a contractual obligation to pay, or

even perform, something in return for a surrender of the claim, thereby innovating on the original relationship and superseding it. After the settlement has been agreed the rights and obligations of the parties are governed by the contractual provisions which they have made and unless these require for any reason to be annulled the agreement provides the measure of the respective rights and obligations of the parties in place of any previous claim or liability in respect of the matter in relation to which the settlement has been made. Actual satisfaction is only achieved when payment or performance on the agreed terms has been made. If that is done then the rights and obligations of the parties under the settlement agreement are spent.

A question could arise about the remedies of the creditor if the debtor fails in performance. Greer L.J. in the *British Russian Gazette case* said, at p. 655, that the "only remedy" was to sue for damages if performance was refused. On the other hand where there has been a settlement but satisfaction has not been made it may well be thought that the plaintiff should be enabled to reopen the matter and if necessary seek his damages against another tortfeasor. This has certainly been recognised in Scotland. In *Steven v. Broady Norman & Co. Ltd.*, 1928 S.C. 351 a worthless decree which had been obtained against one wrongdoer was held to be no bar to an action against another who was alleged to be liable jointly and severally with the other. And in *Arrow Chemicals Ltd. v. Guild*, 1978 S.L.T. 206 it was recognised that recovery from one of two persons alleged to be jointly and severally liable to the pursuer was only precluded where full reparation had been made and the case was continued in order to explore the alleged inability of one of the two to honour a decree which had been pronounced against him for payment.

It may be that the unsatisfied creditor could reopen a settlement on the ground of an implied condition in it for performance, or an implied resolutive condition covering the possibility of a failure in performance; but in the present case the agreed sum was paid and it is unnecessary to express a view on the point.

It was accepted before the Court of Appeal that on the assumption that both Babcock and the C.E.G.B. were liable they were to be regarded as several or concurrent tortfeasors. They would be on that assumption several tortfeasors causing the same damage. I shall refer to them simply as concurrent tortfeasors. It was open to the deceased to have commenced proceedings at the outset against both Babcock and the C.E.G.B. Or he could have commenced proceedings against the one and either he or the C.E.G.B. could have brought the other into the proceedings at a later stage. But he chose to go only against Babcock. If matters had remained in that state at his death it could be said that he would have been entitled to maintain an action against the C.E.G.B. But then the settlement intervened and the question is what effect that had.

One approach to the solution is by way of construction of the agreement. Certainly the parties could have expressed their agreement in terms which would have left the matter in no doubt. It could have been expressly provided that this was a settlement only of the deceased's claims against Babcock without prejudice to any claims he might make against the C.E.G.B. or anyone else and without prejudice to any liability Babcock

might then incur by way of contribution to such a party in the event of a successful claim being made. Or it could have been expressly stated that the settlement was intended not only to resolve the rights and obligations as between the deceased and Babcock, but was also intended to free Babcock absolutely from any further liability by way of contribution to anyone else. Where the proceedings have been brought against both concurrent tortfeasors release of one may more readily be seen as a

reservation of rights against another, as in *Townsend v. Stone Toms & Partners (No. 2)*, 27 B.L.R. 26, where the claims partially overlapped and account had to be taken of the sum recovered by agreement from the one party in the continuation of the action against the other.

Had the C.E.G.B. also been a party to the action and the settlement was made only with Babcock, it might more readily be construed that the deceased's rights against the C.E.G.B., and Babcock's possible liability in contribution were to be preserved. But that was not the situation. The C.E.G.B. was never made party to the action. Nothing was said of any possible claim against the C.E.G.B. Indeed it is a matter of agreed fact that Babcock was never informed of the possibility that any action would be taken against the C.E.G.B. by the deceased or his executors. The possibility of such further action played no part in the settlement.

I do not find the words used in the agreement in the present case readily open to a construction which solves the question one way or the other. The terms of the letters are too general to do that. The terms of the payment into court refer to all the causes of action, which might seem to be comprehensive, but are then qualified with the words "in respect of which the plaintiff claims" which may limit the scope to Babcock's liabilities to the deceased. That certainly appears to be the scope of the first paragraph of the draft order which the solicitors were exchanging as embodying their agreement before the deceased died. On the other hand in agreeing in terms of the fourth paragraph of the draft order that on payment of the balance of damages and agreed costs Babcock should be "discharged from any further liability in respect of the plaintiff's claim in this action" it may be that even a liability in contribution was intended to be released.

As I have already said, a plaintiff can make it clear in the agreement to settle the action whether or not he is reserving his right to go against another person. The question arises what view the law is to take if he has failed to make the position clear. Is it to be assumed that he is reserving his right, so that he must expressly state that he is not doing so? Or is it to be assumed that he is not reserving his right, so that he must expressly state that he is doing so? Where the matter is not resolved by the words used in the agreement in the context of the particular case one has to resort to considerations of policy and principle.

It is plain matter of policy to secure that litigation should be terminated and successive claims discouraged. That can be illustrated by the provision contained in section 4 of the Civil Liability (Contribution) Act 1978. Further it seems to me that the law should discourage any opening up of settlements which parties have concluded between themselves, with a view to analysing whether they are sufficient to secure what the parties believed they were securing, namely a fair compromise of

the differences between them. The problem such as has arisen in the present case can be avoided by taking proceedings against all the potentially liable parties at the one time. As a matter of policy it seems to me that where the matter is left in the air a settlement with one of several parties who are jointly and severally liable to the same plaintiff should involve a release of the others.

But beyond all of that the basic consideration both of policy and principle must be that while those injured by a tort committed by others should be compensated through the processes of the law, they should not be enabled to recover damages twice over. Such a result offends the basic principles of reparation, and, while it was accepted as a possible consequence of the operation of section 4 of the Fatal Accidents Act 1976 it is not to be regarded as an acceptable consequence of an accord and satisfaction. The principle is recognised in England in, for example, *Bird v. Randall* (1762) 3 Burr. 1345, in Australia in *Boyle v. State Rail Authority*, 14 N.S.W.C.C.R. 374 and in the United States of America in *Latham v. Des Moines Electric Light Co.* (1942) 26 N.W.2d 853.

It is necessary also to make some analysis of an agreement to settle. A claim for damages may have a value which does not equate with the quantification of the loss and injury which is claimed. This is not simply because it is an illiquid claim. A claim for an ascertained sum which is due and owing may correspondingly have a value which falls short of the ascertained sum because, for example, there may be some technical difficulty in the proof of it, or more pragmatically because there is some doubt about the financial position of the debtor. In the case of a claim for damages there may be an uncertainty about the proof of the liability of the defendant there may be a variety of factors affecting the prospects of success and there may always be hazards in the process of litigation. So the value of the claim may well be less than the full amount of the debt. In light of such uncertainties the creditor may well feel that a just result can be achieved by a payment of the value of the claim, thereby avoiding the trouble and the uncertainties of insisting on his right to prosecute the matter to a judicial conclusion. So a settlement may be reached under which he would receive what may be seen as the value of the claim, which may or may not be close to the amount of the claim, depending on an assessment of the various factors, some doubtless imponderable, which may arise in the circumstances of the particular case. Such settlements are of course to be encouraged. If, as ought to be the case, the figure is reached after an arm's length negotiation, it can reasonably be assumed that the figure finally agreed upon does represent the full value of the claim. Each party has to balance the strengths and weaknesses of their respective positions and it is only after an assessment, or even a reassessment, of these that the eventual figure is eventually identified.

What is then agreed and paid is a sum which represents the full value of the claim so that the indebtedness is thereby extinguished. What is paid is the present value of a possible future award. So it does not seem to me that in the ordinary case after settlement has been made and satisfied with the one defendant there can be a balance of the claim which is recoverable from another possible defendant. What the parties must be seeking to achieve is a conclusion to their respective rights and liabilities so as to

extinguish them altogether for the future. It may be that the terms of the agreement for settling the action will themselves make it evident that the debtor is being completely discharged so as to bar the claimant from renewing the claim against him. But apart from that by operation of law it seems to me that having received the full value of his claim a vital ingredient has gone from his original cause of action so that he is no longer able to prosecute his claim. If he was allowed to do so that would offend against the principle that he would be getting all or part of his damages twice over.

Where the case has gone to trial and judgment has been awarded and satisfied the plaintiff should not be entitled to go against another concurrent tortfeasor in the same matter. The whole of his loss will have been assessed and quantified, and after payment his whole claim would be exhausted. This result appears to be in conformity with the position established in Scotland. In *Balfour v. Baird & Sons*, 1959 S.C. 64 a steel dresser was awarded damages from one of his former employers for pneumoconiosis. He then endeavoured to sue another of his employers who had allegedly also caused his contraction of the pneumoconiosis, explaining that he had only received partial damages in the earlier proceedings and now sought to recover the balance from the other employer. His claim failed. It was held that having invited a court to give him full satisfaction for the whole of the loss and damages suffered by him and had won an award of damages that was an end of it. The damage had ceased to exist.

But exceptional circumstances may occur where there is a deficiency in the award and the plaintiff may be entitled to sue another concurrent tortfeasor for the balance of his claim. Such a course was allowed in *Kohnke v. Karger* [1951] 2 K.B. 670. That was a somewhat special case in so far as the first action had been taken in France where the one defendant, a driver and his employers, resided and where their assets were. The second action was brought in England where the other defendant resided and where it was assumed his assets were. The judge was satisfied that the assessment of damages in French practice would produce an award less than what would be regarded in England as full satisfaction and he made an award in the English action. But the case must be seen as depending upon its own rather unusual circumstances.

In principle it seems to me that where settlement is sought with one alone, where the others are not involved in the proceedings, the intention of the parties should usually be taken to be that they are achieving a complete termination to any claims by the creditor and a complete freedom for the future for the debtor. On the one hand the creditor is being fully compensated for the value of his claim so as to exhaust any right to pursue it further in any direction. On the other hand the debtor is being discharged from any possible liability in contribution so that the creditor would be in breach of the agreement were he to sue a third party and create such a liability. Particular circumstances and particular terms in the agreement may obviate such consequences, but, where the matter has been left open and unclear, it seems to me that those are the consequences which should follow

upon the settlement of one co-obligant in a joint and

several obligation which has been carried out in the absence of any other co-obligant.

The decision in *Balfour v. Baird* was carried a stage further in *Carrigan v. Duncan*, 1971 S.L.T. (Sh.Ct.) 33 where the pursuer had settled his action against one party by the acceptance of a tender made in the court process which had been followed by a decree of the court awarding the sum which had been offered and accepted. It was held that where the pursuer had maintained the first action solely against one of the parties who might be jointly and severally liable, despite a defence to the effect that the other party had caused or contributed to the accident which gave rise to the claim, and had accepted a tender "in full settlement of the conclusions of the action," he was not entitled to bring proceedings against the other party although he asserted that the tender had been made on a basis of partial liability. The court held that the intention of the parties to the settlement "must be assessed objectively upon the basis of the decree itself in the context of the pleadings of the parties and of the terms of the tender upon acceptance of which the decree proceeded."

The decision in *Carrigan's case* has been followed in Australia. In *Ruffino v. Grace Brothers Pty. Ltd*. [1980] 1 N.S.W.L.R. 732 no distinction was recognised between judgments arrived at by settlement and judgments arrived at by judicial determination. Where the plaintiff had received a payment in his first action which could only be regarded as full satisfaction, that exhausted his rights, so that he was not entitled to take further proceedings against another party who might have been jointly and severally liable. A like view was taken in *Boyle v. State Rail Authority*, 14 N.S.W.C.C.R. 374, where the defendants had all been sued together. The plaintiff settled with eight of the nine defendants, all of whom were jointly and severally liable, and sought to proceed against the ninth, it was held that there was insufficient evidence that the plaintiff had received the amounts of the settlement otherwise than as full compensation for his claim.

This is a case of allegedly concurrent tortfeasors, that is to say several tortfeasors causing the same damage. We were referred to certain cases relating to joint tortfeasors as distinct from several tortfeasors causing the same damage, but it is unnecessary to decide any question about joint tortfeasors in the present case, or indeed any question about concurrent or joint co-obligants in contract, as to which reference could be made to *Deanplan Ltd. v. Mahmoud* [1993] Ch. 151. For present purposes it is enough to hold that the deceased in the present case would not have been entitled to commence proceedings against the C.E.G.B. at the time of his death. I would accordingly allow the appeal.

Appeal allowed.

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B. L. S.

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23.0517 Interest

It is a general long-standing rule in bankruptcy that there may not be proof for interest accruing after the date of bankruptcy.[90] Interest up to the date of bankruptcy is provable as part of the claim of a creditor if the creditor were entitled to claim interest, such as pursuant to a contract, under a judgment of the court[91] or by operation of law.[92]

Based on the theory of equality between creditors of the same class, interest is not allowed on unsecured claims after the date of bankruptcy. If, however, there were a surplus after the payment of the claims as provided in ss. 136 to 142, it should be applied in payment of interest from the date of the bankruptcy at the rate of 5% per annum on all claims proved in the bankruptcy, according to their priority.[93]

23.0518 Rule Against Double-Proof

A court sitting in bankruptcy is a court of equity. An equitable maxim is "equality is equity" which requires a *pari passu* distribution on a *pro rata* basis among unsecured creditors. Thus, if there were only one debt, then there cannot be two proofs, even though there may be separate contracts in respect of the same debt. As Mellish L.J. said, "[T]he true principle is, that there is only to be one dividend in respect of what is in substance the same debt, although there may be two separate contracts".[94]

Although there may be several claimants with respect to a debt, there is only one debt and double-proof in respect of it is not permitted.[95] The existence of separate and distinct claims or liabilities is not determinative of whether or not there is double-proof; the crucial issue is whether or not the separate claims relate in substance to the same debt.[96]

Section 123 of the BIA, however, creates an exception to the rule against double-proof. It provides that where a bankrupt was, at the date of bankruptcy, liable in respect of distinct contracts as a member of two or more distinct firms or as a sole contractor and also as a member of a firm, the circumstance that the firm is, in whole or in part, composed of the same

90 *Savin (Re)* (1872), 7 Ch. App. 760. Under the BIA, see s. 122(2).

91 Andrew Keay, *Insolvency: Personal and Corporate Law and Practice*, 3rd ed. (Sydney: John Libbey & Company Pty. Ltd., 1998), at p. 135.

92 Mars, *op. cit.*, footnote 20, at p. 330.

93 BIA, s. 143.

94 *Oriental Commercial Bank (Re); European Bank (Ex p.)* (1871), L.R. 7 Ch. App. 99 (C.A.), at pp. 103-4; *Hoey (Re); Hoey (Ex p.)* (1918), 1 C.B.R. 139 (D.C.). These two cases were cited and applied in *Steamship Enterprises of Panama Inc., Liverpool (Owners) v. Ousel (Owners); The Liverpool (No. 2)*, [1963] P. 64 (C.A.). See also the editorial commentary, "The Rule Against Double Proofs in Bankruptcy" (1923-24), 4 C.B.R. 26.

95 *Coughlin & Co. (Re); Guarantee Co. of North America (Ex p.)*, [1923] 4 D.L.R. 971 (Man. C.A.).

96 *Olympia & York Developments Ltd. (Re)* (1998), 4 C.B.R. (4th) 189 (Ont. Ct. (Gen. Div.)).

individuals, or that the sole contractor is also one of the joint contractors, does not prevent proof in respect of the contracts, against the properties respectively liable on the contracts.

The intention of the section, the principle of which first appeared in the *Bankruptcy Act, 1861*,[97] is that whenever there is a joint and separate contract and there are joint and separate estates under administration in bankruptcy, the creditor shall be entitled to prove against and receive dividends from both and separate estates.[98]

When a loan was given to a partnership and one of the partners jointly and all the partners gave individual notes as collateral security, it was held that the makers were liable in their individual capacities and that the notes constituted distinct contracts; accordingly, it was also held that the holder of the notes could claim against the separate estate of one of the partners.[99]

The sole contractor referred to in the section need not be carrying on business separately,[100] nor is it necessary that the partners should contract in the firm name if they contract jointly and severally, and where, in fact there is a firm.[101]

Although there must be distinct contracts, they may be contained in one instrument — for example, a joint and several promissory note[102] — and where there are joint and separate contracts by partners to pay a sum of money, it is immaterial whether or not the money has been advanced for partnership purposes.[103]

23.0519 Claims Not Provable

Some claims and liabilities are not provable in proceedings under the BIA by the general policy of the law.

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97 24 & 25 Vict., c. 134.

98 *Sniderman (Re)*, [1953] 1 D.L.R. 323 (Ont. S.C. (Bkcy)); *Jeffery (Re); Honey (Ex p.)* (1871), L.R. 7 Ch. App. 178 (L.J.J.). Where there is a security on the separate estate for the joint debt, see *Walker (Re); Watson (Ex p.)* (1880), 42 L.T. 516; *Foster (Re); Dickens (Ex p.)* (1875), 8 Ch. D. 598.

99 *Sniderman (Re)*, *supra*.

100 *Jeffery (Re); Honey (Ex p.)*, *supra*, footnote 98.

101 *Welsh (Re); Stone (Ex p.)* (1873), 8 Ch. App. 914 (L.J.J.).

102 The holder of a note can treat the payee and the endorsee as having incurred separate liabilities in respect of the holder's endorsement distinct from liability as a maker: *Chaffey (In re); Merchant's Bank of Canada v. Davidson* (1870), 30 U.C.Q.B. 64.

103 *Laine & Longman (Re); Berner & Neilson (Ex p.)* (1886), 56 L.J.Q.B. 153. "It makes no difference who may benefit by the transaction resulting in the debt — the whole question is, 'Who incurred the debt?'", *per* Riddell J. in *Gordon v. Matthews* (1909), 18 O.L.R. 340, at p. 345 (T.C.), 18 O.L.R. 340 at p. 343 (Div. Ct.), affd 19 O.L.R. 564 (C.A.).

In re INVESTORS FUNDING CORPORATION OF NEW YORK SECURITIES LITIGATION; Robert MORSE and Claire S. Morse, Individually and as Trustees, Plaintiffs, v. PEAT, MARWICK, MITCHELL & CO., et al., Defendants; Rachel L. ROTHCHILD, Plaintiff, v. Jerome DANSKER, et al., Defendants; Morris KATZ, et al., Plaintiffs, v. Jerome DANSKER, et al., Defendants; Dr. Bernard METRICK and Bernard Metrick, as custodian for Zachary Metrick, Plaintiffs, v. Jerome DANSKER, et al., Defendants; David HABER and Ruth Haber, Plaintiffs, v. Jerome DANSKER, et al., Defendants

MDL Docket No. 290 (WCC), Nos. 75 Civ. 3681 (WCC), 77 Civ. 616 (WCC), 76 Civ. 4721 (WCC), 78 Civ. 268 (WCC), 78 Civ. 532 (WCC)

UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

9 B.R. 962; 1981 U.S. Dist. LEXIS 11521

March 17, 1981

CASE SUMMARY:

PROCEDURAL POSTURE: Plaintiffs, shareholders and purchasers of **debentures,** filed consolidated **class actions,** alleging that the acts of defendants, banks and accountants, violated § 10(B) of the Securities Exchange Act of 1934, 15 U.S.C.S. § 78j(b), and § 11 of the Securities Act of 1933, 15 U.S.C.S. § 77k, and constituted common law fraud. The parties sought court approval to consider partial settlements. Plaintiffs' counsel sought attorneys' fees and expenses.

OVERVIEW: The complaint alleged that defendants failed to discover aspects of frauds being perpetrated by the main actors and that such frauds led to the corporation's **insolvency.** The court held that the proposed settlement was fair, reasonable, and adequate from the standpoint of the absent class members because: 1) the benefits to the class members were substantial when balanced against the prospect of continued litigation and especially when viewed as being in only partial satisfaction of the asserted claims; 2) the settlements were the result of arm's length-bargaining; 3) no class member had objected to the fairness of the settlements; 4) plaintiffs' attorneys, who were experienced and competent, believed that the agreement was in the best interests of the class members; and 5) plaintiffs had conducted extensive pretrial discovery and were thus in a good position to make a fair assessment of the wisdom of the proposed compromise. The court awarded plaintiffs' counsel the requested amount of attorneys' fees, noting that they were entitled to a modest increase above the lodestar figure.

OUTCOME: The court granted final approval to partial settlements in the consolidated **class actions,** which alleged securities violations and common law fraud. The court awarded plaintiffs' counsel attorneys' fees and expenses.

CORE TERMS: settlement, class members, debenture-holders, reorganization, class actions, attorneys' fees, notice, settlement agreements, purported, debentures, proof of claim, debenture-sellers, shareholders, allocated, partial, entity, hourly rates, final approval, fee award, interrelationship, disbursements, purchasers, balanced, covenants, amount recovered, lodestar figure, discovery, pretrial, proposed settlement, counsel's request

LexisNexis(R) Headnotes

Civil Procedure > Class Actions > Class Members > Nonnamed Members
Civil Procedure > Class Actions > Compromises
Civil Procedure > Class Actions > Judicial Discretion
[HN1] Approval of a settlement in a **class action** turns on whether the settlement is fair, reasonable and adequate from the standpoint of the absent class members. Accordingly, a court should consider: (1) the strength of plaintiffs' case on the merits balanced against the amount offered in settlement; (2) presence of collusion in reaching a settlement; (3) the reaction of members of the class to the settlement; (4) the opinion of competent counsel; and (5) the stage of the proceedings and the amount of discovery completed.

Civil Procedure > Remedies > Costs & Attorney Fees > Attorney Expenses & Fees > Reasonable Fees
[HN2] The starting point in determining an award of attorneys' fees is the amount of time spent in prosecution of the action and the hourly rates normally charged therefor. The product of multiplying the number of hours by the hourly rate constitutes a base or lodestar figure which is then adjusted in accordance with less objective factors. Among the latter factors are the magnitude and complexity of the litigation, the amount recovered and litigation risks.

JUDGES: [1]** Conner, D.J.

OPINION BY: CONNER

OPINION

[*963] OPINION AND ORDER

CONNER, D.J.:

On March 6, 1981, following a hearing, this Court entered an Order granting final approval to partial settlements in these consolidated class actions. This Opinion and Order follows.

BACKGROUND

This multidistrict litigation arises out of the financial demise of Investors Funding Corporation of New York ("IFC"), which petitioned for reorganization under the Federal Bankruptcy Act on October 21, 1974. Each of the five above captioned cases is a purported class action on behalf of either

IFC shareholders or purchasers of IFC **debentures**, and each names a multitude of defendants having various connections with IFC during the years immediately preceding its collapse.

Among the named defendants are:

(1) Republic National Life Insurance Company, Chase Manhattan Bank, N.A., Chemical Bank, Citibank, N.A., Barclays Bank of New York, Federal Deposit Insurance Corporation, as receiver for Franklin National Bank, Israel Discount Bank, Ltd., National Bank of North America, Sterling National Bank & Trust Company of New York, Union Bank, Hambros Bank Limited and the Trust Company of New Jersey ("the Banks"). [1] The **[**2]** Banks, lenders to IFC, **[*964]** are alleged to have known or recklessly disregarded facts putting them on notice that IFC was in precarious financial condition and to have arranged for the conversion of their unsecured loans to secured loans while concealing IFC's actual insolvency; and

(2) Peat, Marwick, Mitchell & Co., Ernst & Whinney, as successor to S.D. Leidesdorf & Co., and individual partners in each ("the Accountants"). The Accountants served as IFC's independent auditors during the relevant years, and are alleged to have performed such services in derogation of accepted professional standards and to have favorably reported on misleading financial statements.

1 Hereafter "the Banks" also includes First National Bank of Chicago, Riggs National Bank of Washington, D.C. and Virginia National Bank. While these entities are not named as defendants in the class actions, they are named as defendants in separate actions brought by the Reorganization Trustee of IFC. Because of the interrelationship of the class action settlements with settlements in the actions by the Trustee and with the Plan of Reorganization for IFC, these three entities are included in the settlements with the Banks in the class actions. "The Banks" also includes defendant Republic National Life Insurance Company for simplicity of reference, although that entity is manifestly not a bank.

[3]** The alleged acts of the Banks and the Accountants are said to have violated Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Section 11 of the Securities Act of 1933, 15 U.S.C. § 77k, and to constitute common law fraud.

On December 8, 1980, this Court tentatively approved a settlement between the class action plaintiffs and the Banks, and notice of this proposed settlement was sent to purported class members. [2] On January 27, 1981, the Court preliminarily approved a settlement between the class action plaintiffs and the Accountants, and directed that appropriate notice be sent. A hearing regarding these proposed settlements was held on March 6, 1981, at the conclusion of which such settlements were given final approval by the Court.

2 That notice also advised that plaintiffs proposed to release from any potential liability six individual former officers of IFC -- Louis Adler, Samuel Heller, Richard Loman, Stanley Rappoport, Leo Sheiner and Sydney Schneider -- based upon written representations by such individuals as to their relatively insubstantial net worth and upon commitments by these defendants to cooperate with plaintiffs in the prosecution of these actions against non-settling defendants. These stipulations have also been approved by the Court following receipt of no objections thereto from class members.

[4]** DISCUSSION

[HN1] Approval of a settlement in a class action turns on whether the settlement is fair, reasonable and adequate from the standpoint of the absent class members. *E.g.*, *West Virginia v. Chas. Pfizer & Co.*, 440 F.2d 1079, 1085 (2d Cir.), *cert. denied*, 404 U.S. 871, 92 S. Ct. 81, 30 L. Ed. 2d 115 (1971). Accordingly, a court should consider:

(1) the strength of plaintiffs' case on the merits balanced against the amount offered in settlement;

(2) presence of collusion in reaching a settlement;

(3) the reaction of members of the class to the settlement;

(4) the opinion of competent counsel; and

(5) the stage of the proceedings and the amount of discovery completed. *Duban v. Diversified Mtg. Investors*, 87 F.R.D. 33, 38 (S.D.N.Y. 1980). Consideration of these factors has impelled the Court to approve the instant settlements.

1. *Strength of Case Balanced Against Settlement*

Because of the intricate interrelationship of these settlements with the Plan of Reorganization involving IFC and the partial settlement of claims brought by the Trustee, the final product of the negotiations reflects an unusually complex and detailed arrangement. The terms of the settlements **[**5]** are capably "summarized" at pages 20-42 of the Affidavit of David J. Bershad in Support of Partial Settlement with Bank and Accounting Defendants, and a full restatement here is unnecessary. In this Opinion and Order, I shall venture only to **[*965]** convey the major features of the two settlement agreements.

Pursuant to the settlement with the Banks, $ 7,030,000, less an award of attorneys' fees and expenses, will be made available to purported class members. That fund will be distributed among three groups -- shareholders, **debenture**-sellers (purchasers of IFC **debentures** who sold prior to the date when a **proof of claim** could have been filed) and **debenture**-holders (purchasers of **debentures** who have continued to hold through the date when a **proof of claim** may be filed). The distribution among the groups is based upon an assessment of the varying probability of success on the merits for each group, as well as the relative damages allegedly sustained by each group. As a result, a substantial majority of the funds -- $ 5,600,000 -- has been allocated to **debenture**-holders. Additionally, under the agreements the costs of notice of the proposed settlement agreements and the processing **[**6]** of claims by class members, estimated at approximately $ 150,000, will be borne by the Reorganization Trustee.

Debenture-holders receive a further substantial benefit by virtue of the fact that the Banks have agreed to compromise their claims as senior **creditors** of IFC (and related entities) and, with the exception of Republic National Life Insurance Company, to release their liens as secured **creditors.** It is now anticipated that, under the Plan of Reorganization, **debenture**-holders will receive amounts equal to approximately 16% of the unpaid principal of their **debentures**, whereas the **debenture**-holders would likely have received no portion of these amounts if the Banks had successfully maintained their prior positions. When the funds that **debenture**-holders will receive directly from the Banks under the Bank settlements are included, it is estimated that **debenture**-holders will

receive a total of 20% of the unpaid principal of their **debentures** (plus a share of any additional funds recovered from defendants other than the Banks).

In consideration for these substantial payments and concessions, the settlement agreement with the Banks provides that any recoveries *by **debenture**-holders* **[**7]** from any other defendants, less any award of attorneys' fees, shall be assigned to the Reorganization Trustee, to be distributed under the Plan of Reorganization in roughly equal shares to the Banks and the **debenture**-holders. Plaintiffs and the class members have also committed to indemnify the Banks for up to 25% of any amount recovered from the Banks by a non-settling defendant who is found liable to plaintiffs and the classes after a trial or other determination on the merits and who then successfully asserts a claim for contribution or indemnification against any of the Banks. Settlements with any other defendants must also include covenants by such other defendants not to sue the Banks.

The settlement with the Accountants provides class members with an additional $ 1,300,000, less any amounts awarded as attorneys' fees. This amount is also allocated to shareholders, **debenture**-sellers and **debenture**-holders in accordance with the factors outlined above. Accordingly, $ 980,000, less attorneys' fees, is allocated to **debenture**-holders. Pursuant to the settlement with the Banks, this amount will be assigned to the Reorganization Trustee and the **debenture**-holders will ultimately **[**8]** receive approximately 50% thereof. The Accountants have also agreed to withdraw any claims they have asserted or could assert in the reorganization proceeding.

Certain provisions in the Banks' settlement appear in substantially identical form in the Accountants' settlement, including the provisions regarding indemnification, covenants not to sue, and the bearing of the costs of notice and the processing of claims by the Trustee. The Banks and the Accountants have executed covenants not to sue each other in accordance with these provisions.

The benefits to purported class members are thus substantial, especially when viewed as being in only partial satisfaction of the claims asserted in these actions. When **[*966]** these advantages are balanced against the prospect of continued litigation, approval of these settlements appears to be the only proper course of action. Consideration of the following factors compels this conclusion:

(1) A review of the complaint reveals that the main actors in the scheme alleged to have led to the collapse of IFC are defendants other than the Banks and the Accountants. The gist of the allegations against the settling defendants is that they aided **[**9]** and abetted other defendants by failing to discover aspects of the frauds allegedly being perpetrated by such other defendants. Thus, the allegations against these defendants are such that proof of liability would be neither simple nor direct, but instead would require that a sequence of issues each be resolved in favor of plaintiffs, including the existence of primary violations by other defendants, the existence of, and failure to satisfy, obligations by the settling defendants to discover and disclose elements of such primary violations, and proof of scienter where required.

(2) Proof that damages were causally related to the acts complained of would undoubtedly be hotly contested. The possibility that plaintiffs could succeed in establishing the liability of the Banks and the Accountants and yet obtain damage awards not substantially exceeding the amounts to be received under these settlements is very real.

(3) The Banks have filed motions to dismiss in three of the five class actions, and Magistrate Harold J. Raby, to whom the motions were referred, has recommended the granting of such motions. The motions were *sub judice* when the settlement with the Banks was reached.

[10]** (4) The Accountants have filed motions to dismiss in all five of the class actions and the Court has ruled in favor of the Accountants on substantial aspects of these motions. Plaintiffs have filed motions to reargue and to intervene (seeking to cure a defect resulting from the limited standing of the named plaintiffs in the *Morse* action), which motions were pending when the settlement with the Accountants was reached.

(5) Because of the interrelationship of these settlements and the Plan of Reorganization, each has been made contingent upon the approval of the other. For reasons that need not be detailed here, certain outside contributors to the Plan of Reorganization have effectively conditioned their participation in the Plan upon its final approval before a specified date, and the present settlements have incorporated corresponding time limitations. Consequently, were the Court to disapprove these settlements, not only would class members have been subjected to the delays and expenses of continued pretrial practice, but such action by the Court would quite possibly have forfeited the class members' sole opportunity to resolve these claims against the Banks and the Accountants **[**11]** short of a much more expensive trial with uncertain results.

2. *Collusion*

There is every indication that these settlements are the result of painstaking, arm's-length bargaining. The standing of counsel in the legal community, the history of the negotiations, the detail and complexity of the settlement agreements and the entire conduct of these litigations impel that conclusion.

3. *Reaction of Class Members*

Over 50,000 notices were sent to purported class members regarding the Banks' settlement and a similar mailing was made regarding the Accountants' settlement. In neither case was a single objection filed, and no objection to the settlements was raised at the hearing. [3]

3 There was one objection as to the definition of "Authorized Claimant"; *i.e.*, a class member entitled to file a **proof of claim**. That objection was not to the fairness of the settlements as such, but simply a premature objection to an anticipated denial of a **proof of claim**.

4. *Recommendation of Counsel*

[12]** Plaintiffs' attorneys' experience and competence are demonstrated and unchallenged. **[*967]** Their opinion that the settlement agreement is in the best interests of the class members is entitled to, and has been accorded, significant weight by the Court in approving the settlements.

5. *Stage of Proceedings*

These settlements come after several years of extensive pretrial discovery by plaintiffs' attorneys and the Reorganization Trustee. Plainly, plaintiffs were "truly in a position to analyze objectively the strength of [their] case on the merits, and to balance that strength against the amount offered in settlement and all other factors relevant to a full and fair assessment of the wisdom of the proposed compromise." *Stull v. Baker*, 410 F. Supp. 1326, 1333 (S.D.N.Y. 1976).

ATTORNEYS' FEES

Plaintiffs' counsel [4] seek attorneys' fees in the amount of $ 890,000, [5] plus expenses and disbursements in the amount of $ 184,500. That total of $ 1,074,500 would come from the following sources:

> $ 680,000 from a fund in that amount specifically established pursuant to the Banks' settlement for the payment of fees and expense relating to the settlement on behalf **[**13]** of **debenture**-holders and **debenture**-sellers.
>
> $ 32,500 from the $ 150,000 fund created for stockholders pursuant to the Banks' settlement.
>
> $ 362,000 from the $ 1,300,000 fund created pursuant to the Accountants' settlement, allocated pro rata among the three portions of this fund set aside for the shareholders, **debenture**-holders and **debenture**-sellers.

The Court has determined to award counsel fees and expenses in the amount and manner requested.

4 Milberg Weiss Bershad & Specthrie, Lawrence Soicher, Esq.; Wolf Haldenstein Adler Freeman & Herz; Crystal & Driscoll, P.C.; Pincus Munzer, Bizer & D'Allesandro.

5 Plaintiffs' counsel also requests that $ 330,000 of the fee award earn interest from the date of the escrow deposit as provided in the Banks' settlement.

The seminal cases in this Circuit on the subject of attorneys' fees are *City of Detroit v. Grinnell Corp.*, 495 F.2d 448 (2d Cir. 1974) *("Grinnell I")*, and *City of Detroit v. Grinnell Corp.*, 560 F.2d 1093 (2d Cir. 1977) **[**14]** *("Grinnell II")*. Under *Grinnell I* and *Grinnell II*, [HN2] the starting point in determining an award of attorneys' fees is the amount of time spent in prosecution of the action and the hourly rates normally charged therefor. The product of multiplying the number of hours by the hourly rate constitutes a base or "lodestar" figure which is then adjusted in accordance with "less objective factors. *Grinnell I, supra,* 495 F.2d at 471, *Grinnell II, supra,* 560 F.2d at 1098. Among the latter factors are "the magnitude and complexity of the litigation, the amount recovered and litigation risks." *FLM Collision Parts, Inc. v. Ford Motor Co.*, 411 F. Supp. 627, 632 (S.D.N.Y.), *aff'd in part and rev'd in part on other grounds,* 543 F.2d 1019 (2d Cir. 1976), *cert. denied,* 429 U.S. 1097, 97 S. Ct. 1116, 51 L. Ed. 2d 545 (1977); see also *Williams v. Schatz Mfg. Co.*, 449 F. Supp. 147 (S.D.N.Y. 1977).

Plaintiffs' counsel have submitted comprehensive affidavits in support of their fee application which detail expenses and disbursements totaling $ 192,053.97 (or $ 7,553.97 in excess of counsel's request for reimbursement). Counsel's time charges total $ 846,560.25 for 7,647.5 **[**15]** hours, or an average hourly rate of just in excess of $ 110, reflecting in part the commendable use of paralegals and associates where appropriate.

Plaintiffs' counsel's request for a fee award of $ 890,000 represents an increase of approximately 5% over normal hourly charges. In view of the facts

(1) that these actions are manifestly complex, requiring counsel to handle the many organizational and strategic problems inherent in a multidistrict litigation of this size,

(2) that counsel have coordinated their efforts to avoid duplicative charges,

[*968] (3) that counsel have been employed on contingency bases and have assumed the substantial risks attendant to the prosecution of plaintiffs' claims,

(4) that in the Court's view these settlements represent favorable recoveries for the class members under all the circumstances existing at this time, and

(5) that counsel's fee request represents less than 11% of the total settlement funds of $ 8,330,000, well within the range of acceptable fee awards in cases such as these,

the Court concludes that counsel are entitled to the modest requested increase above the "lodestar" figure. Counsel are hereby awarded fees in the amount **[**16]** of $ 890,000 and reimbursement for expenses and disbursements in the amount of $ 184,500, for a total of $ 1,074,500, such an amount to be provided from the sources and in the manner specified herein and in the affidavits of plaintiffs' counsel.

SO ORDERED.

Not Reported in F.Supp., 1985 WL 48177 (S.D.N.Y.), Fed. Sec. L. Rep. P 92,414
(Cite as: 1985 WL 48177 (S.D.N.Y.))

United States District Court, S.D. New York.
In RE **SAXON SECURITIES LITIGATION**.

Nos. 82 Civ. 3103 (MJL), 83 CIV. 3760.
Oct. 30, 1985.

Opinion

LOWE, District Judge.

***1** These cases represent the consolidation of numerous class action lawsuits alleging various securities fraud claims. Presently before the Court are motions to approve settlements of the class actions pursuant to Fed.R.Civ.P. 23(e). Under the proposed settlements, plaintiffs will receive in excess of $20 million. For the reasons stated below, the motions for approval of the settlements are granted. The objections to that portion of the Plan for Distribution ("Plan") which denies benefit to persons who purchased debentures after the petition in bankruptcy are disposed of in a separate opinion of even date herewith.

I.

Background

The Class Settlement Agreements are an integral part of a Global Settlement Agreement of the same date, compromising and resolving the disputes among the parties in 12 consolidated class actions (*In re Saxon*) and the one independent class action (*Lewis v. Lurie*), and more than thirty other related actions all arising from alleged frauds at Saxon Industries, Inc. ("Saxon"). The Global Settlement Agreement is conditioned upon Court approval of the Class Settlement Agreements.

The Class and the Global Settlement Agreements are the culmination of extensive negotiations spanning more than two years.

Defendants indicated early in the negotiations that they might be willing to settle the cases, but only on a global basis. Approximately forty conferences were held among counsel for the class plaintiffs and counsel for the non-class plaintiffs. Throughout the negotiations, class counsel demanded parity of recovery with Saxon's bank creditors who claimed to have been defrauded into making their loans to Saxon as a result of the same frauds alleged by the class plaintiffs. In other words, class counsel insisted that the class members [FN1] recover the same percentage of their claimed out of pocket losses that Saxon's bank creditors would recover by way of settlement of the district court litigation *and* the Saxon bankruptcy reorganization. The banks and other non-class plaintiffs objected on the ground that their position was superior to the class's under the bankruptcy laws.[FN2]

II.

Summary of the Litigation

Until the early Spring of 1982, Saxon, from all outward appearances, was a financially healthy corporation engaged in three lines of business: (a) a paper and paper products manufacturing group; (b) a business products group, which manufacturered, sold and leased photocopiers and related equipment and supplies; and (c) an advertising specialty group, which made calendars, playing cards and commercial gift items.

On March 30, 1982, the outward appearances of financial health were shattered when Saxon reported an estimated pre-tax loss of $47 million for the fourth quarter of fiscal 1981, and indicated that it might take an additional $40–$50 million charge against earnings. On April 8, 1982, Saxon announced that it was in default on certain debt provisions. One week later, Saxon filed a Petition for Relief under Chapter 11 of the Bankruptcy Code, thereby protecting itself from its creditors.

***2** Numerous actions were soon filed alleging, among other things, that Saxon's books and records had been falsified and its public financial statements and other reports during the March 31, 1976 through April 15, 1982 period were materially misleading.

Most of the class actions were brought on behalf of purchasers of Saxon's securities during that period; the non-class actions were filed by, among others, Saxon's lenders, insurers, trade and other creditors. Plaintiffs in all the actions found themselves competing in litigation for the limited assets and inadequate and questionable insurance coverage of Saxon's

Not Reported in F.Supp., 1985 WL 48177 (S.D.N.Y.), Fed. Sec. L. Rep. P 92,414
(Cite as: 1985 WL 48177 (S.D.N.Y.))

officers, directors and auditors, all of whom were sued as co-conspirators and aiders or abettors of the fraud.[FN3]

In re ***Saxon Securities Litigation***, (No. 82 Civ. 3103 (MJL) ("In Re Saxon") is a consolidation of 12 class actions. The Second Consolidated Amended Complaint in In Re Saxon alleges that Saxon's former officers, directors and independent auditors, Fox & Company ("Fox"), violated Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), Rule 10b–5 promulgated thereunder and common law by disseminating to the public materially false and misleading financial statements and other documents which misrepresented that Saxon was a financially healthy and prospering company. All the defendants are alleged to have engaged in a plan and scheme to falsify Saxon's income, sales and inventories, so that Saxon's annual and quarterly reports and press releases were materially false in their portrayal of the company's financial condition, including its accounting practices and policies, inventory controls, revenue recognition policies, sale and leaseback program, debt structure, and ability to meet debt obligations. The individual defendants are also alleged to have been controlling persons of Saxon within the meaning of Section 20 of the Exchange Act, and thereby liable for the acts of Saxon.

On February 23, 1984, over the substantial objections of defendants and after a report and recommendation had been issued by Magistrate Gershon, this Court certified the consolidation action as a class action on behalf of all persons or entities who purchased Saxon Common stock or Saxon debentures during the period March 31, 1976 through April 15, 1982 (the "Class Period"), including holders of: (1) 5 3/4 % Convertible Subordinated Debentures due 1987; (2) 6% Subordinated Debentures due 1990; and (3) 5 1/4 % Convertible Subordinated Debentures due 1990, and who suffered damages as a result thereof (the "class"). Excluded from the class are Saxon, its affiliates and subsidiaries, the named defendants, members of their immediate families, any entity in which any of the named defendants have a controlling interest, and the legal representative, heirs, successors and assigns of any of the defendants.

For the purposes of settlement only, this Court also certified a class in *Lewis v. Lurie* (No. 83 Civ. 3760 (MJL)) ("Lewis"). The Lewis complaint also alleged that Saxon controlled persons and Fox committed violations of § 10(b) of the Exchange Act and Rule 10b–5 thereunder. The class in Lewis consists of all persons whose shares or debentures of Standard Packaging Corporation ("Standard") [FN4] were exchanged for shares or debentures of Saxon by reason of the merger of Standard into a wholly-owned subsidiary of Saxon pursuant to certain proxy materials, and who sold such Saxon securities at a loss prior to April 15, 1982. As in the *In Re Saxon* certification, Saxon, its affiliates and subsidiaries, the named defendants and members of their immediate families, etc. were excluded from the class.

III

The Proposed Class Settlement Agreements

***3** The terms of the proposed Class Settlement Agreements are set forth in the Stipulation of Settlement dated March 21, 1985.[FN5] In summary, $18,150,000 of the global settlement amount has been allocated to settle the class claims in the *In Re Saxon* case and $500,000 has been allocated to settle the class claims in Lewis. Pursuant to the Global Settlement Agreement, the $18,650,000 earmarked for the classes has been earning interest since March 22, 1985.

As noted, the Class Settlement Agreements achieve parity for the classes with Saxon's bank creditors. Thus, the classes recover the same percentage of their loss as the banks will recover in the Saxon reorganization and under the Global Settlement Agreement. Under the parity provisions of the Class Settlement Agreements, the class members will recover more than 61 percent of their recognized losses.

The Class Settlement Agreements provide that after deduction from the Class Settlement Fund of class plaintiffs', attorneys', experts' and accountants' fees and expenses to the extent allowed by the Court, and the costs associated with providing notice to the class and administering and processing the claims submitted by class members, the Net Class Settlement Fund will be distributed to class members in accordance with a complex Plan of Distribution set forth in paragraphs 3 and 4 of the Stipulation of Settlement. Annexed as Appendix "A" [Not reproduced. CCH.] is a discussion of the major aspects of the Plan of Distribution and how it was derived, which was submitted to the Court by lead counsel for plaintiffs in *In Re Saxon.*

Briefly, the Plan provides for the distribution of the Class Settlement Fund among the class members depending upon which issue of Saxon securities they purchased during the Class Period and whether they held the securities until the end of the period or bought and sold them within the period. The Plan maximizes the recoveries for each group of securities holders within the class. For example, those who purchased Saxon common stock during the Class Period and held the shares until the end of the period will receive more than 61 percent of the difference between their purchase price and $1.50 per share (the approximate market value of the common shares following disclosure of the alleged fraud) up to a maximum of $4.75 per share. The maximum of $4.75 was derived by subtracting $1.50 from $6.25, which was the average market price of the common stock during the Class Period. Similar provisions in the Plan of Distribution allow the debenture purchasers to recover more than 61 percent of their maximum recognized losses. Caps on the potential recovery of the various groups within the class are provided to account for market factors unrelated to the fraud which affected the price of the securities. The Plan also recognizes the competing interests of the class and Saxon's creditors for the same finite, recoverable assets, and provides for a limited reverter to the non-class plaintiffs who are signatories to the Global Settlement Agreement depending upon the amount of allowed claims ultimately filed by the class members.

***4** The Class Settlement Agreements will confer a substantial cash benefit upon the classes and end a complex and costly litigation. It will also allow Saxon to be reorganized and bring to an end the lawsuits filed by the non-class plaintiffs.

The experienced and highly qualified counsel for plaintiffs in both *In Re Saxon* and *Lewis* have expressed their considered judgment that the proposed settlement is superior to the recovery that could be achieved by continued litigation.

IV

The Standards For Judicial Approval of Class Action Settlements Under Fed.R.Civ.P. 23(e)

The standards to be applied in determining whether to approve settlement of a class action are well established. Courts consistently favor settlement of lawsuits in general. *Williams v. First Nat'l Bank*, 216 U.S. 582 (1910); *City of Detroit v. Grinnell Corp.*, 495 F.2d 448 (2d Cir.1974); *Jones v. Amalgamated Warbasse Houses, Inc.*, 97 F.R.D. 355, 358 (E.D.N.Y.), *aff'd*, 721 F.2d 881 (2d Cir.1983), *cert. denied*, 104 S.Ct. 1929 (1984). In class actions in particular, "there is an overriding public interest in favor of settlement." *Cotten v. Hinton*, 559 F.2d 1326, 1331 (5th Cir.1977); *Armstrong v. Board of School Directors*, 616 F.2d 305, 313 (7th Cir.1980); *Van Bronkhorst v. Safeco Corp.*, 529 F.2d 943, 950 (9th Cir.1976).

This policy promotes the interests of the litigants by saving them the expense of trial of disputed issues and reduces the strain upon an already overburdened judicial system. *Newman v. Stein*, 464 F.2d 689, 691–92 (2d Cir.), *cert. denied*, 409 U.S. 1039 (1972); *Armstrong v. Board of School Directors*, 616 F.2d at 313; *Van Bronkhorst v. Safeco Corp.*, 529 F.2d at 950.

In deciding whether to approve a proposed settlement of a class action, the court must find that the proposal is "fair, reasonable and adequate." *Weinberger v. Kendrick*, 698 F.2d 61, 73 (2d Cir.1982), *corrected on other grounds on pet. for reh'g*, [1982–83] FED.SEC.L.REP. (CCH) ¶ 99,074 (2d Cir.), *cert. denied*, 104 S.Ct. 77 (1983); *West Virginia v. Chas. Pfizer & Co.*, 440 F.2d 1079, 1085 (2d Cir.), *cert. denied*, 404 U.S. 871 (1971). However, courts have consistently noted the necessity of restraint in their inquiry into proposed settlements. Settlements, by definition, are compromises which "need not satisfy every single concern of the plaintiff class, but may fall anywhere within a broad range of upper and lower limits." *Alliance to End Repression v. City of Chicago*, 561 F.Supp. 537, 548 (N.D.Ill.1982). The court's role is neither to substitute its judgment for that of the parties who negotiated the settlement nor to litigate the merits of the action. *Finn v. FMC Corp.*, 528 F.2d 1169 (4th Cir.1975), *cert. denied*, 424 U.S. 967 (1976); *Weinberger v. Kendrick*, 698 F.2d at 74; *Ochs v. Ruttenberg*, 446 F.Supp. 145, 148 (S.D.N.Y.1978); *Zerkle v. Cleveland–Cliffs Iron Co.*, 52 F.R.D. 151, 159 (S.D.N.Y.1971). As noted in *Katz v. E.L.I. Computer Systems, Inc.*, [1970–71] FED.SEC.L.REP. (CCH) ¶ 92,994 at 90,676 (S.D.N.Y.1971): "there is a strong initial presumption that the compromise is fair and reasonable."

***5** Judicial evaluation of a proposed settlement of a class action thus involves a limited inquiry into

whether the possible rewards of litigation with its risks and costs are outweighed by the benefits of the settlement. In *City of Detroit v. Grinnell Corp.*, 495 F.2d at 462, the court, quoting with approval *Young v. Katz*, 447 F.2d 431, 433 (5th Cir.1971), 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 procedure 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 defenses, the situation of the parties, and the exercise of business judgment in determining whether the proposed settlement is reasonable.

Accord, Newman v. Stein, 464 F.2d 689 (2d Cir.), *cert. denied*, 409 U.S. 1039 (1972); *West Virginia v. Chas. Pfizer & Co.*, 314 F.Supp. 710, 741 (S.D.N.Y.1970).

Courts have also examined the "negotiating process by which the settlement was reached." *Weinberger v. Kendrick*, 698 F.2d at 74. They have focused on whether the settlement was achieved through "arm's length negotiations" by counsel who have "the experience and ability ... necessary to effective representation of the class' interest." *Id.* Again, however,

The court's function is not "to reopen and enter into negotiations with the litigants in the hopes of improving the terms of the settlement" or to "substitute its business judgment for that of the parties who worked out the settlement."

Argo v. Harris, 84 F.R.D. 646, 647–48 (E.D.N.Y.1979); *Friedman v. Colgate–Palmolive Co.*, [1984] FED.SEC.L.REP. (CCH) ¶ 91,493 at 98,451 (E.D.N.Y.1984).

Courts in this and other circuits recognize that the opinion of experienced counsel supporting the settlement is "entitled to considerable weight." *Fielding v. Allen*, 99 F.Supp. 137, 144 (S.D.N.Y.1951). *Accord, In re Chicken Antitrust Litigation*, 1980–1 Trade Cas. (CCH) ¶ 63,237 at 78,143 (N.D.Ga.1980) ("Notwithstanding the court's substantial involvement in the suit over the past five years, the parties' counsel are best able to weigh the relative strengths and weaknesses of their arguments. The court is not inclined to substitute its educated estimate of the complexity, expense and likely duration of this litigation without a sound basis for concluding that the settlements are inadequate."); *Cannon v. Texas Gulf Sulphur Co.*, 55 F.R.D. 308, 316 (S.D.N.Y.1972); *Lyons v. Marrud*, [1972–73] FED.SEC.L.REP. (CCH) ¶ 93,525 (S.D.N.Y.1972), *quoting, Protective Committee for Independent Stockholders of TMT Trailers Ferry, Inc.*, 390 U.S. 414 (1968); *Josephson v. Campbell*, [1967–69] FED.SEC.L.REP. (CCH) ¶ 92,347 at 97,658 (S.D.N.Y.1969).

These Class Settlement Agreements were negotiated vigorously at arm's length with the approval of all class counsel and the active encouragement and participation of the Court. Class counsel have many years of experience in litigating securities fraud class actions and have negotiated numerous other class action settlements which have been approved by courts throughout the country. They urge approval of the settlement based upon their experience and the factors which are to be considered in evaluating a proposed class action settlement.

***6** The Second Circuit has identified nine specific factors to be considered in determining whether to approve the settlement of the class action:

(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

City of Detroit v. Grinnell, 495 F.2d at 643 (citations omitted). We will consider each of the criteria separately.

V

A. *The Complexity, Expense and Likely Duration of the Litigation*

This litigation has been pending for more than three years. Without the proposed settlement, the conclusion of pretrial proceedings and trial would

unquestionably consume additional years. Whatever the outcome of a trial, appeals would likely be taken in a case of this magnitude and complexity, consuming additional time.

There are considerable obstacles confronting plaintiffs if they are ultimately to prevail. Several of the defendants, including Fox, have filed motions to dismiss the complaint on the ground, among others, that it fails to plead fraud with the particularity required by Fed.R.Civ.P. 9(b). Those motions are pending. Other defenses to the class claims have also been raised, including the alleged inability of plaintiffs to prove *scienter* on the part of most of the defendants, including Fox, and plaintiff's right to recover based on the "fraud on the market" theory of damages. Litigation of all the issues would require additional extensive discovery, the continued retention of expensive experts to assist in the pretrial stage and at the trial, a lengthy trial and inevitable appeals. The expense of preparing the case for trial, including the costs of depositions, experts and additional attorney time, would be substantial. Moreover, because defendants are facing huge potential exposure in more than thirty related actions, and because their insurance coverage appears to be grossly inadequate relative to the hundreds of millions of dollars in claims, there is a very real risk that even if class plaintiffs were victorious in the courts they might end up facing defendants with empty pockets.

By the time of trial the fraud alleged in *In Re Saxon* would be more than ten years old. Some of the alleged acts of fraud in the Lewis case occurred well over 15 years ago.[FN6] Also, the fact that some of the defendants have been indicted would cause further delays in prosecuting the case.[FN7]

***7** The proposed Class Settlement Agreements secure for the classes substantial benefit, undiminished by further increased fees and expenses, without the delay, risk and uncertainty of continued litigation.

B. *The Reaction of the Class to the Settlement*

More than 100,000 notices of the proposed class settlement agreements were mailed to class members. Notice was also published twice each in *The Wall Street Journal, The International Herald Tribune* and *The London Financial Times.* Not a single objection to the fairness, reasonableness or adequacy of the Class Settlement Agreement has been received.

The notice called for any objections to be filed with the Court. With the exception of the objections to the Plan of Distribution,[FN8] there were none. Also, pursuant to the Notice, the Court held a public hearing on September 20, 1985. The Court invited anyone present to raise any objections not filed. No objections were heard.

The total absence of objections by class members is persuasive evidence of the fairness of the settlement. *See e.g., Grinnell,* 495 F.2d at 462; *In re Warner Communications Securities Litigation,* 82 Civ. 8288 (JFK) (S.D.N.Y. 8/20/85) slip op. at 22; *Burger v. CPC Intern'l Inc.*, 76 F.R.D. 183, 186 (S.D.N.Y.1977).

C. *The State of the Proceedings and the Amount of Discovery Completed*

By the time the Class Settlement Agreements were reached, the classes had been certified and the pending motions to dismiss had been fully briefed. There was extensive document discovery [FN9] including the inspection and analysis of hundreds of thousands of pages of documents produced in Florida, California and New York by Saxon, Fox, the individual defendants, customers of Saxon, and Saxon's bank lenders.

To aid class counsel in their discovery and analysis, accounting and financial experts were retained. The accountants and the financial analysts played substantial and essential roles in assisting Class counsel in negotiating the Class Settlement Agreement and in urging its approval by the Court. Class counsel are undoubtedly acting with a firm grasp of the strengths and weaknesses of the cases.

D. *The Risks of Establishing Liability*

In assessing the fairness, reasonableness and adequacy of the Class Settlement Agreements this Court must balance the benefits afforded by the proposed settlement, and the immediacy and certainty of a substantial recovery for the class members, against the continuing risks of litigation. There are considerable legal obstacles confronting plaintiffs in attempting to establish liability which would remain in the event that the Class Settlement Agreements were not approved. The defenses raised relate primarily to issues of *scienter,* "fraud on the market" and damages.

The principal claim asserted against defendants on behalf of the classes is based upon § 10(b) of the Exchange Act and Rule 10b–5. Plaintiffs must establish that the alleged misstatements were material, *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (1976), and made with *scienter*. *Ernest & Ernst v. Hochfelder*, 425 U.S. 185 (1976). Thus, plaintiffs would have the burden of proving that defendants not only possessed information regarding Saxon's financial condition which, if publicly disseminated, would have materially affected the price of the stock, but also that defendants withheld that information from the investing public either with actual intent to deceive, manipulate or defraud or in reckless disregard of the facts and their consequences.

***8** While plaintiffs' cases appear to have considerable merit, particularly in regard to Saxon's Business Products Division, and individual defendants Lurie, Horowitz and Monteil, an important question remains unanswered: whether Fox and each of the officer-director defendants (particularly other than Lurie, Horowitz & Monteil) acted with *scienter* and thereby violated Section 10(b) of the Exchange Act and Rule 10b–5. Plaintiffs' burden in this regard is particularly difficult with respect to most of the individual defendants who were outside directors of Saxon. See *Lanza v. Drexel*, 479 F.2d at 1289 ("a director in his capacity as a director (a non-participant in the transaction) owes no duty to insure that all material, adverse information is conveyed to prospective purchasers of the stock of the corporation on whose board he sits"). Even now, having had the benefit of considerable discovery, it is not certain whether plaintiffs would be able to meet the applicable legal standards upon trial and prove the requisite *scienter* of many of the individual defendants and Fox.

Plaintiffs have also sought to impose liability upon the individual defendants under the "controlling person" theory. Plaintiffs contend that all the individual defendants, as "controlling persons" under Section 20 of the Exchange Act, are liable for the acts of Saxon and its management. Controlling person liability, however, is subject to a defense of good faith, which most of the individual defendants would surely invoke. As stated in *Moscarelli v. Stamm*, 288 F.Supp. 453, 460 (E.D.N.Y.1968):

> [Section 20] provides that controlling persons liable under the Act are liable for the other person's actions unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action. [Footnote omitted.]

Plaintiffs would also have to establish a causal connection between the alleged fraud and their purchases of Saxon securities to their damage. In order to sustain this burden plaintiffs rely upon the presumption asserted in *Affiliated Ute Citizens v. United States*, 406 U.S. 128 (1972), and its progeny and the "fraud on the market" theory. *See, Panzirer v. Wolf*, 663 F.2d 365 (2d Cir.1971), *vacated as moot*, 459 U.S. 1027 (1982); *Ross v. A.H. Robins Co.*, 607 F.2d 545 (2d Cir.1979), *cert. denied*, 448 U.S. 911 (1980). However, even if plaintiffs successfully establish a "fraud on the market" and, accordingly, a presumption of reliance, this presumption is rebuttable. *Blackie v. Barrack*, 524 F.2d 891 (9th Cir.1975), *cert. denied*, 429 U.S. 816 (1976); *Grossman v. Waste Management*, 100 F.R.D. 781 (N.D.Ill.1984). Moreover, although the "fraud on the market" theory of liability has been adopted by the Second Circuit, it has not been ruled upon by the Supreme Court.

E. *The Risks of Establishing Damages*

The Second Circuit employs the "out of pocket" damage measure in Rule 10b–5 cases. *Levine v. Seilon, Inc.*, 439 F.2d 328, 334 (2d Cir.1971); *Quintel Corp. N.V. v. Citibank, N.A.*, 596 F.Supp. 797, 802 (S.D.N.Y.1984); *Freschi v. Grand Coal Ventures*, 588 F.Supp. 1257, 1259 (S.D.N.Y.1984); *Bonime v. Doyle*, 416 F.Supp. 1372, 1384 (S.D.N.Y.1976). Under this measure, a defrauded buyer may recover the difference between the price paid for the stock and the "fair value" of that stock (*i.e.*, value absent the fraud) as of the time of that person's purchase. *Sirota v. Solitron Devices, Inc.*, 673 F.2d 566, 577–78 (2d Cir.), *cert. denied*, 459 U.S. 838 (1982). *See generally* A. Jacobs, *The Measure of Damages in Rule 10b–5 Cases*, 65 Geo.L.J. 1093, 1099–1102 (1977).

***9** Because the "fair value" of a stock will differ from its public market price (the latter being inflated by the fraud), expert testimony is necessary to fix the amount—and indeed the existence—of actual damages. *See, e.g., Sirota v. Solitron Devices, Inc.*, 673 F.2d at 576–78; *Burger v. CPC Internat'l, Inc.*, 76 F.R.D. 183, 187–88. Such an evaluation takes into consideration not only stock price history, but other more elusive factors as well: corporate asset value,

cash flow, product acceptance, prospects for the future, industry and economic trends, the quality of management, the nature and amount of liabilities, and a myriad of other variables. In the unavoidable "battle of experts," it is impossible to predict with any certainty which arguments would find favor with the jury. *In re Warner Communications Securities Litigation,* 82 Civ. 8288 (JFK) (S.D.N.Y.8/20/85) slip. op. at 18.

A rough estimate of a stock's "fair value" may be drawn from the market price it commands following revelation of the fraudulently withheld information. *Harris v. American Investment Co.*, 523 F.2d 220, 226–27 (8th Cir.1975), *cert. denied*, 423 U.S. 1054 (1976); *In re Brown Co. Securities Litigation*, 355 F.Supp. 574, 588 (S.D.N.Y.1973); *SEC v. Texas Gulf Sulphur Co.*, 331 F.Supp. 671, 672 (S.D.N.Y.1971). However, plaintiff is obligated to separate the effect of the fraud from the effect of non-actionable forces. [FN10]

Even if plaintiff satisfied the other elements of his Section 10b–5 claim, he would still have to prove damages caused by the alleged omissions. Such proof would ... require expert testimony. Defendants would argue, perhaps successfully, that any drop in the price of [the] stock was due to non-actionable factors, such as the national economy, inflation, or the demand for grain, and was unaffected by the alleged omissions.... [P]laintiff faced considerable uncertainties in proving damages.

Burger v. CPC Internat'l, Inc., 76 F.R.D. at 187–88 (approving settlement). Similarly, in *Bonime v. Doyle*, 416 F.Supp. at 1384, Judge Lasker, in approving a settlement, rejected simple reliance on post-revelation market price as a substitute for fair value on the date of purchase.

Defendants would also contend that the post-revelation price reflected not merely disclosure of the previously withheld information, but adverse industry and market trends as well. Plaintiffs would be required to prove at trial how much of the post-revelation decline was attributable to disclosure (and by extension, the fraud), and how much was the result of non-actionable market and industry trends.

During the Class Period of In Re Saxon—March 31, 1976 through April 15, 1982—the price of Saxon common stock fluctuated considerably.[FN11] In the few days following April 15, 1982 and the announcement of Saxon's bankruptcy, the price of Saxon common stock declined very sharply. From an average closing price of $4.21 per share during the period January 1 through April 15, 1982, the average closing price of Saxon common stock declined to an average of $1.58 per share for the period April 16 through April 22, 1982. Using post-disclosure prices as a rough indication of "fair value," class plaintiffs would argue that class members who purchased Saxon common stock in the 3 1/2 months prior to disclosure and held through the end of the Class Period suffered damages in the neighborhood of $2.63 per share. ($4.21 minus $1.58 = $2.63). Similar estimates for all class members could be made in the same manner: each member's purchase price minus an assumed "fair value" of $1.58 per share. The weight a jury [FN12] would give to the decline in Saxon's stock (and debentures) following disclosure in calculating damages throughout the Class Period is problematic.

***10** Inevitably, damage questions would spark a lively debate among the parties' respective experts. The outcome of this contest is surely unpredictable. The substantial risks on this score are avoided, by both sides, by settlement of this action.

Establishing damages in the Lewis case is even more problematic than in In Re Saxon. As in In Re Saxon loss must be established by rough valuation based on market indications. However, the problem would be exasperated by passage of time since the alleged fraud in Lewis.

F. *The Risks of Maintaining the Class Action Through the Trial*

Although the Court has certified the classes under Fed.R.Civ.P. 23(c)(1), these certifications are conditional. Defendants may always move to decertify the classes if they so choose. As noted before, the Lewis Class was certified for settlement only. While there is no apparent reason for defendants to attack the certification in *In Re Saxon*, there is always the possibility that the class, or a portion of it, may be vulnerable to a decertification motion. See also unnumbered footnote on previous page.

G. *The Ability of Defendants to Withstand a Greater Judgment*

Another factor to be taken into consideration in determining whether to approve this settlement is the defendants' ability to withstand a judgment greater

than the settlement amount. *City of Detroit v. Grinnell Corp.*, 495 F.2d at 467. In assessing the fairness and adequacy of the Class Settlement Agreement, Saxon's bankruptcy and proposed reorganization must be considered, as well as the fact that plaintiffs in more than 30 actions, in addition to the class actions, are all competing for the finite assets of the defendants and their insurance coverage (discussed below). The claims of the non-class plaintiffs alone total more than $150,000,000. In negotiating the Global Settlement Agreement all plaintiffs recognized the reality of the situation—that the well is only so deep.

Among the factors class plaintiffs had to take into consideration were the resources upon which the defendants could draw for their contributions to the aggregate settlement consideration. There were serious controversies as to the amount available for settlement under the several insurance policies and, indeed, the applicability of the policies.

There were two directors' and officers' ("D & O") insurance policies for $15 million each, issued by National Union Fire Insurance Co. ("National Union"). As to the first policy, National Union contended that it was obtained by fraud, having been signed by defendant Alfred E. Horowitz, an alleged principal participant in the scheme. In fact, National Union commenced an adversary proceeding in the bankruptcy court to rescind this policy and filed two related actions in state court claiming that it had been fraudulently induced into writing the policy by largely the same allegedly false financial statements that the class plaintiffs were alleging in their actions. Thus, there were serious questions as to whether this policy would cover claims in the litigation. The second policy was a renewal of the first; it was issued after Saxon filed its bankruptcy petition. National Union took the position that this policy covered only conduct of the directors and officers after the bankruptcy filing and therefore did not apply to the claims asserted in the class actions.

***11** Plaintiffs maintained that even if National Union could disclaim coverage on the first policy as to defendant Horowitz, it could not disclaim coverage for the other officer-director defendants. Plaintiffs also contended that coverage under the second policy was not limited to post-bankruptcy acts. In any event, both of the D & O policies were so-called "wasting assets," because they were rapidly being depleted by the fees and expenses of defense counsel.

One of the defendant directors, Reynolds C. Springborn, was covered for his activities as a Saxon director by a separate $10 million insurance policy taken out by his primary employer, Bear Stearns & Co. Springborn, however, was an outside director who was not involved in the day-to-day operations of the company. One of his defenses to plaintiffs' claims was lack of *scienter*. As discussed above, establishing liability on the part of outside directors was among plaintiffs' most difficult burdens. The insurer, Lloyds of London, recognized this and was extremely reluctant to pay on the policy.

There was also a serious dispute with Fox over its insurance coverage. The face amount of its policy was only $30 million. Through a complex interpretation of certain clauses in the policy, plaintiffs took the position that the actual coverage was considerably more than $30 million, perhaps three times that amount. Fox held firm in its view, however, that $30 million was the limit.

The difficulties and uncertainties respecting the insurance availability was a factor strongly militating in favor of the proposed settlement.[FN13] Class plaintiffs had to compete with the nonclass plaintiffs (*e.g.*, banks and trade creditors) for the limited insurance coverage. Even if class plaintiffs overcame the substantial obstacles in their path and received a judgment in excess of the proposed settlement fund, we believe that there was a very real possibility that plaintiffs would find shallow pockets. By the time class plaintiff recovered their judgment, much of the available insurance proceeds would be gone. This Court is very familiar with all of the litigation surrounding Saxon and strongly believes that the settlements are in the classes' best interests.

The Range of Reasonableness of the Settlement Fund in Light of the Best Possible Recovery

The proposed Class Settlement Funds of $18,650,000, plus interest, which represent one of the largest securities fraud class action settlements ever, is not only reasonable in light of the best possible recovery, it is remarkable.

To calculate the "best possible" recovery, one must assume complete success on both liability and damages as to all class members. Unfortunately, the

data needed to make this calculation, *i.e.*, the number of securities purchased by the class multiplied by the difference between price paid and fair value at the time of each purchase, are not entirely available. As Judge Lasker observed in *Bonime v. Doyle*, 416 F.Supp. at 1384: "Where the suit is maintained as a class action the complexities of calculating damages increase geometrically."

***12** Despite considerable uncertainties, estimates of market loss can be made, but these estimates vary considerably. Class plaintiffs' counsel conducted studies of the various theories of damages and the potential recovery the class could achieve if successful at trial. Counsel in *In re Saxon*, retained Probe Consultants, a firm of expert financial analysts, to assist them in this regard.

Looking at the weekly trading records of Saxon during the In Re Saxon Class Period, Probe Consultants first estimated that trading losses for class members who purchased *and sold* Saxon common stock during the Class Period (the "Ins and Outs") [FN14] were approximately $19 million. Probe next calculated at approximately five million the number of shares which were purchased during the Class Period *and held* until the end of the period ("Common Holders"). Since the average price per share of Saxon common stock traded during the Class Period was $6.25, and the market value of Saxon's common stock after disclosure of the fraud was approximately $1.50, recoverable damages for the Common Holders approximated $4.75 a share. Multiplying this $4.75 a share by the five million shares held to the end of the Class Period, it was estimated that damages for the Common Holders were approximately $20 to $25 million. Thus, the total losses for the common stock Ins and Outs and Common Holders was roughly $39–44 million.

Several attempts were also made to estimate the out of pocket losses suffered by the persons who bought and held and the persons who bought and sold the three issues of debentures included within the class (5 1/4 %, 5 3/4 % and 6%). The estimates ranged from a little over $1 million to approximately $8 million. There was no way to estimate these damages any more precisely.

Non-class plaintiffs urged that the debenture purchasers should recover much less than the common stock purchasers. They argued that the debentures traded as a debt security and were largely unaffected by the fraud. Some parties claimed that those who purchased and sold debentures during the Class Period should receive nothing. They argued that since the debentures traded in a narrow price range during the Class Period, those who bought and sold during the period were not damaged at all. It is also argued that the 5 3/4 % debentures, which were sold in bearer form principally outside the United States, should receive little, if anything, because they barely reacted (if at all) to disclosure of the fraud. Trading information on that debenture issue was particularly scarce, making it nearly impossible to estimate damages. (Nevertheless, as more fully discussed in the explanation of the Plan of Distribution, Appendix A, debenture Class Members whose claims are allowed will likely receive more than 61% of their recognized losses.)

Under another measure of damages recoverable by the common stock class members, the total loss could be less than the Class Settlement Fund. During the class Period, Saxon had outstanding approximately seven million shares of stock. Total volume of shares traded during the Class Period, however, was approximately 32 million. Obviously, many shares were transferred more than once during the period. Given the length of the Class Period (more than six years), and the volatility of the stock price and the amount of trading, it can be assumed that half of Saxon's outstanding shares turned over more than once and consequently would be limited in their recovery of damages; for profitable turnovers, damages could be zero. This leaves some 3 1/2 million shares on which full damage claims could be based. Further, assuming that class members paid an average of $6.25 per share (the average price during the Class Period), and that the fair value of the stock on the date of each purchase was $1.58 per share (the market price following the bankruptcy petition and disclosure of the fraud), the loss would approximate $16.3 million.[FN15]

***13** Thus, class plaintiffs in In Re Saxon estimated a maximum award of damages range from about $17 million to about $50 million. The Class Settlement Fund of about $20 million is well within the range of reasonableness whichever estimate is considered most appropriate.

While the same type of highly technical damage estimations are not available in the Lewis litigation,

the $500,000 settlement fund in that case also appears to be well within the range of reasonableness. The far smaller measure of damages in Lewis did not justify the large expenditures on experts necessary for *In Re Saxon.* [FN16] Moreover the remoteness of the Lewis damages makes the calculations far more difficult.

In addition, as discussed above, the maximum possible *recovery* that the classes could reasonably hope to achieve after trial is considerably less than the best judgment on damages theoretically obtainable; recovery is limited by the resources available to the defendants to satisfy a judgment, including their limited insurance coverage.

As the *Grinnell* court appreciated, a "best possible" scenario must be tempered with a sizable dose of reality:

The fact that a proposed settlement may only amount to a fraction of the potential recovery does not, in and of itself, mean that the proposed settlement is grossly inadequate and should be disapproved.

City of Detroit v. Grinnell Corp., 495 F.2d at 455. Indeed, as Judge Moore emphasized in *Grinnell:* "[T]here is no reason, at least in theory, why a satisfactory settlement could not amount to a hundreth or even a thousandth part of a single percent of the potential recovery." *Id.* at 455 n. 2. *Accord, Weinberger v. Kendrick*, 698 F.2d at 65 (where the Second Circuit upheld a settlement which, because of legal difficulties, amounted to "only a negligible percentage of the losses suffered by the class"); *TBK Partners, Ltd. v. Western Union Corp.*, 675 F.2d 456, 463–64 (2d Cir.1982); *Flinn v. FMC Corp.*, 528 F.2d 1169, 1173–74 (4th Cir.1975); *Zerkle v. Cleveland–Cliffs Iron Co.*, 52 F.R.D. 151, 159 (S.D.N.Y.1971) (noting that in stockholder litigation, "the Courts have displayed a healthy skepticism in the face of optimistic forecasts or large demands").

Given the obstacles and uncertainties, the proposed settlement is fair and adequate. It achieves a very substantial portion of the *likely* recovery in this case, and is unquestionably better than another "possibility"—little or no recovery at all.

The Range of Reasonableness of the Settlement Fund in Light of the Risks of Litigation

Obviously, the foundation of any settlement is uncertainty as to the outcome of the litigation. If a party were assured that a better result awaited which would justify the added delay, effort and expense, then litigation would be continued without apprehension. Such assurance, however, is rarely the case. "It is known from past experience that no matter how confident one may be of the outcome of litigation, such confidence is often misplaced." *In re Warner Communications Securities Litigation*, 82 Civ. 8288 (JFK) (S.D.N.Y.8/20/85) slip. op. at 14, quoting *State of West Virginia v. Chas. Pfizer & Co.*, 314 F.Supp. 710, 743–44 (S.D.N.Y.1970). Indeed, in *Upson v. Otis*, 155 F.2d 606, 612 (2d Cir.1946), a settlement was rejected by the court as inadequate in view of the likelihood of recovery at trial. Plaintiffs later were victorious at trial, however, "the ultimate recovery ... turned out to be substantially less than the amount of the rejected compromise." Haudek, *The Settlement and Dismissal of Stockholders' Actions*, 23 Sw.L.J. 765, 894 (1969).

***14** Recent events have again demonstrated the enormous risks of litigation. The press has reported the loss of a major class action against the manufacturer of the drug Bendectin. A jury ruled for the defendant. That case was originally settled for $120 million. However, the Court of Appeals for the Sixth Circuit decertified the class, thereby voiding th proposed settlement. *In re Benedectin Products Liability Litigation*, 749 F.2d 300 (6th Cir.1984). Thereupon, the plaintiffs tried the case and lost the $120 million they originally bargained for. *The Wall Street Journal*, March 13, 1985 at 10:3.

Experienced counsel for both plaintiffs and defendants, negotiating vigorously at arm length and possessing all relevant information, recommend the present settlement because each side recognizes the risk of failure and the high costs attendant to continued litigation. As already discussed, their views are entitled to considerable weight. The legal and factual difficulties which confront plaintiffs, when added to the unpredictability of a lengthy and complex jury trial—where witnesses could suddenly become unavailable or jurors could react to the evidence in unforeseen ways—make the benefits to the classes of the present settlement apparent.

Further litigation is, of course, costly as well. The present settlement must be balanced against the expense of achieving a more favorable recovery. *Young v. Katz*, 447 F.2d 431, 433 (5th Cir.1971), *citing In re*

Riggi Bros. Co., 42 F.2d 174, 176 (2d Cir.1930). This case is obviously a complex one which has been and, except for the Global and Class Settlement Agreements, will continue to be fiercely contested by the scores of parties. All the while, the limited funds available for damage payments would dwindle away in the form of counsel fees and costs for experts.

Such additional and very substantial expense would diminish any eventual recovery. Moreover, delay, not just at the trial stage but through post-trial motions and the appellate process as well, would require class members to wait years for any recovery, further reducing its value. *See City of Detroit v. Grinnell*, 495 F.2d at 467.

Conclusion

For the reasons stated above, the settlement agreements in In Re Saxon and Lewis are approved pursuant to Fed.R.Civ.P. 23(e) as being fair, reasonable and adequate and in the best interest of the plaintiffs.

It is So Ordered.

FN1. Members of the classes hereinafter will be collectively referred to as "class members".

FN2. Indeed, there is considerable authority that the claims in bankruptcy of defrauded common stock purchasers (which constitute the majority of the class) are subordinated to the residuary interest current stockholders have in the bankrupt's estate and are therefore entitled to nothing. The version of 11 U.S.C. § 510(b) which was in effect at the time of Saxon's bankruptcy petition and for all other bankruptcy cases filed prior to October 11, 1984 provided:

> Any claim for recission [sic] of a purchase or sale of a security of the debtor or of an affiliate or for damages arising from the purchase or sale of such a security shall be subordinated for purposes of distribution to all claims and interests that are senior or equal to the claim or interest represented by such security. 11 U.S.C. § 510(b) (1979).

FN3. Because Saxon was operating as a debtor-in-possession, lawsuits against the company were precluded by 11 U.S.C. § 362(a).

FN4. In 1970 Saxon acquired beneficial ownership of all of Standard's stock. On December 31, 1978, Standard was merged into Saxon.

FN5. The Class Settlement Agreements are with all defendants in the consolidated class actions except defendant Arthur Monteil, a former vice president of Saxon's Business Products Division and an alleged participant in the fraud. The value of the remaining claim against Mr. Monteil is not a significant factor in appraising the fairness of the proposed settlement.

FN6. The long delay presents obvious problems for plaintiffs. Moreover, many of Saxon's records have been destroyed.

FN7. Within the past month defendants Lurie and Horowitz have pled guilty to certain counts of the indictments. The government has announced that its investigation is continuing with the possibility of additional indictments.

FN8. One objector was Martin Schere ("Schere"). In June 1973, Schere purchased $60,000 face amount of Standard 5 1/4 debentures due April 30, 1990. These debentures were bought well after the 1970 purchase by Saxon of all standard stock, yet supposedly in reliance upon representations made in connection with that "merger." On December 31, 1978—during the Class Period—Standard, a wholly-owned subsidiary, was merged into Saxon and Saxon assumed the obligations on the Standard debentures, which continued to trade on the NYSE as "Standard Packaging" debentures. Schere "object(s) to the proposed settlement unless [he is] included and [is] properly paid from the Fund...." ¶ 10. This is not an objection to the settlement itself; it only challenges the expected denial of Schere's claim, which is a

matter of settlement administration and claims processing.

> If Schere's claim is denied during the settlement administration because he is not a member of any class, he will be given a hearing pursuant to the settlement. If he is finally adjudged not to be a class member he will not be bound by any judgment in these actions and will be free to pursue his own action against the defendants. Again, it must be stressed that Schere is not objecting to the fairness of adequacy of the settlement. At the hearing on September 20, 1985, Schere did not appear.
>
> The other two objections to the Plan of Distribution are dealt with in a separate opinion of even date. Suffice to say these objections do not challenge the fairness, adequacy, or reasonablness of the settlements.

FN9. On July 16, 1982, the Bankruptcy Court appointed Arthur J. England, Jr. as the Examiner in Saxon's Chapter 11 proceedings. Following two months of investigation, which included the study of Saxon internal memoranda and accounting documents and interviews of numerous current and former Saxon employees, Mr. England issued his Preliminary Report supported by substantial documentation. Subsequently, Mr. England issued an additional report. The reports and materials were reviewed by class counsel and considered in negotiating the settlement. Class counsel also conferred with Mr. England and obtained and reviewed the transcripts of all depositions taken in connection with the Saxon bankruptcy proceeding.

FN10. The requirement that plaintiffs prove that other conditions did not affect the price might prove very difficult. For example, defendant would argue that the potential takeover of Saxon by Carl Icahn during the class period drove up the price of Saxon securities unrelated to the fraud.

FN11. [Footnote 11 not reproduced. CCH.]

FN12. In addition, the "demand for time on the existing judicial system must be evaluated in determining the reasonableness of the settlement." *City of Detroit v. Grinnel Corp.*, 356 F.Supp. 1380, 1389 (S.D.N.Y.1972). Here, as in *Grinnell*, if underlying liability is found on a classwide basis, defendants would contend that they were entitled to a jury trial as to each class member's actual reliance and damages. *See Blackie v. Barrack*, 524 F.2d at 906 n. 22; *Green v. Wolf Corp.*, 406 F.2d 291, 301 (2d Cir.1968), *cert. denied*, 395 U.S. 977 (1969); *Lorber v. Beebe*, 407 F.Supp. 227, 289 (S.D.N.Y.1976). Assuming, as the *Grinnell* court did, trials lasting only one hour per class member and full cooperation of the parties, such a "herculean task" could still take years of judicial and jury time. *City of Detroit v. Grinnell*, 495 F.2d at 467. The proposed settlement is certainly desirable from this perspective also.

FN13. Another factor class plaintiffs had to take into consideration was that Fox was also a defendant in *In re Flight Transportation Securities Litigation*, MDL Docket No. 517, a major securities fraud class action pending in this District Court for the District of Minnesota. In that action, Fox bore substantial exposure for many millions of dollars in damages to a certified nationwide class of securities purchasers. Class plaintiffs were concerned that if Fox were to be held liable in *Flight Transportation*, Fox's ability to contribute to the settlement proposed herein could be seriously jeopardized. In July, well after the Class Settlement Agreement was signed, it was announced that *Flight Transportation* had been settled with Fox paying more than $5 million.

FNClass counsel were additionally aware that Fox was also a defendant in the recent *O.P.M. Leasing Services, Inc.* securities fraud litigation and contributed to the $65 million settlement of that case.

FN14. Magistrate Gershon, in recommending exclusion of the "Ins and Outs" from the class, found they "may have benefitted from, rather than been harmed by, the defendants"

conduct. This Court, however, ruled that "potential conflicts among class members regarding proof of damages are insufficient to defeat class certification...." Slip op. at 7 (2/24/84).

FN15. $6.25 minus $1.58 = $4.97 loss per share x 3.5 million shares = $16.3 million total loss.

FN16. It appears that expert fees in In Re Saxon will exceed $300,000. If the same fees were incurred in Lewis, class plaintiffs would realize a mere 10% of the settlement fund (including estimated $125,000 in attorney's fees).

S.D.N.Y.,1985.
In re Saxon Securities Litigation
Not Reported in F.Supp., 1985 WL 48177 (S.D.N.Y.), Fed. Sec. L. Rep. P 92,414

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Ontario Supreme Court

Millgate Financial Corp. v. BF Realty Holdings Ltd.,

Date: 1994-08-16

Millgate Financial Corporation Limited

and

BF Realty Holdings Limited, BCE Inc., Carena Developments Limited, Partnerco Equities Ltd., Brookfield Developments Corporation, Gordon E. Arnell, Warren Chippindale, Jack L. Cockwell, Josef J. Fridman, Willard J. L'Heureux, Robert E. Kadlec, John R. McCaig, Allan S. Olson, John A. Rhind, J. Stuart Spalding, Kevin Benson, C. Wesley M. Scott, J.V. Raymond Cyr, A. Jean de Grandpre, Lynton R. Wilson, Henry A. Roy, Gerald T. McGoey and National Trust Company

Ontario Court of Justice (General Division [Commercial List]) Farley J.

Heard – May 11-12 and June 14, 1994.

Judgment – August 16, 1994.

Written Reasons for Judgment – September 7, 1994.

W.A. Derry Millar and Carole McAfee Wallace, for plaintiff.

Charles F. Scott and Wendy A. Kelley, for defendants BF Realty Holdings Limited and Brookfield Development Corporation.

Lyndon A.J. Barnes and Mark A. Gelowitz, for defendants Robert E. Kadlec, John R. McCaig, Allan S. Olson and John A. Rhind.

David R. Byers and Elizabeth Turner, for defendants Carena Developments Limited, Partnerco Equities Ltd., Jack L. Cockwell, Gordon E. Arnell, Willard J. L'Heureux and Kevin Benson.

Alan J. Lenczner, Q.C., and Anne Posno, for defendants J.V. Raymond Cyr, J. Stuart Spalding, Warren Chippindale, Lynton R. Wilson, Josef J. Fridman, C. Wesley M. Scott, Gerald T. McGoey, A. Jean de Grandpre and Henri A. Roy.

B40/94

[1] August 16, 1994. FARLEY J.: – The defendants, excepting National Trust Company ("National"), moved for an order staying or dismissing the action. The hearing was argued on procedural grounds and there should be nothing implied from this decision as to the merits of the substantive claims. The grounds for such motion were stated to be:

(a) the plaintiff is without legal capacity to commence or continue the action;

(b) substantially the identical proceeding is pending in British Columbia as Supreme Court of British Columbia Action No. C910991;

(c) this proceeding is vexatious and is an abuse of process;

(d) Rules 1.04(1), 1.05, 21.01(3)(*b*), (*c*) and (*d*)… of the *Rules of Civil Procedure;* and

(e) s. 106 of the *Courts of Justice Act,* R.S.O. 1990, c. C.43.

[2] The further submission of June 14, 1994 was that the defendants BF Realty Holdings Limited ("BF") and Brookfield Development Corporation ("Brookfield") had proceeded, as I was previously alerted, with a motion in the British Columbia Supreme Court to dismiss the British Columbia action for want of prosecution. On June 6, 1994, Stewart J. ordered that the action be dismissed against all defendants (BF, Brookfield, BCE Inc. ("BCE"), Carena Developments Limited ("Carena") and Partnerco Equities Ltd. ("Partnerco")) but that such order not take effect until June 20, 1994 with the provision that in the interim period the plaintiff in that action, National, would have leave to apply. Apparently, National did not seek leave so that the dismissal of the British Columbia action is now final. National appears to have lost its appetite for this litigation, having expended approximately $1 million on it to date.

[3] The moving defendants asked for an alternative order that as a condition of proceeding with the action the plaintiff Millgate Financial Corporation Limited ("Millgate"), be required to post security for costs, citing r. 56.09.

[4] The parties through their counsel exhibited excellent cooperation by their preparation of an agreed statement of facts (a copy of which is annexed to these reasons [at pp. 235-255]). Unless otherwise defined herein, the definitions set out in the agreed statement of facts apply to these reasons. I was also given a five-stage set of corporate diagrams which are helpful in visualizing the transactions at the various material times. There was some quarrel over the legal significance implied by the oval (which perhaps Freudianly looks like a goose egg) drawn around various of the boxes in stages four and five. The set of diagrams is also attached [at pp. 256-260]. I would note that even with their co-operation, the material was an unwieldy 2 feet high and 35 lbs. Counsel have the advantage in preparing their cases of not having to wrestle with such monsters, however, cervically cranky judges are expected to do so in rendering a decision.

[5] The moving defendants also sought other relief, but there was mutual agreement that I should make a decision on the foregoing elements before the parties returned, if necessary, to argue the balance of the issues. While I am of the view that it would have been preferable to have reached that conclusion earlier in the process, it appears that the request is compatible with *Ashmore v. Corp. of Lloyd's,* [1992] 2 All E.R. 486 (H.L.) of dealing with a potentially determinative issue of the lawsuit first (see Lord Roskill, at p. 488).

Legal Capacity

[6] The first item to be dealt with is whether Millgate has the legal capacity to commence and continue with the Ontario action. Rule 21.01(3)(*b*) of the *Rules of Civil Procedure,* R.R.O. 1990, Reg. 194 provides:

> (3) A defendant may move before a judge to have an action stayed or dismissed on the ground that…
>
> (b) the plaintiff is without legal capacity to commence or continue the action…

[7] See *Pizzolati & Chittaro Manufacturing Co. v. May,* [1972] 2 O.R. 606 (C.A.) where it was determined that the plaintiff had no status to maintain the action since it was not a creditor within the meaning of the bulk sales legislation as it only had an unliquidated claim for damages, and *Goldex Mines Ltd. v. Revill* (1974), 7 O.R. (2d) 216 (C.A.) where it was determined, although leave of the court to bring a derivative action was not sought, that the action should not be struck since the action was not derivative in nature. Arnup J.A. for the court in *Pizzolati* stated, at p. 612:

> In the result I therefore conclude that the plaintiff has no status to maintain this action. While there is some old law to the effect that an action brought by a plaintiff who has no status to do so should be stayed, I can see no useful purpose in doing so and in my view the action ought now to be dismissed.

[8] See also *E.J. Hannafin Enterprises Ltd. v. Esso Petroleum Canada* (1994), 17 O.R. (3d) 258 (Gen. Div.), at p. 264 where Blair J. appears to adopt the principle enunciated by Lord Roskill in *Ashmore*:

> In this matter there does seem to me to be a separate and distinct issue which, depending upon how it is decided, could be determinative of the lis between the parties. That is the question of whether or not, even if it is in default under the supply agreement, Hannafin has the right to exercise its option under the head lease. If the answer to that question is “yes”, then the issue of Hannafin’s default need not be litigated, at least in the context of the right to exercise the option to purchase the option facilities. If the answer is “no”, of course, then the question of Hannafin’s default under the supply agreement will have to be litigated and a trial of that issue will be necessary.

[9] Has National, as trustee, been incompetent, guilty of mismanagement, misconduct or put itself into a position where it cannot faithfully or competently discharge its duties. If it has so done this then it would appear the American cases support the proposition that a precondition or no action clause would not prevent a bondholder from commencing an action: see *Rabinowitz v. Kaiser-Frazer Corp.,* 111 N.Y.S.2d 539 (Sup. Ct., 1952), at pp. 548-7; *Feldbaum v. McCrory Corp.* (1992 Del. Ch. lexis 113), at p. 22; and *Home Mortgage Co. v. Ramsey,* 49 F.2d 738 (4th Cir. N.C., 1931), at p. 741.

[10] Section 8.05 of the trust indenture provides that unless four conditions are met, any proceeding to enforce under the debentures may be instituted only by the trustee. That section provides that:

> S. 8.05. No holder of any [Debenture] or coupon shall have any right to institute any action, suit or proceeding at law or in equity for the purposes of enforcing payment of the principal or any premium or interest on any [Debenture] or coupon, or for the execution of any trust or power hereunder or… for any other remedy hereunder… unless
>
> (i) such [Debentureholder] shall previously have given to the Trustee written notice of the happening of an Event of Default hereunder;
>
> (ii) the [Debentureholders] by Extraordinary Resolution… shall have made a request to the Trustee and the Trustee shall have been afforded reasonable opportunity either itself to proceed to exercise the powers hereinbefore granted or to institute an action, suit or proceeding in its name for such purpose;
>
> (iii) the [Debentureholders] or any of them shall have furnished to the Trustee, when so requested by the Trustee, sufficient funds and security and indemnity satisfactory to it, against the costs, expenses and liabilities to be incurred therein or thereby; and
>
> (iv) the Trustee shall have failed to act within a reasonable time after such notification, request and offer of indemnity and such notification, request and offer of indemnity are hereby declared in every such case, at the option of the Trustee, to be conditions precedent to any such proceedings.

[11] The Ontario statement of claim does not allege that these conditions have been met so as to allow someone other than the trustee (National) to bring the action. Rather to the contrary it is clear from the statement of claim, the agreed statement of facts and the cross-examination of Edwin Weiss, the sole director, officer and shareholder of Millgate, that the preconditions have not been met. One may question whether it is appropriate or truly possible to meet such conditions when Millgate is seeking a class action proceeding against the defendants including National. Ordinarily one would think it peculiar if a plaintiff with an (apparent) just cause were to be prevented from proceeding because the party

who was to initially take the proceedings did not do so. It would of course be unusual for such a party to encourage litigation against itself. If the precondition simply came down to a situation in which the "gatekeeper" could prevent (or even retard or otherwise impede) litigation against itself, then I would generally think that the court would find that such a precondition was superfluous. However, I think it desirable to analyze whether there is such simplicity in this case.

[12] The B.C. action was brought by National in 1991 against BF, BCE, Carena, Partnerco and Brookfield. The claim was set out at p. 9 of that writ:

> Wherefore the plaintiff claims:
>
> (1) A declaration that Brookfield is bound by the Trust Indenture;
>
> (2) A judgment against BF and Brookfield for the full amount due and owing under the Trust Indenture;
>
> (3) Damages against BF and Brookfield for breach of contract, and an injunction requiring BF to cause Brookfield to execute the instruments called for by the Trust Indenture;
>
> (4) Damages against BCE, Carena, Partnerco and Brookfield for wrongful interference with the Plaintiff's contractual rights;
>
> (5) Punitive damages;
>
> (6) A charging order, pendente lite, against the undertakings, property and assets of Brookfield;
>
> (7) An interlocutory injunction enjoining the Defendants BF and Brookfield from refusing to pay all reasonable expenses of the Plaintiff in relation to these proceedings;
>
> (8) An interlocutory injunction enjoining BF and Brookfield from failing to provide information to which the Plaintiff is entitled on request;

(9) An interlocutory injunction enjoining the Defendants BCE, Carena, Partnerco and Brookfield from interfering with the performance by BF and Brookfield of their obligations to pay the Plaintiff's reasonable expenses and provide information, and

(10) Permanent injunctions, costs, and such other and further relief as to this honourable Court seems meet and just.

[13] The Ontario action brought by Millgate in November 1993 adds directors of the various corporate defendants in the B.C. action as well as National. The prayer for relief against National is expressly stated as:

(r) as against the Defendant, National Trust Company, damages for breach of the Trust Indenture dated as of May 25, 1988, for breach of fiduciary duty and negligence in the amount of $150,000,000.00

[14] The Ontario action is neatly divided into two parts after the prayer: (a) claims against all of the defendants other than National Trust; and (b) claims against National Trust. The thrust of the claims against National appears to be that National improperly and negligently commenced and conducted the B.C. action. It would not appear to me that there was any necessity to link the two sets of claims in one action; that result would appear to have been something done as a preference of Millgate. I am therefore of the view that the fact that Millgate has named National as a defendant in the Ontario action along with the other defendants (the corporate defendants in the B.C. action and various of their directors now added in the Ontario action) should not work against the non-National defendants.

[15] I note as well that a formal committee of debentureholders was formed under the provisions of the trust indenture, which committee was apprised of the facts forming the substance of this matter but is not taking any part in this Ontario action.

[16] Millgate, however, relies on s. 3.04 of the trust indenture which provides:

Section 3.04 – Obligation to pay Unimpaired.

Nothing contained in this Article III or elsewhere in this Indenture, or in the Subordinated Debentures, is intended to or shall impair, as between the Company, its creditors and the holders of the Subordinated Debentures and coupons, the obligation of the

Company, which is absolute and unconditional, to pay to the holders of the Subordinated Debentures and coupons the principal of, premium, if any, and interest on the Subordinated Debentures and coupons, as and when the same shall become due and payable in accordance with their terms, or affect the relative rights of the holders of the Subordinated Debentures and coupons and the other creditors of the Company (other than the holders of Senior Indebtedness), *nor shall anything herein or therein prevent the Trustee or the holder of any Subordinated Debenture or coupon from exercising all remedies otherwise permitted by applicable law upon default under this Indenture, subject to the rights, if any, under this Article III of the holders of Senior Indebtedness with respect to cash, property or securities of the Company received upon the exercise of any such remedy.* [Emphasis added]

[17] It may well appear that this trust indenture is one which has been adjusted from the original precedent, with grafting (and cutting) over the years. One suspects that the only time that these types of documents get a thorough review is when litigation rears its head. This conclusion may be readily discerned when one examines s. 3.03 where it is stated that:

> …it being understood that the provisions of this Article III are and are intended solely for the purpose of defining the relative rights of the holders of the Subordinated Debentures, on the one hand, and the holders of Senior Indebtedness on the other hand.

[18] Thus it is clearly stated that the provisions of article III (which contains s. 3.04) are to be *solely* for the purpose of defining the relative rights of the debentureholders and any holders of senior security. Then too when one looks at the emphasized provisions of s. 3.04, but from a distance so that they may be taken in context, one is able to appreciate that the procedure set out in s. 8.05 does not infringe or deteriorate from s. 3.04. Section 8.05 merely provides that the debentureholders who have a complaint proceed in accordance with the steps set out – that is, that the four preconditions be satisfied before the debentureholders take any direct action. Thus I do not see in the context that the debentureholders are prevented from taking action, but rather they must take their action in a prescribed fashion.

[19] Millgate submits that BF has breached its obligations under s. 7.03 of the trust indenture to:

> …pay the Trustee's reasonable remuneration for its services as Trustee hereunder and will repay to the Trustee on demand all moneys which shall have been paid by the Trustee in and about the execution of the trusts hereby created with interest at 8% per annum from 30 days after the date of the invoice from the Trustee to the Company with respect to such expenditure until repayment, and such moneys and the interest thereon, including the Trustee's remuneration, shall be payable out of any funds coming into the possession of the Trustee in priority to any of the Subordinated Debentures or interest thereon. The said remuneration shall continue payable until the trusts hereof be finally wound up and whether or not the trusts of this Indenture shall be in course of administration by or under the direction of the court.

[20] Millgate's position is that but for BF's breach, National would be in a position to have continued the B.C. action. I find this argument somewhat circular. However I think it suffices to observe that National would have no difficulty in appreciating that it would have a claim for remuneration for its services as trustee.

[21] I was advised by all counsel that there were no Canadian cases on pre-condition clauses in trust indentures. They then referred me to various American and English cases. In *Greene v. New York United Hotels Inc.,* 261 N.Y. 698, 185 N.E. 798 (1933) it was stated, at pp. 798-799 in dismissing an action:

> …the trust agreement incorporated by reference into the complaint, read in part as follows: "To avoid multiplicity of suits, all the Debentures shall be subject to the condition that no holder of any Debenture of coupon appertaining thereto shall have any right to institute any action, at law or in equity, under or growing out of any provision of this indenture, or for the enforcement thereof, unless and until and Trustee shall refuse or neglect to institute proper proceedings by way of remedy within a reasonable time after request of the holders of at least twenty-five per cent in principal amount of the Debentures then outstanding, filed with the Trustee, with offer of indemnity satisfactory to the Trustee". The complaint contained no allegations showing compliance with these provisions.

[22] Wasservogel J. in *Relmar Holding Co. v. Paramount Public Corp.,* 147 Misc. 824, 263 N.Y.S. 776 (1993), affirmed 237 A.D. 870, 261 N.Y.S. 959 (1933) said, at p. 778:

The plaintiff as a bondholder holds his securities subject to the condition of this underlying trust agreement and can maintain an action only upon the conditions specified in the trust agreement. *Krepchin v. Barclay-Arrow Holding Corp.,* 236 App. Div. 777, 258 N.Y.S. 1031. The complaint contains no allegations showing compliance with these provisions of the trust agreement. The plaintiff as an individual creditor holding this small number of bonds had no capacity to maintain this action and his complaint should have been dismissed.

[23] See also *Friedman v. Chesapeake & Ohio Railway Co.,* 395 F.2d 663 (2nd Cir. N.Y., 1968). *Home Mortgage,* supra, contains some pertinent observation, at p. 743 [49 F.2d], when Cochran J. for the court stated:

Moreover, we think that the plaintiff is precluded from maintaining this suit by the terms of her bonds and the indenture securing them which provide in substance that action can be taken for the protection of the interest of the bondholders only where a certain number of the bondholders join. These provisions have already been quoted. The plaintiff argues that these provisions are void because it is an attempt to oust the jurisdiction of the courts. We do not so regard them. Under the terms of the bonds and indenture, the trustee is the representative of the plaintiff, and entitled to bring suit. The provisions are merely reasonable conditions precedent to the right of the plaintiff to bring the suit herself. They are intended for the security of all the bondholders, and no doubt rendered the bonds more salable. They were devised for just such a case as is presented here, where one bondholder, or a small minority, is determined upon action which a large majority believe hostile to their interests. The limitations imposed by the contract have not been met in this case. The plaintiff has not only not complied with the provisions, but has made no demand whatever upon the trustee to take action, nor is there any showing that if such demand had been made, it would be futile. If it were shown that the trustee had colluded with the majority of the bondholders, or was engaged with the Home Mortgage Company in perpetrating a fraud upon the plaintiff, and that the other bondholders would not join with her in protecting their rights, a different situation would be presented; but there is no such showing. The plaintiff as against the corporation is seeking to enforce rights which the trustee is the proper person to enforce. She had made no demand upon the trustee to safeguard these

rights, and has not secured the co-operation of the bondholders required by the provisions of the indenture.

[24] See also *Rogers & Co. v. British & Colonial Colliery Supply Assn.* (1898), 68 L.J.Q.B. 14, and *Pethybridge v. Unibifocal Co.,* [1918] W.N. 278 (K.B.).

[25] Chancellor Allen in *Simons v. Cogan,* 542 A.2d 785 (Del. Ch., 1987) made the following observations, at p. 786:

> It has now become firmly fixed in our law that among the duties owed by directors of a Delaware corporation to holders of that corporations' debt instruments, there is no duty of the broad and exacting nature characterized as a fiduciary duty. Unlike shareholders, to whom such duties are owed, holders of debt may turn to documents that exhaustively detail the rights and obligations of the issuer, the trustee under the debt indenture, and of the holders of the securities.
>
> Such documents are typically carefully negotiated at arms-length. In a public offering, the underwriter of the debt, and to some extent the indenture trustee, have an interest in negotiating in that fashion; in a private placement, the purchaser has a similar interest. More importantly, the purchaser of such debt is offered, and voluntarily accepts, a security whose myriad terms are highly specified. Broad and abstract requirements of a "fiduciary" character ordinarily can be expected to have little or no constructive role to play in the governance of such a negotiated, commercial relationship.
>
> [1-4] Accordingly, it is elementary that rights of bondholders are ordinarily fixed by and determinable from the language of documents that create and regulate the security. In a publicly distributed debenture the notes themselves and a trust indenture serve this function, but other documents such as a note agreement or, in the case of secured bonds, security agreements may be involved. Of course, in some circumstances bondholders may have rights against an issuer that are not expressly created by the indenture or other original documents.

[26] He went on to say, at p. 790:

> Thus, there exists a body of judicial opinion willing to extend the protection offered by the fiduciary concept to the relationship between an issuer and the holders of its

convertible debt securities. These seeds, however, have fallen upon stones. None of the appellate opinions actually represent a holding so extending that concept and, indeed, each of those cases evidence the fact that prevailing judicial opinion remains to the contrary.

[27] He concludes, at p. 793, by determining that a similar provision to the subject s. 8.05 precludes the plaintiff bondholder from pressing her contractual clauses:

> Here, the document creating the bundle of rights that plaintiff owns specifically provides that, among those rights, is no right, in these circumstances, to sue for breach of contract individually. The document creating this property defines, in Section 8.08, what steps that must be taken to assert breach of contract claims. The complaint clearly discloses that those steps were not followed in this instance and, therefore, no justiciable claim for violation of the indenture is presented.
>
> [footnote: Were a claim for fraud or breach of some other non-contractual duty alleged, this failure would not be fatal. See *Continental Illinois,* supra; *Reinhardt v. Interstate Telephone Co.,* 71 N.H. Eq. 70, 63 A. 1097 (1906)]
>
> It is not an adequate response to this result that, as a practical matter, plaintiff may not be able to get the concurrence of 35% of the principal amount of debentures.

[28] Thus it appears to me that the only defendant which is able to rely on the precondition clause is BF and then only to the extent that Millgate is alleging that it is in breach of its contractual obligations pursuant to the payment of principal and interest on the debentures being in default.

Stay of Proceedings

[29] Section 106 of the *Courts of Justice Act* provides:

> 106. A court, on its own initiative or on motion by any person, whether or not a party, may stay any proceeding in the court on such terms as are considered just.

[30] Rule 21.01(3)(*c*) provides:

(3) A defendant may move before a judge to have an action stayed or dismissed on the ground that…

(c) another proceeding is pending in Ontario or another jurisdiction between the same parties in respect of the same subject matter…

[31] Given that the B.C. action has now been dismissed, it would appear to me that there is no element of competing cases or competing jurisdictions. It would not therefore seem necessary to canvass the jurisprudence in this sector. In my view the test in *Huebner v. Direct Digital Industries Ltd.* (1975), 11 O.R. (2d) 372 (H.C.) does not in these circumstances come into play. It may be desirable for counsel to discuss what elements, if any, of the discovery process may be salvaged from the B.C. action.

Forum Conveniens Test

[32] A second approach applied by the courts on a motion for a stay of an action is the forum conveniens test. That test was set out in *Bonaventure Systems Inc. v. Royal Bank* (1986), 57 O.R. (2d) 270 (Div. Ct.), leave to appeal to Ont. C.A. refused February 1, 1987 (Ont. C.A.), relying on *MacShannon v. Rockware Glass Ltd., Fyfe v. Redpath Dorman Long Ltd., Jardine v. British Steel Corp., Patterson v. Stone Manganese Marine Ltd.,* (sub nom. *Rockware Glass Ltd. v. MacShannon, Redpath Dorman Long Ltd. v. Fyfe, British Steel Corp. v. Jardine, Stone Manganese Marine Ltd. v. Patterson*) [1978] A.C. 795 (H.L.) [hereinafter referred to as *"Rockware"*] especially at pp. 811-812. Ewaschuk J. for the Divisional Court stated, at pp. 278-279:

I have concluded that the convenient forum test as articulated by Diplock L.J. in *Rockware Glass Ltd. v. MacShannon, supra,* is the proper test to be applied. I keep in mind the two competing but valid principles that a litigant has a *prima facie* right to select the forum of his choice but that there is nothing inherently better about suing in Ontario than in any other foreign jurisdiction, especially where that foreign jurisdiction is another province in Canada – the principle of judicial comity must be given recognition.

The first stage in an application to stay an Ontario action or injunction to stay a competing action in a foreign jurisdiction is that the applicant must justify the stay or injunction. The applicant must thus "'satisfy the court that there is another forum to

whose jurisdiction he is amenable in which justice can be done between the parties at *substantially* less inconvenience or expense'" (emphasis added [by Ewaschuk J.]): see *Rockware Glass Ltd. v. MacShannon, supra, per* Diplock L.J. at p. 812.

As part of the first stage, the applicant for a stay must satisfy the court that the foreign jurisdiction is the convenient forum. Convenient forum means that the applicant must establish that the foreign jurisdiction is the more appropriate natural forum to try the actions in the sense that the foreign jurisdiction has the most real and substantial connection with the lawsuit. It will be presumed that justice can best be obtained in the foreign jurisdiction if it is the natural forum in the sense that justice can be done between the parties at substantially less inconvenience or expense in the natural forum of a lawsuit. However, in the exceptional case, justice may not be best done in the natural forum where a substantial number of major witnesses reside in the other jurisdiction.

The applicant for a stay of an Ontario action must thus establish that justice can clearly be best done in the foreign jurisdiction. That test satisfied, the applicant is still not yet entitled to a stay.

The second stage of an application for a stay of an Ontario action in a case of competing jurisdiction raises the question as to whether the stay will deprive the respondent plaintiff of a legitimate personal or juridical advantage by maintaining the Ontario action which will not be available to him in the foreign jurisdiction. At this stage, the onus lies on the respondent plaintiff to establish the loss of a legitimate personal or juridical advantage. The court must not presume such loss.

[33] It was clear from the speeches in *Rockware* that their Lordships considered that the test in *St. Pierre v. South American Stores (Gath & Chaves) Ltd.,* [1936] 1 K.B. 382 (C.A.) was to be modified in the forum conveniens sense.

[34] In granting a stay the court must be satisfied that there is some other forum having competent jurisdiction in which the case may be more suitably tried in the interests of all parties and for the ends of justice. See *Spiliada Maritime Corp. v. Cansulex Ltd.,* [1987] A.C. 460 (H.L.), at pp. 476-478. According to *Bonaventure, Rockware* and *Spiliada* the burden is on the defendants to show that there exists a more convenient or appropriate jurisdiction for the litigation; with that established then the burden is on the plaintiff to show

that there are special circumstances preventing justice from being done in the foreign jurisdiction or that the plaintiff would lose some legitimate personal or juridical advantage from conducting the litigation in the foreign jurisdiction. “Legitimate” in the phrase “legitimate personal or juridical advantage” refers to the proper operation of the civil legal process: see *Jaffe v. Dearing* (1988), 65 O.R. (2d) 113 (H.C.), at pp. 123-124; *Middle East Banking Co. S.A.L. v. Al-Haddad* (1989), 70 O.R. (2d) 97 (H.C.), at pp. 102-103.

[35] A litigant has a prima facie right to select the forum of his choosing; however “there is nothing inherently better about suing in Ontario than in any other foreign jurisdiction, especially where that foreign jurisdiction is another province in Canada – the principle of judicial comity must be given recognition” (p. 278 [57 O.R. (2d)], *Bonaventure*).

[36] As Lord Goff said, at pp. 477-478 [[1987] A.C.] of *Spiliada:*

> (d) Since the question is whether there exists some other forum which is clearly more appropriate for the trial of the action, the court will look first to see what factors there are which point in the direction of another forum. These are the factors which Lord Diplock described, in *MacShannon’s* case [1978] A.C. 795, 812, as indicating that justice can be done in the other forum at “substantially less inconvenience or expense”. Having regard to the anxiety expressed in your Lordships’ House in the *Societe du Gaz* case, 1926 S.C. (H.L.) 13 concerning the use of the word “convenience” in this context, I respectfully consider that it may be more desirable, now that the English and Scottish principles are regarded as being the same, to adopt the expression used by my noble and learned friend, Lord Keith of Kinkel, in *The Abidin Daver* [1984] A.C. 398, 415, when he referred to the “natural forum” as being “that with which the action had the most real and substantial connection.” So it is for connecting factors in this sense that the court must first look and these will include not only factors affecting convenience or expense (such as availability of witnesses), but also other factors such as the law governing the relevant transaction (as to which see *Credit Chimique v. James Scott Engineering Group Ltd.,* 1982 S.L.T. 131), and the places where the parties respectively reside or carry on business.

[37] The issue between the two sides appears to be whether the litigation should proceed in Ontario or be forced to proceed in another jurisdiction with British Columbia appearing to be the alternative by default. The trust indenture and related documents as well as the

conveyance were executed in British Columbia. The law applicable to the trust indenture is that of British Columbia. However, aside from those elements which are "current" (BF now having continued under the CBCA [*Canada Business Corporations Act,* R.S.C. 1985, c. C-44]) there does not appear, given the kitchen sink offensive now mounted by Millgate, to be any overwhelming link with British Columbia. Despite the assertion in the defendants' factum: "National Trust is stated in the Trust Indenture as having its principal offices in Vancouver," it is clear that the reference is to where in Vancouver its principal office in Vancouver was located. In reality there does not appear to be any particular jurisdiction in Canada which one could point to and say that this litigation is obviously one for the courts of Province "Z." It seems to me that the defendants have not met the onus of showing that British Columbia is the appropriate forum.

[38] Millgate also submits as the second branch that it will suffer a juridical and personal disadvantage if the Ontario action is stayed since it (and the class of persons it proposes to represent) would be deprived of the opportunity to proceed by way of a class action under the *Class Proceedings Act, 1992,* S.O. 1992, c. 6 ("CP Act").

[39] Legal Capacity – CP Act

[40] Section 37 of the CP Act provides:

> 37. This Act does not apply to,
>
> (*a*) a proceeding that may be brought in a representative capacity under another Act;
>
> (*b*) a proceeding required by law to be brought in a representative capacity; and
>
> (*c*) a proceeding commenced before this Act comes into force.

[41] The defendants submit that the B.C. action was a prior proceeding which would disqualify Millgate from bringing the Ontario action. I would think this too broad; it would seem to me that the most the defendants could do would be to prevent Millgate from having the Ontario action certified as a class action if I found that the B.C. action was a prior proceeding within the meaning of s. 37 (see also s. 7, CP Act). It would seem to me that the legislation was somewhat loosely drafted. The word "proceeding" is used throughout but in some contexts it means "class proceeding" (with or without the

appendage of the word “class” to “proceeding” – e.g., s. 5(1)(*e*)(ii), s. 5(2)(*b*); s. 9); in other places it is used to designate an action or application (see s. 35) – e.g., s. 10(2) or s. 13. What does “proceeding” in s. 37 mean? Clearly it does not mean a class proceeding since s. 37(*c*) would not make any sense in that context. Is “proceeding” in the context of s. 37 restricted to litigation commenced in Ontario (and in the sense of s. 37(*c*) commenced in Ontario prior to January 1, 1993) or can it encompass litigation in other jurisdiction(s) (such as the B.C. action).

[42] The claim for relief in the B.C. action was substantially the same as against the corporate defendants (excepting National) in the Ontario action. Thus it seems to me that the foundation of the Ontario action for these defendants (and the tagged along directors) has already been the subject of litigation in the nature of the B.C. action. Was the B.C. action a proceeding within the meaning of s. 37(*c*). I am of the view that it was. I base this conclusion on the following:

> (a) There is no limitation expressed explicitly or implicitly in the CP Act which would indicate that that legislation was to be restricted to litigants of the province of Ontario. Indeed, to the contrary, s. 23 indicates that statistical information purporting to be prepared or published under the authority of… the legislature of any province or territory of Canada may be admitted as evidence without proof of its authenticity. It would seem likely then that this non-Ontario statistical information would relate to non-Ontario concerns.
>
> (b) “Class” is not defined in s. 1 but rather s. 2(1) provides:
>
> > 2.–(1) One or more members of a class of persons may commence a proceeding in the court on behalf of the members of the class.

[43] It would seem that this reference to class should receive the broadest interpretation. This would appear to be supported by s. 5(1)(*b*): “there is an identifiable class of two or more persons that would be represented by the representative plaintiff or defendant”; and s. 5(1)(*c*): “the claims or defences of the class members raise common issues.” Thus it would appear to be the common issues and not provincial boundaries or some other artificial separation which comes into play. This would appear to be emphasized by

s. 5(2): “Despite subsection (1), where a class includes a subclass whose members have claims or defences that raise common issues not shared by all the class members…”

(c) Lastly, Millgate in its statement of claim does not limit in any way those for whom it would act (except disassociating itself from the defendant BCE which is also a debentureholder) if the Ontario action were certified under the CP Act. Specifically Millgate does not limit its desire to be champion to only the Ontario debentureholders but rather all debentureholders either inside or outside Ontario. At para. 2 of the statement of claim Millgate states:

> The class of persons represented by the Plaintiff under the *Class Proceedings Act* are the beneficial or registered holders (or both) of Debentures other than the Defendant BCE Inc. (the “Debentureholders”).

[44] Thus, it would appear to me that the CP Act should receive a broad interpretation which, of course, would allow it to fulfill what its proponents say are its obvious benefits. However, if it is to be broadly interpreted to achieve that end, I do not see how one can narrowly interpret the definition of proceeding in s. 37(*c*). I note in particular the observations of the Supreme Court of Canada in *Morguard Investments Ltd. v. De Savoye* (1990), 76 D.L.R. (4th) 256 (S.C.C.), and *Hunt v. T & N plc,* (sub nom. *Hunt v. T & N plc*) [1993] 4 S.C.R. 289 which suggest that courts should pay particular attention to interprovincial comity. La Forest J. in *Morguard* said, at pp. 270-273:

> The world has changed since the above rules were developed in 19th century England. Modern means of travel and communications have made many of these 19th century concerns appear parochial. The business community operates in a world economy and we correctly speak of a world community even in the face of decentralized political and legal power. Accommodating the flow of wealth, skills and people across state lines has now become imperative. Under these circumstances, our approach to the recognition and enforcement of foreign judgments would appear ripe for reappraisal. Certainly, other countries, notably the United States and members of the European Economic Community, have adopted more generous rules for the recognition and enforcement of foreign judgments to the general advantage of litigants. However that may be, there is really no comparison between the interprovincial relationships of today and those

obtaining between foreign countries in the 19th century. Indeed, in my view, there never was and the courts made a serious error in transposing the rules developed for the enforcement of foreign judgments to the enforcement of judgments from sister provinces. The considerations underlying the rules of comity apply with much greater force between the units of a federal state, and I do not think it much matters whether one calls these rules of comity or simply relies directly on the reasons of justice, necessity and convenience to which I have already adverted. Whatever nomenclature is used, our courts have not hesitated to co-operate with courts of other provinces where necessary to meet the ends of justice… [(p. 270)]

In any event, the English rules seem to me to fly in the face of the obvious intention of the Constitution to create a single country. This presupposes a basic goal of stability and unity where many aspects of life are not confined to one jurisdiction. A common citizenship ensured the mobility of Canadians across provincial lines, a position reinforced today by s. 6 of the *Canadian Charter of Rights and Freedoms…*

These arrangements themselves speak to the strong need for the enforcement throughout the country of judgments given in one province. But that is not all. The Canadian judicial structure is so arranged that any concerns about differential quality of justice among the provinces can have no real foundation. All superior court judges – who also have superintending control over other provincial courts and tribunals – are appointed and paid by the federal authorities. And all are subject to final review by the Supreme Court of Canada, which can determine when the courts of one province have appropriately exercised jurisdiction in an action and the circumstances under which the courts of another province should recognize such judgments. Any danger resulting from unfair procedure is further avoided by subconstitutional factors, such as, for example, the fact that Canadian lawyers adhere to the same code of ethics throughout Canada. [(p. 271)]

These various constitutional and subconstitutional arrangements and practices make unnecessary a “full faith and credit” clause such as exists in other federations, such as the United States and Australia. The existence of these clauses, however, does indicate that a regime of mutual recognition of judgments across the country is inherent in a federation. Indeed, the European Economic Community has determined that such a

feature flows naturally from a common market, even without political integration. To that end its members have entered into the 1968 Convention on Jurisdiction and Enforcement of Judgments in Civil and Commercial Matters.

[…] In short, the rules of comity or private international law as they apply between the provinces must be shaped to conform to the federal structure of the Constitution. [(p. 272)]. As I see it, the courts in one province should give full faith and credit, to use the language of the United States Constitution, to the judgments given by a court in another province or a territory, so long as that court has properly, or appropriately, exercised jurisdiction in the action. I referred earlier to the principles of order and fairness that should obtain in this area of the law. Both order and justice militate in favour of the security of transactions. It seems anarchic and unfair that a person should be able to avoid legal obligations arising in one province simply by moving to another province. [(p. 273)]

[45] In giving the decision of the court in *Hunt,* La Forest J. said, at pp. 313-314 [[1993] 4 S.C.R.]:

In principle, I see no reason why there should be a categorical rule to prevent a judge from dealing with a constitutional issue that incidentally arises in the ordinary course of litigation. As this Court observed in *Morguard, supra,* the guiding element in the determination of an appropriate forum must be principles of order and fairness. In considering these principles, some of the considerations set forth in *Morguard* bear repeating. At page 1103, the following statement appears:

> “Why should a plaintiff be compelled to begin an action in the province where the defendant now resides, whatever the inconvenience and costs this may bring, and whatever degree of connection the relevant transaction may have with another province? And why should the availability of local enforcement be the decisive element in the plaintiff’s choice of forum?”

I recognize, of course, and this was mentioned in *Morguard,* that these considerations must be weighed against the need for fairness to the defendant as

well. This, as is there noted at p. 1103, “requires that the judgment be issued by a court acting through fair process and with properly restrained jurisdiction”.

So far as the first of these conditions is concerned, it is difficult to question the basic fairness of the process given the essentially unitary nature of the Canadian court system; see *Pembina, supra,* at p. 215. I would reiterate here what was said in *Morguard, supra,* at pp. 1099-1100:

> “The Canadian judicial structure is so arranged that any concerns about differential quality of justice among the provinces can have no real foundation. All superior court judges – who also have superintending control over other provincial courts and tribunals – are appointed and paid by the federal authorities. And all are subject to final review by the Supreme Court of Canada, which can determine when the courts of one province have appropriately exercised jurisdiction in an action and the circumstances under which the courts of another province should recognize such judgments.”

It may, no doubt, be advanced that courts in the province that enacts legislation have more familiarity with statutes of that province. It must not be forgotten, however, that courts are routinely called to apply foreign law in appropriate cases.

[46] He went on to say, at pp. 321-322, in commenting on *Morguard:*

A central idea in that judgment was comity. But as I stated, at p. 1098, “I do not think it much matters whether one calls these rules of comity or simply relies directly on the reasons of justice, necessity and convenience” that underlie them. In my view, the old common law rules relating to recognition and enforcement were rooted in an outmoded conception of the world that emphasized sovereignty and independence, often at the cost of unfairness. Greater comity is required in our modern era when international transactions involve a constant flow of products, wealth and people across the globe.

In any event, I indicated, at p. 1099, that the traditional rules emphasizing sovereignty seem to “fly in the face of the obvious intention of the Constitution to create a single country”. Among the factors I identified that would also support a more cooperative spirit in recognition and enforcement were (1) common citizenship, (2) interprovincial mobility

of citizens, (3) the common market created by the union as reflected in ss. 91(2), 91(10), 121 and the peace, order and good government clause, and (4) the essentially unitary structure of our judicial system with the Supreme Court of Canada at its apex to which I have earlier referred.

[47] He did counsel reason at p. 325 where he said:

> One must emphasize that the ideas of "comity" are not an end in themselves, but are grounded in notions of order and fairness to participants in litigation with connections to multiple jurisdictions.

[48] MacPherson J. embraced *Morguard* in his decision *Arrowmaster Inc. v. Unique Forming Ltd.* (1993), 17 O.R. (3d) 407 (Gen. Div.). See p. 411 where he states:

> However, the historical analysis in La Forest J.'s judgment, of both the United Kingdom and Canadian jurisprudence, and the doctrinal principles enunciated by the court are equally applicable, in my view, in a situation where the judgment has been rendered by a court in a foreign jurisdiction. This should not be an absolute rule – there will be some foreign court orders that should not be enforced in Ontario, perhaps because the substantive law in the foreign country is so different from Ontario's or perhaps because the legal process that generates the foreign order diverges radically from Ontario's process.

[49] In light of those caveats I would observe that it appears clear that the Ontario legislature determined that there should be a cut-off (or perhaps more accurately a cut-on) which precluded pre-existing litigation (i.e., anything in litigation prior to January 1, 1993) from being certified under the CP Act. It does not appear that there was anything in the British Columbia litigation process (and specifically how it operated vis-à-vis the B.C. action) which diverges radically from the Ontario process. Put another way, why should the result be any different because the B.C. action was commenced in Vancouver in February 1991 as opposed to it having been commenced in Toronto that same month?

[50] I would observe that England is a unitary state. The English rules as they were referred to by La Forest J. thus had their origin in a unitary state (and not a federation or confederation), which state was in military and trading ascendency for a significant period

of the evolution of these rules. Secondly I would observe that class proceedings legislation has been established in the various states of the United States of America for some time and it is obvious that the American experience was heavily relied on in the drafting and implementation of the CP Act. It would seem to me that the general basis of dealing with the class action started in one state and being given effect to in another is based upon the full faith and credit concept found in the U.S. Constitution. In this context it would seem inappropriate to limit proceeding in s. 37(*c*) to a "proceeding in Ontario."

Security for Costs

[51] Rule 56.03(1) provides:

> 56.03(1) In an action, a motion for security for costs may be made only after the defendant has delivered a defence…

[52] No defence has been delivered by the defendants in the Ontario action. Need I say more (except a gentle reminder that counsel should read *Ashmore,* especially at p. 493 [[1992] 2 All E.R.]).

[53] Thus it would appear to me that the end result of these various determinations is that Millgate is allowed to proceed but subject to the various restrictions indicated.

Motion dismissed.

Agreed Statement of Facts

[54] The parties hereto agree, for the purposes only of the motions for which these facts are submitted, that the following facts are substantially correct. The facts set out herein are not admitted for any other purpose.

[55] The plaintiff, Millgate Financial Corporation Limited ("Millgate") is a corporation, incorporated under the laws of Ontario on March 2, 1972.

[56] The defendant, BF Realty Holdings Limited ("BF Realty"), was incorporated as Dawson Housing Developments Ltd. under the *Company Act* (British Columbia) on November 19, 1964 by certificate of incorporation and later changed its name to BCE Development Corporation ("BCED") on February 21, 1986. On July 14, 1989, it was continued under the *Canada Business Corporations Act,* R.S.C. 1985, c. C-44 ("CBCA") and on August 19,

1991 it changed its name to BF Realty Holdings Limited. The head office was moved from Vancouver to Toronto in 1990.

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[57] The defendant, BCE Inc. (“BCE”), is a widely held Canadian telecommunications holding company, continued under the CBCA, having its head office in Montreal, Quebec. At all material times prior to April 12, 1994, BCE owned 67% of the common shares of BF Realty, 49.9% of the common shares of Partnerco Equities Ltd. (“Partnerco”) and $101 million Class D preferred shares of Brookfield Development Corporation (“Brookfield”).

[58] The defendant, Carena Developments Limited (“Carena”), is incorporated under the CBCA, with its head office in Toronto, Ontario. At all material times Carena owned 50.1% of the common shares of Partnerco. At all material times prior to April 12, 1994, Carena did not own any shares in BF Realty or Brookfield.

[59] The defendant, Partnerco (formerly 171582 Canada Limited) was incorporated under the CBCA on December 14, 1989 and has its head office in Toronto, Ontario. It was at all material times owned by Carena and BCE. Partnerco owns $30 million Class C preferred shares of Brookfield.

[60] The defendant, Brookfield, is and was at all material times a subsidiary of BF Realty. At all material times, all of the outstanding common shares of Brookfield are owned by BF Realty. It was incorporated as BCE Realty Inc. under the CBCA on June 26, 1984. It changed its name on July 24, 1987 to BCED Realty Inc. On April 30, 1990, it was continued under the *Business Corporations Act* (Ontario), R.S.O. 1990, c. B.16 (“OBCA”) and changed its name to Brookfield Development Corporation. Its head office is in Toronto, Ontario.

[61] The Defendant, Gordon E. Arnell, resides in Ontario, and was at all material times a director and officer of Carena, a director and officer of BF Realty until December 9, 1993, and a director of Partnerco from January 24, 1990. He was the President and Chief Executive Officer of BF Realty from November 30, 1989 to August 15, 1991 and Chairman and Chief Executive Officer from November 18, 1991 to the present date. On May 17, 1990 Gordon E. Arnell became a director of Brookfield and thereafter an officer of Brookfield.

[62] The Defendant, Warren Chippindale, resides in Quebec, and was at all material times a director of BCE, a director of BF Realty until December 2, 1993, and a director of Brookfield from June 5, 1990 to December 2, 1993.

[63] The Defendant, Jack L. Cockwell, resides in Ontario, and was at all material times a director of Carena, a director of Partnerco commencing on January 24, 1990, a director of BF Realty until December 2, 1993 and a director of Brookfield from June 5, 1990.

[64] The Defendant, Josef J. Fridman, resides in Quebec, and was at all material times a senior officer of BCE, a director of Partnerco from January 24, 1990 to December 6, 1993, an officer of Partnerco from January 24, 1990 to October 26, 1992, a director of BF Realty until December 6, 1993, and a director of Brookfield from June 5, 1990 to December 6, 1993.

[65] The Defendant, Willard J. L'Heureux, resides in Alberta, and is a director of Carena. He was a director and officer of Partnerco from January 24, 1990 to May 27, 1993, a director of BF Realty until he resigned on August 15, 1991, and a director of Brookfield from June 5, 1990 to March 31, 1993.

[66] The Defendant, Robert E. Kadlec, resides in British Columbia, and was at all material times a director of BF Realty until June 28, 1990.

[67] The Defendant, John R. McCaig, resides in Alberta, and was at all material times a director of BF Realty until December 9, 1993, and a director of Brookfield from June 5, 1990.

[68] The Defendant, Allan S. Olson, resides in Alberta, and was at all material times a director of BF Realty until December 9, 1993, and a director of Brookfield from June 5, 1990.

[69] The Defendant, John A. Rhind, resides in Ontario, and was a director of BF Realty until August 15, 1991, and a director of Brookfield from June 5, 1990 to August 15, 1991.

[70] The Defendant, J. Stuart Spalding, resides in Quebec, and at the material time was a senior officer of BCE until December 31, 1990, a director and Chairman of BF Realty until December 31, 1990, a director of Partnerco from January 24, 1990 to December 31, 1990, and a director and the Chairman of the Board of Brookfield from June 5, 1990. He resigned as Chairman on December 31, 1990.

[71] The Defendant, Kevin Benson, resides in Alberta, and was a director of BF Realty from June 28, 1990 to August 15, 1991, and a director of Brookfield from June 5, 1990 to August 15, 1991.

[72] The Defendant, C. Wesley M. Scott, resides in Quebec, and was at all material times an officer of BCE, a director of BF Realty from June 28, 1990 to December 14, 1990, a director of Partnerco from January 24, 1990 to December 14, 1990, and a director of Brookfield from June 5, 1990 to December 14, 1990.

[73] The Defendant, J.V. Raymond Cyr, resides in Quebec, and was at all material times a Chairman and director of BCE, from August 1988 to April 1, 1993 and throughout that period he also held various other senior positions in BCE.

[74] The Defendant, A. Jean de Grandprè, resides in Quebec, and was at all material times a director of BCE, and Chairman of the Board from May to August 1, 1988.

[75] The Defendant, Lynton R. Wilson, resides in Quebec, and was at all material times a director of BCE and President since November 1, 1990, a director of BF Realty from December 14, 1990 to August 15, 1991, a director of Partnerco from December 14, 1990 to May 27, 1993, and a director of Brookfield from December 14, 1990 to January 29, 1993.

[76] The Defendant, Henri A. Roy, resides in Quebec, and was a senior officer of BCE from July 2, 1990 to August 31, 1991, and a director of Partnerco, BF Realty, and Brookfield from December 31, 1990 to June 6, 1991.

[77] The Defendant, Gerald T. McGoey, resides in Ontario, and was a director of Partnerco from June 6, 1991 to December 6, 1993, a director of Brookfield until December 6, 1993, a director of BF Realty until August 15, 1991, and a senior officer of BCE commencing in June 1991.

[78] The Defendant, National Trust Company, (“National Trust”) is a trust company incorporated under the laws of Ontario and is the Trustee under a certain Trust Indenture hereinafter referred to.

8% Convertible Debentures

[79] On May 5, 1988 BF Realty and its subsidiaries issued a Short Form Prospectus for $100 million 8% Convertible Subordinated Debentures (the “Debentures”). The prospectus provided that the Debentures would earn interest at the rate of 8%, payable semi-annually on June 30 and December 31, commencing December 31, 1988, to mature on December 31, 1988.

Short Form Prospectus, Motion Record, Tab 2, p. 3

[80] BCE agreed to purchase $25 million of the Debentures and the remaining $75 million of the Debentures were sold to Wood Gundy Inc., McLeod Young Weir Limited and RBC Dominion Securities Inc. as underwriters for resale to members of the public pursuant to the Short Form Prospectus (“Debentureholders”).

Short Form Prospectus, Motion Record, Tab 2

[81] The debentures were issued under a trust indenture (the “Trust Indenture”) dated May 25, 1988, made between BF Realty and National Trust, as Trustee.

Short Form Prospectus, Motion Record, Tab 2, p. 8

[82] 28. As set out in the Short Form Prospectus, the Trust Indenture provides that the debentures;

> (a) rank equally and rateably among themselves together with the 10 3/4% Convertible Subordinated Debentures of BF Realty (Trust Indenture s. 2.07)
>
> (b) are subordinated in right of payment to all other indebtedness and liabilities of BF Realty except as specified in the Trust Indenture, and (Trust Indenture s. 3.01 (1)); and
>
> (c) do not restrict the Company from incurring additional indebtedness or from mortgaging, pledging or otherwise charging its undertaking, property or assets to secure any indebtedness or liability. (Trust Indenture s. 3.01 (2))

Short Form Prospectus, Motion Record, Tab 2

Trust Indenture, Motion Record, Tab 3

[83] Further, the subordination terms in section 3.01 of the Trust Indenture provide:

> Section 3.01 – Subordination
>
> > (1) The indebtedness evidenced by the Subordinated Debentures, including the principal thereof, premium, if any, and interest thereon, shall be subordinated, subject and junior in the right of payment to the prior payment in full of the principal of, and interest, and premium, if any on, and all other items of indebtedness in

respect of, all Senior Indebtedness, whether outstanding on the date hereof or hereafter created, incurred, assumed or guaranteed, to the extent and in the manner set forth in this Article III, and each holder of Subordinated Debentures and coupons, by his acceptance thereof, covenants and agrees, and shall be deemed to have covenanted and agreed, to such subordination and shall be bound by the provisions of this Article III.

(2) Nothing contained in this Article III is intended to or shall restrict the Company from incurring additional indebtedness or from mortgaging, pledging or otherwise changing its undertaking, properties or assets to secure any indebtedness or liability.

Trust Indenture, Motion Record, Tab 3

[84] Section 8.05 of the Trust Indenture provides that, unless four conditions are met, any proceeding to enforce under the debentures may be instituted only by the Trustee. A Debentureholder may institute a proceeding only if:

(i) the Debentureholder shall have given written notice to the Trustee that an event of default under the debenture has occurred;

(ii) the debentureholders shall have requested by extraordinary resolution that the trustee institute the proceedings and the trustee shall be afforded a reasonable opportunity to institute proceedings;

(iii) the trustee shall have been provided with sufficient funds, security and indemnity; and

(iv) the trustee shall have failed to act within a reasonable time after the first three conditions have been met;

Trust Indenture, Motion Record, Tab 3

[85] Section 9.01 of the Trust Indenture provides that:

The Company [i.e. BF Realty] shall not enter into any transaction (whether by way of reconstruction, reorganization, consolidation, amalgamation, merger, transfer, sale, lease or otherwise) whereby all or substantially all of the undertakings, property and assets of the Company would become the property of any other person or, in the case of any amalgamation, of the continuing company resulting therefrom unless, but may do so if, the other person or continuing company is a corporation (herein called the "Successor Company") and:

(a) the Successor company shall execute, prior to or contemporaneously with the consummation of the transaction, such instruments as are satisfactory to the Trustee and in the opinion of the Counsel to the Company are necessary or advisable to evidence the assumption by the Successor Company of the liability for the due and punctual payment of all principal moneys on the Subordinated Debentures and the interest thereon and premium, if any, and all other moneys payable hereunder and the covenant of the Successor Company to pay the same and its agreement to observe and perform all the covenants and obligations of the Company under this Indenture;

(b) if such transaction is to be completed prior to the time of expiry of any rights of conversion of Subordinated Debentures to shares of any class of the authorized capital of the Company attaching to Subordinated Debentures of a particular series, the Successor Company shall reserve for issue out of its authorized capital and conditionally allot to the holders of the Subordinated Debentures of such series prior to or contemporaneously with the consummation of the transaction, a sufficient number of shares of such class to satisfy such rights of conversion;

(c) the transaction shall to the satisfaction of the Trustee and in the opinion of Counsel to the Company be upon such terms as substantially to preserve and not to impair any of the rights and powers of the Trustee or of the Subordinated Debentureholders hereunder and thereunder and upon such terms as to be in no way prejudicial to the interests or the Subordinated Debentureholders; and

(d) no condition or event shall exist in respect of the Company, or the Successor Company, either at the time of the transaction and immediately after the

reconstruction, reorganization, consolidation, amalgamation, merger, transfer, sale, lease or other transaction and after giving full effect thereto, or immediately after the Successor Company complying with the provisions of clause (c) of this Section 9.01, which constitutes or would constitute an Event of Default hereunder.

Trust Indenture, Motion Record, Tab 3

[86] Section 10.11(c) of the Trust Indenture provides as follows:

In addition to the powers conferred upon them by any other provisions of this Indenture or by law, a meeting or [sic] the Debentureholders shall have the following powers exercisable from time to time by Extraordinary Resolution:

* * *

(c) power to sanction any scheme for the reconstruction or reorganization of the Company [i.e. BF Realty] or for the consolidation, amalgamation or merger of the Company with any other corporation or for the sale, leasing, transfer or other disposition of the undertaking, property and assets of the Company or any part thereof, provided that no such sanction shall be necessary with respect to any such transaction if the provisions of Section 9.01 shall have been complied with;

Trust Indenture, Motion Record, Tab 3

[87] Section 7.02 of the Trust Indenture provides that:

Subject to the express provisions hereof, the Company [i.e. BF Realty] will, and will cause each material Subsidiary that is actively engaged in business to, carry on and conduct its business in a proper and efficient manner; and at all reasonable times it will furnish or cause to be furnished to the Trustee or its duly authorized agent or attorney such information relating to the business of the Company and its material Subsidiaries as the Trustee may reasonably require; and, subject to the express provisions hereof, it will do or cause to be done all things necessary to preserve and keep in full force and effect its corporate existence and rights.

Trust Indenture, Motion Record, Tab 3

[88] Section 13.08 of the Trust Indenture provides, *inter alia,* that the Trustee may employ such assistance as may be necessary to the appropriate discharge of its duties, and may pay appropriate compensation for legal and other advice and assistance, and section 7.03 of the Trust Indenture provides:

> The Company [BF Realty] will pay the Trustee's reasonable remuneration for its services as Trustee hereunder and will repay to the Trustee on demand all moneys which shall have been paid by the Trustee in and about the execution of the trusts hereby created with interest at 8% per annum from 30 days after the date of the invoice from the Trustee to the Company with respect to such expenditure until repayment, and such moneys and the interest thereon, including the Trustee's remuneration, shall be payable out of any funds coming into the possession of the Trustee in priority to any of the Subordinated Debentures or interest thereon. The said remuneration shall continue payable until the trusts hereof are finally wound up and whether or not the trusts of this Indenture shall be in course of administration by or under the direction of the court.

Trust Indenture, Motion Record, Tab 3

Proposed Transactions with Olympia & York

[89] BF Realty's Annual Report for 1988 includes information about its current financial situation and outlook together with financial statements.

1988 BF Realty Annual Report, Motion Record, Tab 4

[90] During 1989, BF Realty actively searched for a substantial partner that could provide additional equity funding. On January 27, 1989, Olympia and York Developments Limited ("Olympia & York"), BF Realty and BCE announced that they were discussing a proposal that would result in a $225 million equity infusion into BF Realty by Olympia & York. Under the proposal Olympia & York would have offered to BCE and other public shareholders of BF Realty to purchase a certain number of BF Realty's common shares at $3.75 per share, but negotiations on this proposed transaction ultimately failed.

Directors' Circular, Motion Record, Tab 5

[91] On July 14, 1989, Olympia & York launched a bid to acquire all of BF Realty's outstanding common shares and other securities at a price of $2.80 per common share. The bid was subject to a number of conditions, including a condition that at least 90% of the common shares be tendered under the bid. BCE agreed to tender its 67% shareholding. In the Directors' Circular responding to the bid, the Board of Directors of BF Realty endorsed the recommendation of a special committee struck to consider the Olympia & York offer and unanimously recommended that the bid be accepted.

Directors' Circular, Motion Record, Tab 5

[92] The Directors' Circular, which was issued prior to the expiry of the Olympia & York bid, stated that "as a result of the efforts of BF Realty to dispose of its U.S. properties, and in the event that the securities are not taken up by Olympia & York pursuant to the offer, it will be necessary for BF Realty to review the carrying values of its properties. It may be necessary for BF Realty to make provision in its financial statements with respect to certain of those properties, and this provision may be material". Notwithstanding, the required minimum percentage of common shares was not tendered to Olympia & York and the bid failed.

Directors' Circular, Motion Record, Tab 5

BF Realty 1989 Annual Report, Motion Record, Tab 6

Arrangements with Carena

[93] In the Fall of 1989 Carena entered into an agreement with BCE to provide new funds and management to BF Realty ("October Agreement"). BF Realty was not a party to this agreement. The October Agreement provided for the establishment of a joint venture company (Partnerco) to be owned by BCE and Carena which would subscribe for up to $415 million in convertible preference shares of BF Realty as part of a new financing for BF Realty. The new financing for BF Realty was to be raised by way of a rights offering by BF Realty with BCE and Carena to backstop the financing to ensure that the full amount of $415 million was raised. The October Agreement provided that if the rights issue did not take place before December 31, 1989, BCE and Carena would try to find an alternative method of financing BF Realty. The rights issue did not take place.

October Agreement, Motion Record, Tab 7

[94] Pending implementation of the October Agreement, BCE and Carena entered into an agreement with BF Realty dated November 30, 1989 (“Bridge Financing Agreement”) to provide secured bridge financing to BF Realty for up to a maximum amount of $207.5 million each until the earlier of November 30, 1990 and the completion of the rights offering.

Bridge Financing Agreement, Motion Record, Tab 8

[95] The October agreement could not be completed as planned and the parties entered into discussions regarding the financing of Brookfield. On January 24, 1990 BCE and Carena entered into an agreement setting out the basis upon which Carena would participate in the management of the affairs of BF Realty and the future ownership of Brookfield (“January Agreement”), which BF Realty acknowledged. The January Agreement stated that it superseded any previous agreement or negotiation pertaining to Carena’s participation except the Bridge Financing Agreement.

January Agreement, Motion Record, Tab 9

Financial Difficulties

[96] In its 1989 Annual Report BF Realty announced its proposed business restructuring plans and explained that the prevailing real estate environment had brought the recognition that the carrying value of the company’s assets exceeded their net realizable value or net recoverable amount. Accordingly, a $550 million asset writedown, together with a foreign currency translation loss of $61 million principally relating to BF Realty’s U.S. property asset transfers, was recorded in BF Realty’s 1989 audited financial statements. In light of BF Realty’s losses and extensive writedown, BCE announced that it had determined effective December 31, 1989 to reflect BF Realty as a discontinued operation and wrote off its investment in BF Realty on its own books. This represented a loss of $440 million to BCE.

BF Realty 1989 Annual Report, Motion Record, Tab 6

1989 BCE Annual Report, Motion Record, Tab 10

Partnerco Credit Facility

[97] The January Agreement provided for the establishment by BCE and Carena, through Partnerco (to be 50.1% owned by Carena and 49.9% owned by BCE), of a secured $500 million financing facility in favour of Brookfield ("Partnerco Credit Facility"). The January Agreement also provided that Brookfield would proceed with a rights issue to BF Realty's public securityholders prior to June 30, 1991. Under the rights issue, each of BF Realty's public securityholders would receive rights to buy equity securities of Brookfield at a time, in an amount and on terms to be determined prior to the rights issue. Partnerco agreed to ensure that at least $500 million was raised under the rights issue through the application of funds advanced to Partnerco by BCE and Carena. The issue price of the securities to be offered under the rights issue was to be based upon a market valuation of Brookfield's common shares on or before June 30, 1991.

January Agreement, Motion Record, Tab 9

[98] The Partnerco Credit Facility was amended by letters dated May 15, 1990, October 5, 1990, October 11, 1990 and November 26, 1990. The effect of these amendments was to increase the maximum amount of the Partnerco Credit Facility to $700 million and to increase the face amount of the security therefor from $600 million to $1.2 billion. Partnerco has continuously reinvested the interest on the Partnerco Credit Facility.

Letters, Motion Record, Tab 11

Asset Transfers

[99] At the end of 1989 and during the course of 1990, many U.S. assets owned through a number of BF Realty's subsidiaries were realigned to a new group of BF Realty subsidiaries that had been organized under Brookfield. On May 1, 1990, certain Canadian projects from BF Realty's portfolio were realigned in this manner ("May Transfer"). It is in issue between the parties as to which properties were realigned and the value and significance of such realignments.

May Agreement, Motion Record, Tab 12

[100] The May Agreement stated an aggregate purchase price for the transferred BF Realty properties of $219,155,000. As a result of the realignment referred to, Brookfield assumed certain senior corporate obligations of BF Realty and all project specific debt related to the realigned projects.

May Agreement, Motion Record, Tab 12

[101] National Trust was not consulted about these transactions and did not consent to them. It is in issue between the parties as to whether such consultation and consent was required.

Payment of Interest

[102] Interest and dividend payments were deferred and allowed to accumulate on BF Realty's subordinated debentures and preferred shares. Interest has not been paid in respect of the Debentures since June 30, 1990.

Payment of Expenses

[103] The plaintiff alleges that in breach of the Trust Indenture, and section 7.03 thereof in particular, BF Realty on or about January 9, 1991 informed the Trustee that it would not reimburse it for any expenses incurred by it or its counsel other than those for identified services which BF Realty requests and which are settled in advance with BF Realty.

[104] Prior to January 9, 1991, BF Realty paid, however, substantial expenses to National Trust, in excess of $56,050.65.

British Columbia Action

[105] On February 4, 1991 National Trust Company commenced legal proceedings in British Columbia before the Supreme Court of British Columbia, as Action No. C910991, which claim was amended on February 22, 1991 and November 26, 1991 ("B.C. Action"), on behalf of the Debentureholders.

Statements of Claim, Motion Record, Tabs 13, 14, 15

[106] In the B.C. Action, National Trust pleaded and relied upon, inter alia, s. 8.04 of the Trust Indenture. Section 8.04 reads:

> (1) Subject to the provisions of Section 8.03 and to the provisions of any Extraordinary Resolution that may be passed by the Subordinated Debentureholders, in case the Company shall fail to pay to the Trustee, forthwith after the same shall have been declared to be due and payable under Section 8.01, the principal of and premium, if any, and interest on all Subordinated Debentures then outstanding, together with any other amounts due hereunder, the Trustee may in its discretion and shall upon receipt of a Debentureholder's Request, and upon being indemnified to its reasonable satisfaction against all costs, expenses and liabilities to be incurred, proceed in its name as Trustee hereunder to obtain or enforce payment of the said principal of and premium, if any, and interest on all the Subordinated Debentures then outstanding together with any other amounts due hereunder, by such proceedings authorized by this Indenture or by law or equity as the Trustee in such request shall have been directed to take, or if such request contains no such direction, or if the Trustee shall act without such request, then by such proceedings authorized by this Indenture or by suit at law or in equity as the Trustee shall deem expedient.

Statements of Claim, Motion Record, Tabs 13, 14, 15

[107] The claims in the B.C. Action allege the occurrence of certain defaults under the Trust Indenture, including:

> (a) the non-payment of interest,
>
> (b) the failure to provide National Trust with information that it had requested,
>
> (c) the transfer of all or substantially all of the assets of BF Realty to Brookfield;

Statements of Claim, Motion Record, Tabs 13, 14, 15

[108] The prayer for relief in the B.C. Action sets out the following as the relief claimed:

> (a) a declaration that Brookfield is bound by the Trust Indenture;

(b) a judgment against BCED (now BF Realty) and Brookfield for the full amount due and owing under the Trust Indenture;

(c) damages against BCED (now BF Realty) and Brookfield for breach of contract, and an injunction requiring BCED (now BF Realty) to cause Brookfield to execute the instruments called for by the Trust Indenture;

(d) damages against BCE, Carena, Partnerco and Brookfield for wrongful interference with the Plaintiffs contractual rights;

(e) punitive damages;

(f) a charging order, *pendente lite,* against the undertakings, property and assets of Brookfield;

(g) an interlocutory injunction enjoining the Defendants BCED (now BF Realty) and Brookfield from refusing to pay all reasonable expenses of the Plaintiff in relation to these proceedings;

(h) an interlocutory injunction enjoining BCED (now BF Realty) and Brookfield from failing to provide information to which the Plaintiff is entitled on request;

(i) an interlocutory injunction enjoining the Defendants BCE, Carena, Partnerco and Brookfield from interfering with the performance by BCED (now BF Realty) and Brookfield of their obligations to pay the Plaintiff's reasonable expenses and provide information; and

(j) permanent injunctions, costs, and such other and further relief as to this honourable court seems meet and just. (sic.)

Statements of Claim, Motion Record, Tabs 13, 14, 15, p. 10

[109] The solicitors acting for BF Realty, Brookfield, and Carena, served demands for particulars in the B.C. Action of the Statement of Claim. On April 10, 1991 National Trust delivered the particulars pursuant to an Order of Master Grist dated April 4, 1991.

Particulars, Motion Record, Tab 16

[110] Upon receipt of the particulars, each defendant in the B.C. Action delivered a statement of defence denying all of the material allegations (other than the non-payment of interest) and defended the action.

Statement of Defence of Carena, Motion Record, Tab 17

Statement of Defence of BF Realty & Brookfield, Motion Record, Tab 18

Statement of Defence of Partnerco, Motion Record, Tab 19

Statement of Defence of BCE, Motion Record, Tab 20

Amended Statement of Defence of BCE, Motion Record, Tab 21

[111] In or about August 1991, the B.C. Action was set for trial, to commence September 14, 1992 and then changed to November 16, 1992. Prior to November 16, 1992, the date for trial was reset to November 8, 1993.

[112] Discovery of documents took place, which involved the production of thousands of documents. BF Realty, alone, produced in excess of 15,000 documents.

[113] Following disclosure and review of the productions, the examinations for discovery began in the Spring of 1992. The representative of BF Realty was examined on February 18, 19 and 20 and the representatives of Carena and Partnerco were examined on March 23 and 24, 1992.

[114] As a result of these discoveries in the B.C. Action, counsel to National Trust concluded that there should be further amendments to the Statement of Claim and that there should be no further examinations for discovery prior to making the amendments. Also, counsel for National Trust was advised by counsel for BCE that they would be producing further documents and the trial date was adjourned to November 16, 1992 from September 14, 1992. As a result of these developments and the subsequent illness of National Trust's senior counsel, examinations for discovery of the representatives for BCE and for Brookfield, which had been scheduled to take place in May and April 1992, were postponed. These examinations for discovery have not yet been held.

[115] In the Spring of 1992, National Trust advised certain of the Debentureholders that its examinations for discovery were complete except for an examination of one officer and the completion of the examination of a second officer. National Trust advised certain Debentureholders that a trial was expected in November, 1992.

[116] In January 1991, some of the Debentureholders began meeting informally to discuss issues arising from their relationship with BF Realty, including the B.C. Action.

Letter dated July 28, 1992, Motion Record, Tab 22

[117] On July 31, 1992, a letter, signed by Jerome Lapointe and Edwin Weiss, was sent to all Debentureholders for the purpose of soliciting money from the Debentureholders to support the B.C. Action, and of arranging a meeting of the Debentureholders (the "July 31 Letter"). The July 31 Letter was accompanied by a short note from National Trust, urging the Debentureholders to read the letter.

July 31 Letter, Motion Record, Tab 23

[118] On August 21, 1992, National Trust mailed a second letter of its own to Debentureholders captioned "Trustee's Position" ("Trustee's Position Letter") which was said to be in response to numerous telephone calls from Debentureholders concerning the July 31 Letter.

Trustee's Position Letter, Motion Record, Tab 24

[119] On September 3, 1992, pursuant to the request in the July 31 Letter, an informal meeting of the Debentureholders was held in Toronto.

Letter of BF Realty dated September 10, 1992, Motion Record, Tab 25

[120] On September 11, 1992, BF Realty wrote to National Trust concerning the representations made in the July 31 Letter and the Trustee's Position Letter, expressing concern that all Debentureholders receive fair and equal treatment and be provided with all information necessary to make an informed decision about, amongst other things, the B.C. Action ("BF Realty Letter").

BF Realty Letter, Motion Record, Tab 26

[121] In the Fall of 1992, National Trust sought the appointment of a formal committee pursuant to the Trust Indenture to represent the Debentureholders ("Formal Committee") so as to deal with several issues relating to the Debentures and BF Realty, including the power to direct or authorize National Trust with respect to the B.C. Action. At that time National Trust advised Edwin Weiss:

> Having incurred over $1 million for legal fees and disbursements in the legal action, the Trustee does not intend to incur further liability for costs on our own account. Thus Mr. Murphy has been instructed, for the time being, not to continue with the discoveries. Section 13.15 of the trust indenture states that the Trustee's obligation to continue the legal action is conditional on the debentureholders furnishing the trustee with sufficient funds to continue the legal action and a satisfactory indemnity in our favour protecting us against prospective expenses, liabilities, loss and damage.

Letter of National Trust dated September 10, 1992, Motion Record, Tab 27

BF Realty and National Trust Announcement, Motion Record, Tab 28

[122] On or about October 21, 1992, National Trust forwarded to the Debentureholders the following:

(a) an undated letter from National Trust;

(b) a letter dated October 21, 1992, from BF Realty; and

(c) a Notice and Information Circular dated October 21, 1992 from BF Realty calling a meeting of Debentureholders for November 12, 1992.

BF Realty and National Trust Announcement, Motion Record, Tab 28 Information Circular dated October 21, 1992, Motion Record, Tab 29 BF Realty Letter dated October 21, 1992, Motion Record, Tab 30

[123] The purpose of the meeting was to appoint a formal committee ("Formal Committee") with broad powers by Extraordinary Resolution relating to, *inter alia,* the B.C. Litigation.

[124] On November 3, 1992, National Trust served a Notice of Motion, seeking to adjourn the trial of the B.C. Action to April 1993. In reply, the Chief Justice of the Supreme Court of

British Columbia wrote to National Trust's counsel advising that the Court could not accommodate a trial date in the month of April 1993 of the duration that was needed.

Chief Justice Memo, Motion Record, Tab 31

[125] Upon receipt of the Chief Justice's memo, on November 5, 1992, counsel for National Trust withdrew the application for a fixed date and filed an amended Notice of Trial, adjourning the trial date to November 8, 1993.

Notice of Trial, Motion Record, Tab 32

[126] On November 12, 1992 a formal meeting of Debentureholders or their representatives was held. At that meeting, an Extraordinary Resolution ("Extraordinary Resolution") was passed forming the Formal Committee empowered to:

(a) instruct the Trustee, National Trust, with respect to the B.C. Action;

(b) consider any restructuring proposal submitted to the Debentureholders;

(c) solicit contributions to indemnify National Trust for its future costs of the B.C. Action.

[127] In connection with this mandate and pursuant to paragraph 1(d) of the Extraordinary Resolution, the Formal Committee retained David Stockwood, Q.C., of the law firm Stockwood, Spies, Ashby & Craigen, to act as independent counsel.

*Letter re Stockwood dated December 7, 1*992, *Motion Record, Tab 33*

[128] A pre-trial was scheduled for the Spring of 1993, but did not proceed. The reason is unknown.

Letter of Stockwood dated April 30, 1993, Motion Record, Tab 34

[129] By letter dated August 30, 1993, National Trust requested the Formal Committee appointed under the November 12, 1992 Extraordinary Resolution to, *inter alia:*

(1) obtain from its counsel, David Stockwood, Q.C., a legal opinion providing counsel's judgment concerning the prospects of success in the legal proceedings, success to

include a substantial monetary recovery proportionate to the total amount of the monies invested by the Debentureholders in the Company;

(2) meet and, having regard to opinion of counsel and the refusal of the CBC Pension Fund to provide the indemnity required by National Trust, decide whether the prospects for a solicitation by the Committee of contributions from the Debentureholders under paragraph 9(c) of the Extraordinary Resolution offer a realistic promise of success;

failing which, the Formal Committee was requested to instruct the Trustee to terminate the litigation.

National Trust Letter dated August 30, 1993, Motion Record, Tab 35

[130] On October 8, 1993 the Formal Committee wrote to the Debentureholders advising that:

Now that a major Debentureholder has decided not to provide the total indemnity, it is necessary for other Debentureholders to come forward if they wish the B.C. litigation to proceed. Interested Debentureholders should contact National Trust directly. They are advised to communicate in writing their offers of contribution toward the indemnity required, or any other proposal to:

Mr. Tony Kalvik

Senior Vice

President

Corporate Financial Services

National Trust

One Financial Place

1 Adelaide Street East

Toronto, Ontario

M5C 2W8

Telephone (416) 361-3611

October 8, 1993 Letter, Motion Record, Tab 36

[131] On October 12, 1993, with the trial date approaching, National Trust wrote to the Debentureholders. It advised that it had collected approximately $252,000 from certain Debentureholders during the course of the year to defray litigation costs. It also advised the Debentureholders that a precondition to its willingness to proceed with the B.C. Action was an effective indemnification against any future costs and liability to be incurred by it. The letter stated:

> In the absence of any indemnity and a proposal from the company, the committee has advised us that it is unable to instruct the trustee with respect to the litigation.
>
> To continue with the existing litigation, we require an indemnity of $1.5 million. The indemnity must cover legal fees and expenses to complete the trial as well as costs associated with the potential appeal. If the litigation is unsuccessful, the indemnity must also cover the costs and damages awarded by the Court against the Trustee.
>
> Any debentureholders interested in providing or contributing toward the required indemnity are requested to write to the undersigned by *November 12, 1993,* stating their quantum and other relevant details.

[132] Pursuant to a request from a Debentureholder, he was provided with a form of indemnity by letter dated October 19, 1993.

October 12, 1993 Letter, Motion Record, Tab 37

[133] National Trust never received the requisite indemnity from the Debentureholders for its carriage of the B.C. Action. On October 19, 1993 the trial was adjourned *sine die* by praecipe.

Statements of Claim, Motion Record, Tabs 13, 14, 15

Praecipe, Motion Record, Tab 38

Ontario Action

[134] The plaintiff, Millgate Financial Corporation Limited ("Millgate") is a corporation, incorporated under the laws of Ontario on March 2, 1972. The last annual return of Millgate was filed with the Ministry of Consumer and Commercial Relations on December 18, 1989. Millgate is not a registered owner of the Debentures.

[135] Edwin Weiss was the sole incorporator and first director of Millgate. He is the sole shareholder of Millgate and is the registered owner of $20,000 in Debentures.

[136] On November 22, 1993, Millgate commenced the within action in Ontario ("Ontario Action"). Millgate's claims are against all of the same defendants as those named in the B.C. Action, as well as National Trust and some of the directors and officers of the corporate defendants.

Statement of Claim, Motion Record, Tab 39

[137] The Ontario action arises from the same factual circumstances as set out in the B.C. Action. Millgate alleges that the defendant, BF Realty, failed to pay interest on the Debentures and breached other provisions of the Trust Indenture. Millgate pleads that the May Transfer amounted to a breach of the Trust Indenture, and that the defendants, other than BF Realty and Brookfield, participated in the May Transfer in such a way as to also be legally liable. Millgate further alleges negligence against the defendants other than BF Realty and Brookfield and pleads several additional causes of action against all defendants, including:

(i) misrepresentation and inducing negligent misrepresentation

(ii) fraudulent conveyance

(iii) violation of the *Bulk Sales Act*

(iv) violation of the *Assignment and Preferences Act*

(v) breaches of the CBCA, specifically:

– section 44

–section 120

– section 189

– sections 241 & 248

Statement of Claim, Motion Record, Tab 39

[138] The following relief claimed in the Ontario action is identical to the relief claimed in the B.C. Action:

(b) a declaration that the defendant, Brookfield is bound by the terms of the Trust Indenture dated as of May 25, 1988;

(c) judgment against BF Realty and Brookfield for the full amount due and owing for principal and interest under the debentures issued under the Trust Indenture dated as of May 25, 1988;

(d) a mandatory injunction directing the defendants, except National Trust to cause the defendant, Brookfield, to execute the instruments called for by the Trust Indenture;

(e) as against the defendants, BF Realty and Brookfield, damages for breach of contract in the amount of $150 million;

(q) as against all of the defendants, except National Trust, punitive damages in the amount of $25 million;

Statement of Claim, Motion Record, Tab 39

[139] The following additional relief is claimed in the Ontario Action which was not claimed in the B.C. Action:

(a) a declaration that BF Realty breached the terms of the Trust Indenture;

(f) $150 million for inducing breach of contract; intentionally interfering with the economic interests of the Debentureholders; intentionally interfering with contractual relations between BF Realty and the Debentureholders; and negligence;

(g) $150 million for conspiracy to injure the Debentureholders;

(h) a declaration that the May Transfer was oppressive to the Debentureholders under section 241 of the CBCA and section 248 of the OBCA;

(i) orders under section 241 of the CBCA and section 248 of the OBCA, *inter alia,* setting aside the May Transfer;

(j) orders necessary to carry out the purposes of the CBCA and OBCA, including an order for interim costs;

(k) a declaration pursuant to section 44 of the CBCA;

(l) an order declaring the May Transfer void pursuant to section 189 of the CBCA;

(m) an order declaring the May Transfer a fraudulent conveyance;

(n) an order declaring the May Transfer an unjust preference; and

(o) a declaration that the May Transfer constituted a sale in bulk and an accounting under the *Bulk Sales Act*

Statement of Claim, Motion Record, Tab 39

April 29, 1994

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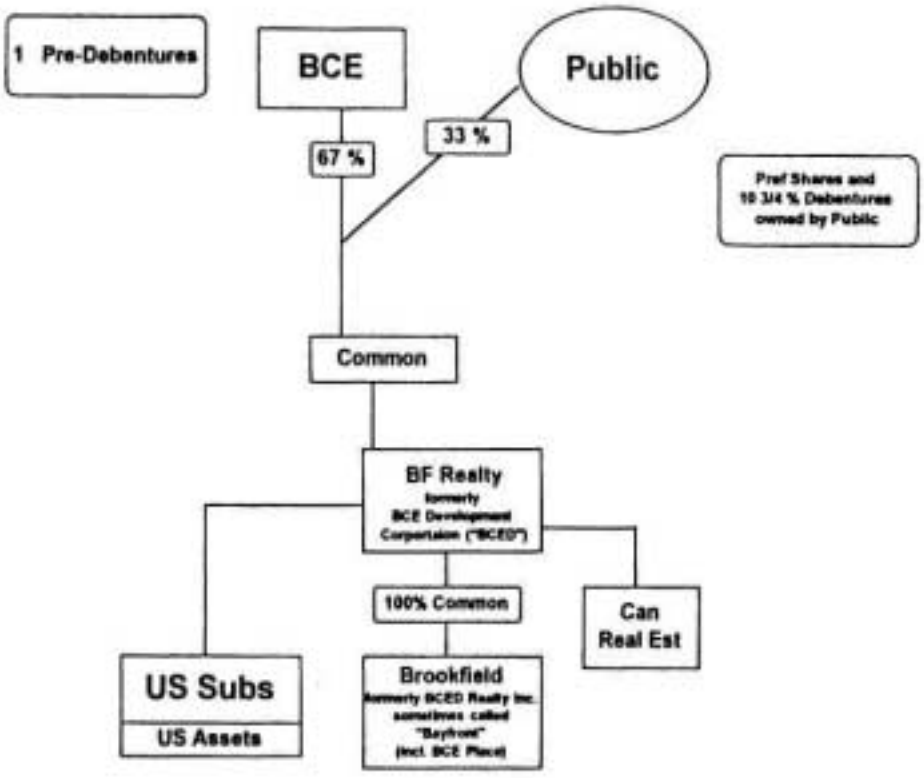

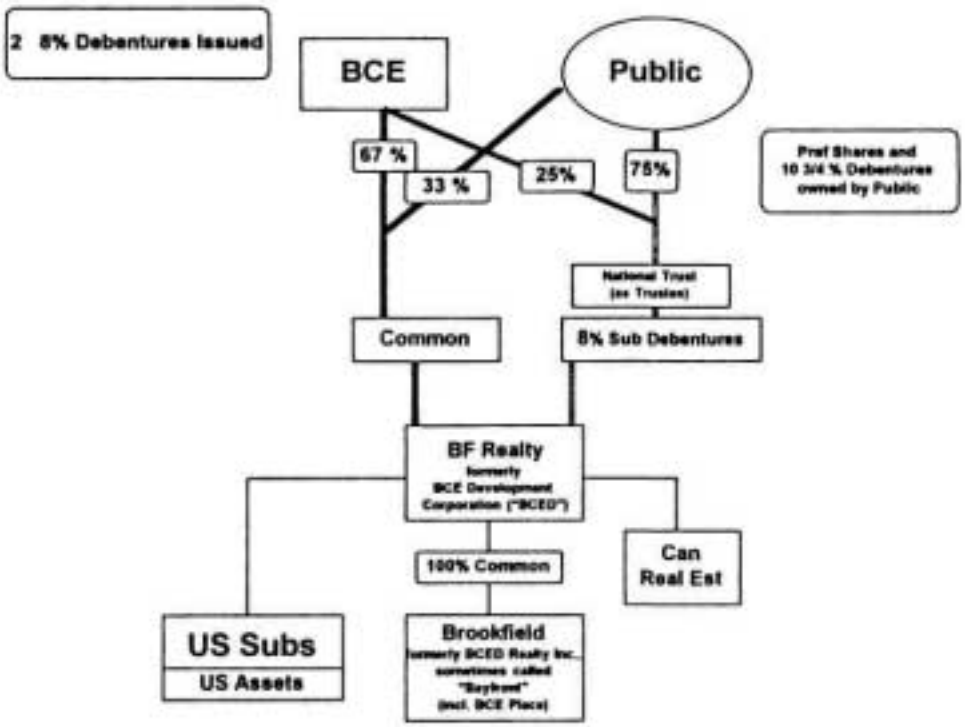

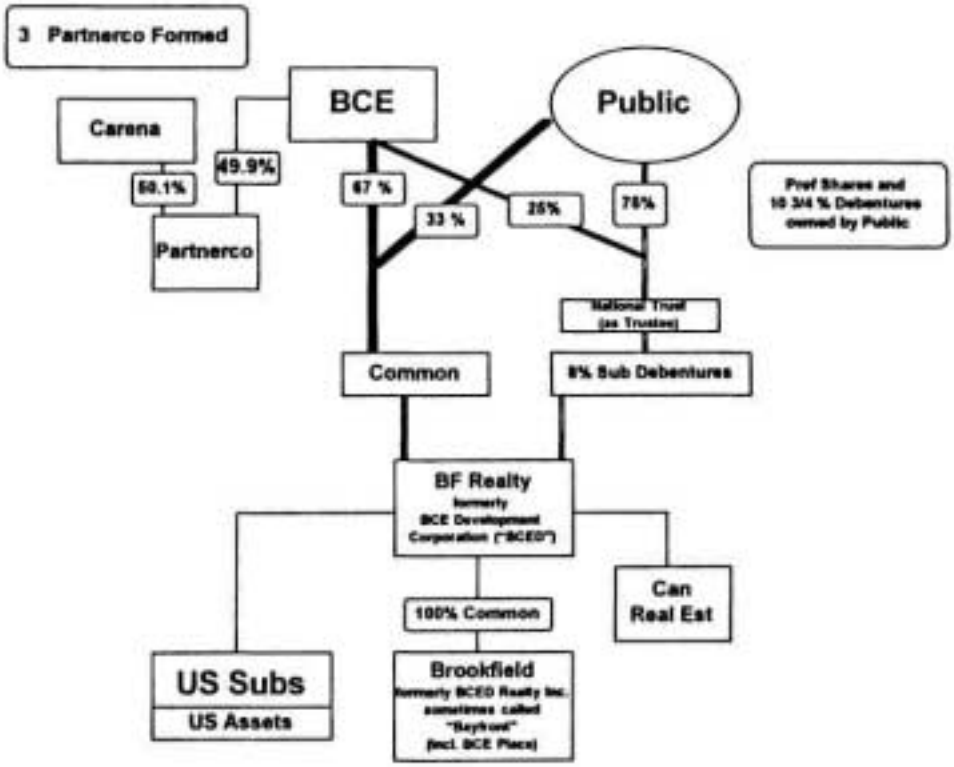

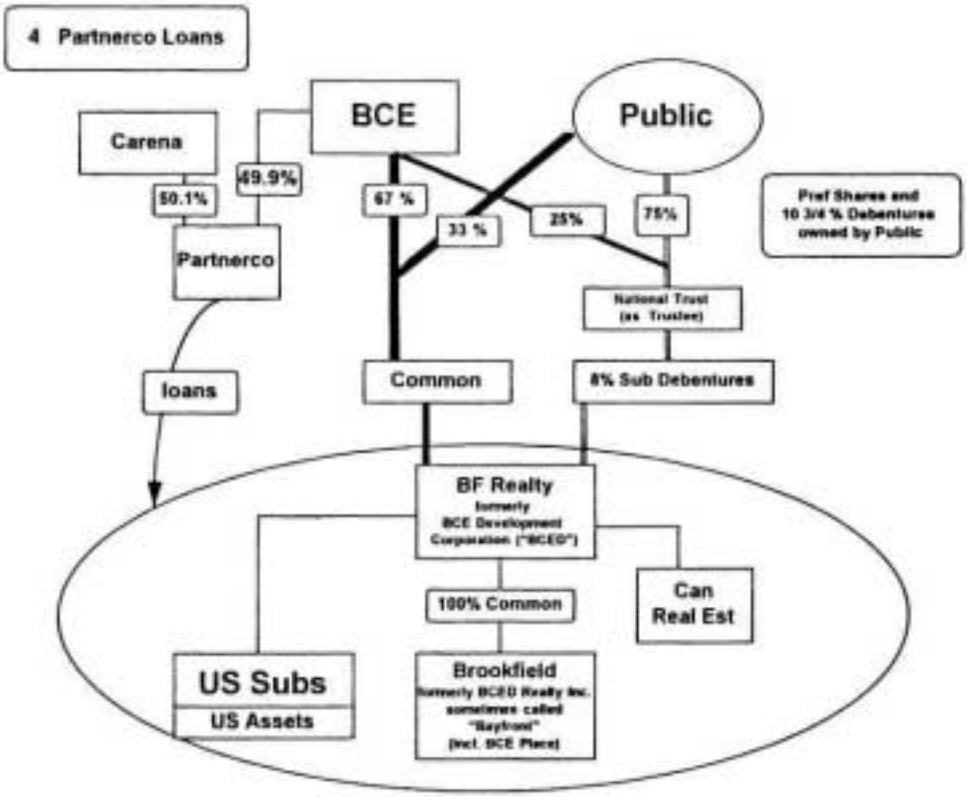

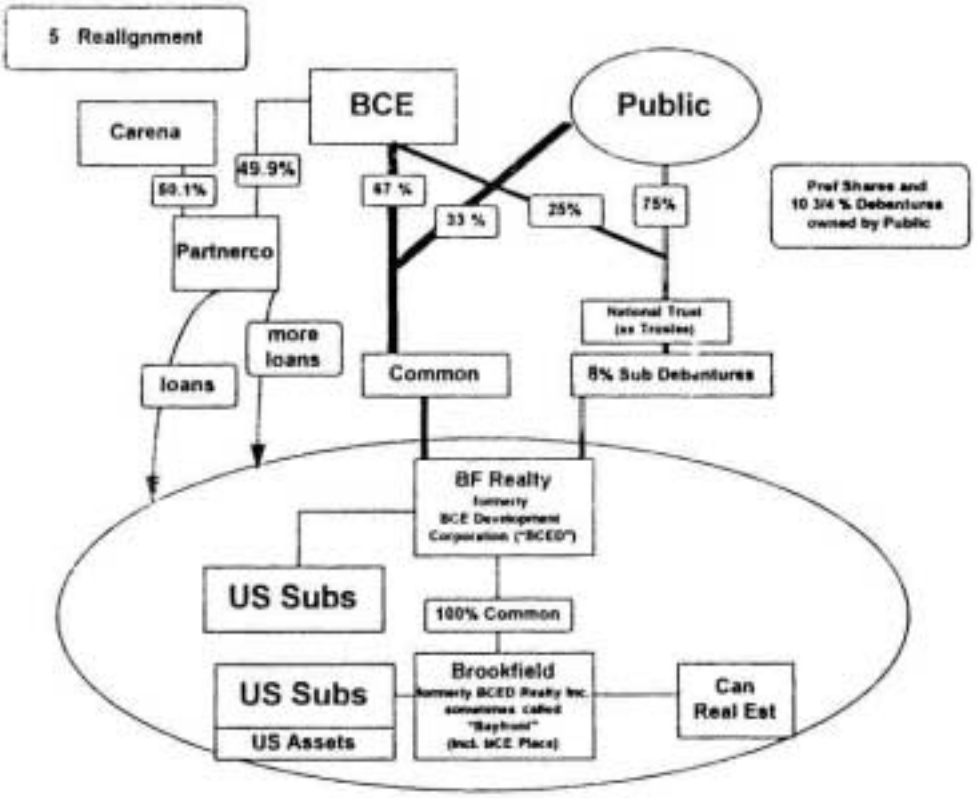

MCMAHAN & COMPANY; FROLEY, REVY INVESTMENT CO., INC.; WECHSLER & KRUMHOLZ, INC.; and DON THOMPSON, on behalf of himself and all others similarly situated, Plaintiffs-Appellees, v. WHEREHOUSE ENTERTAINMENT, INC.; LOUIS A. KWIKER; GEORGE A. SMITH; MICHAEL T. O'KANE; LAWRENCE K. HARRIS; DONALD E. MARTIN; JOEL D. TAUBER; FURMAN SELZ MAGER DIETZ & BIRNEY, INC.; WEI ACQUISITION CORP.; WEI HOLDINGS, INC.; and ADLER & SHAYKIN, Defendants-Appellants.

Docket No. 95-7008

UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

65 F.3d 1044; 1995 U.S. App. LEXIS 25979; Fed. Sec. L. Rep. (CCH) P98,868

June 8, 1995, Argued
September 13, 1995, Decided

SUBSEQUENT HISTORY: [1]** As Amended.

PRIOR HISTORY: Appeal by permission from an order entered in the United States District Court for the Southern District of New York (Lowe, J.) denying, in part, defendants' motion for summary judgment, the court having ruled that plaintiffs may be entitled to recover benefit-of-the-bargain damages for alleged securities law violations and that a no-action clause in the underlying indenture did not bar plaintiffs' federal securities law claims.

DISPOSITION: Affirmed in part, reversed in part.

CASE SUMMARY:

PROCEDURAL POSTURE: Defendant securities issuers appealed the order of the United States District Court for the Southern District of New York, which denied, in part, their motion for summary judgment in plaintiff debentureholders' securities violation action against them, and determined that benefit-of-the-bargain damages were available to plaintiffs under the Securities Act of 1933 and under the Securities Exchange Act of 1934.

OVERVIEW: Plaintiff debentureholders purchased bonds from defendant securities issuers, which entitled them to tender the debentures for certain events such as a merger. A merger occurred and plaintiffs attempted to tender their debentures for a redemption of 106.25 percent of par. Defendants refused to redeem the bonds at that price, claiming that the right to tender had not been triggered as the board approved the merger. Plaintiffs commenced this lawsuit (a consolidation of two separate actions), claiming that they were misinformed as to the true nature of the right to tender and misled by the registration statements and prospectus. Defendants' motion for summary judgment was granted, plaintiffs appealed, and the judgment was reversed. On remand, defendants again moved for summary judgment, the court denied the motion, and they appealed. The court affirmed the order, in part, and remanded, holding that the securities Acts of 1933 and 1934 precluded the forcing of individual security holders to forego their rights due to a contract provision. The court also held that plaintiffs' right to tender was a valuable right, and established measurable benefit-of-the-bargain damages.

OUTCOME: That portion of the order that denied defendant securities issuers' motion for summary judgment in plaintiff debentureholders' federal securities law cause of action on the determination that benefit-of-the-bargain damages were statutorily available and that the no-action provision in the indenture could not bar plaintiffs' securities law claim was affirmed, and the case was remanded for application of the measure of damages.

CORE TERMS: debenture, indenture, benefit-of-the-bargain, no-action, securities law, merger, registration statements, market price, debentureholders, misrepresentation, holders, summary judgment, market value, inter alia, tender offer, misstatement, promised, leave to appeal, common stock, true value, measure of damages, amount paid, starting point, securityholders, speculative, arbitration, causation, defrauded, offering, omission

LexisNexis(R) Headnotes

Civil Procedure > Summary Judgment > Standards > General Overview
[HN1] Summary judgment may be granted if, upon reviewing the evidence in the light most favorable to the nonmovant, the court determines that there is no genuine issue of material fact and that the movant is entitled to judgment as a matter of law.

Civil Procedure > Summary Judgment > Appellate Review > Standards of Review
Civil Procedure > Appeals > Standards of Review > De Novo Review
[HN2] We review a grant of summary judgment de novo.

Securities Law > Liability > Securities Act of 1933 Actions > Civil Liability > False Registration Statements > General Overview
[HN3] Section 11(a) of the Securities Act of 1933 imposes civil liability on issuers and other signatories of a registration statement if the registration statement contains material misstatements or omissions and the plaintiffs acquired the securities without knowledge of such misrepresentations. 15 U.S.C.S. § 77k(a).

Securities Law > Liability > Securities Act of 1933 Actions > Civil Liability > General Overview
[HN4] See 15 U.S.C.S. § 77k(e).

Antitrust & Trade Law > Clayton Act > Defenses
Securities Law > Liability > Securities Act of 1933 Actions > Civil Liability > Defenses > General Overview
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Express Liabilities > Misleading Statements > General Overview
[HN5] While any decline in value is presumed to be caused by the misrepresentation in the registration statement, section 11(e) of the Securities Act of 1933 provides the following affirmative defense: If the defendant proves that any portion or all of such damages represents other than the depreciation in value of such security resulting from the part of the registration statement that contains the material misstatement or omission, such portion of or all such damages shall not be recoverable. 15 U.S.C.S. § 77k(e). This defense is known as the defense of "negative causation." Accordingly, where a defendant proves that the decline in the value of the security in question was not caused by the material omissions or misstatements in the registration statement, a plaintiff is not entitled to recover any damages.

Securities Law > Additional Offerings & the Securities Exchange Act of 1934 > Jurisdiction & Scope > Limitations on Remedies
Securities Law > Liability > Remedies > General Overview
[HN6] The starting point in every case involving construction of a statute is the language itself. The plain language of section 11(e) of the Securities Act of 1933, 15 U.S.C.S. § 77k(e), prescribes the method of calculating damages, and the court must apply that method in every case.

Securities Law > Additional Offerings & the Securities Exchange Act of 1934 > Jurisdiction & Scope > Limitations on Remedies
[HN7] Section 11(g) of the Securities Act of 1933 provides that in no case shall the amount recoverable under section 11 exceed the price at which the security was offered to the public. 15 U.S.C.S. § 77k(g).

Securities Law > Additional Offerings & the Securities Exchange Act of 1934 > Jurisdiction & Scope > Limitations on Remedies
[HN8] The term "value" in section 11(e) of the Securities Act of 1933, 15 U.S.C.S. § 77k(e), was intended to mean the security's true value after the alleged misrepresentations are made public. The value of a security may not be equivalent to its market price. Congress' use of the term "value," as distinguished from the terms "amount paid" and "price" indicates that, under certain circumstances, the market price may not adequately reflect the security's value. However, instances where the market price of a security will be different from its value are unusual and rare situations. Indeed, in a market economy, when market value is available and reliable, market value will always be the primary gauge of an enterprise's worth. Moreover, even where market price is not completely reliable, it serves as a good starting point in determining value.

Criminal Law & Procedure > Criminal Offenses > Fraud > Securities Fraud > Elements
Securities Law > Additional Offerings & the Securities Exchange Act of 1934 > Jurisdiction & Scope > Limitations on Remedies
[HN9] As a general rule, a price decline before disclosure may not be charged to defendants. A defendant, however, bears the burden of proving that the price decline was not related to the misrepresentations in the registration statement.

Securities Law > Additional Offerings & the Securities Exchange Act of 1934 > Jurisdiction & Scope > Limitations on Remedies
Securities Law > Liability > Remedies > Actual Damages
[HN10] Section 28(a) of the Securities Exchange Act of 1934 provides that no person permitted to maintain a suit for damages under the provisions of this chapter shall recover a total amount in excess of his actual damages on account of the act complained of. 15 U.S.C.S. § 78bb. The statute does not prescribe a particular method of calculating damages, and, in fact, courts have allowed benefit-of-the-bargain damages under section 10, § 78j(b), and Rule 10b-5, 17 C.F.R. § 240.10b-5, promulgated thereunder.

Securities Law > Additional Offerings & the Securities Exchange Act of 1934 > Jurisdiction & Scope > Limitations on Remedies
Securities Law > Initial Public Offerings & the Securities Act of 1933 > Contrary Stipulations Void
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Express Liabilities > Validity of Contracts > Void & Voidable Contracts
[HN11] The anti-waiver provisions of both the the Securities Act of 1933 and the Securities Exchange Act of 1934 provide, in pertinent part, that any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of the Acts or any rule or regulation of the Commission or an exchange shall be void.

Civil Procedure > Alternative Dispute Resolution > Arbitrations > General Overview
Contracts Law > Contract Conditions & Provisions > Arbitration Clauses
Labor & Employment Law > Collective Bargaining & Labor Relations > Arbitration > Enforcement
[HN12] Arbitration clauses are enforceable under federal securities laws because they are procedural in nature and do not serve to waive compliance with the provisions of substantive law.

COUNSEL: PHILIP K. HOWARD, New York, NY (Linda C. Goldstein, Howard, Darby & Levin, New York, NY, Judith L. Spanier, Abbey & Ellis, New York, NY, of counsel), for Plaintiffs-Appellees.

DENNIS J. BLOCK, New York, NY (Joseph S. Allerhand, Miranda S. Schiller, Howard L. Kneller, Weil, Gotshal & Manges, New York, NY, of counsel), for Defendants-Appellants.

(Simon M. Lorne, General Counsel, Jacob H. Stillman, Assoc. Gen. Counsel, Susan S. McDonald, Special Counsel, Diane V. White, Senior Counsel, and Paul Gonson, Solicitor, Securities and Exchange Commission, Washington, DC) submitted a brief as amicus curiae for the Securities & Exchange Commission.

JUDGES: Before: OAKES, MINER, and LEVAL, Circuit Judges.

OPINION BY: MINER

OPINION

[*1046] MINER, **[**2]** *Circuit Judge*:

Defendants-appellants appeal from an order entered on August 12, 1994 in the United States District Court for the Southern District of New York (Lowe, J.) denying, in part, defendants' motion for summary judgment, the court having determined, *inter alia*, that benefit-of-the-bargain damages are available to plaintiffs under section 11 of the Securities Act of 1933 (the "1933 Act") and under section 10 of the Securities Exchange Act of 1934 (the "1934 Act"), and that the no-action clause in the underlying indenture did not bar plaintiffs' federal securities law claims. The district court identified these issues as warranting interlocutory review and certified its order, pursuant to 28 U.S.C. § 1292(b). A panel of this Court granted defendants' motion for leave to appeal on January 3, 1995. [1]

1 Plaintiffs' cross-motion for leave to appeal the remaining issues decided by the district court in its August 12, 1994 order was denied by the panel, and we will not consider those issues.

For **[**3]** the following reasons, we affirm so much of the district court's order as allows plaintiffs to recover benefit-of-the-bargain damages under section 10 of the 1934 Act and as holds that the no-action clause in the underlying indenture does not bar plaintiffs' federal securities law claims. We reverse the district court's order to the extent that it allowed benefit-of-the-bargain damages under section 11 and refused to consider defendants' statutorily prescribed affirmative defense.

BACKGROUND

In July of 1986, defendant-appellant Wherehouse Entertainment, Inc. ("Wherehouse") issued 6.25% Convertible Subordinated Debentures (the "Debentures") at $ 1,000 par value. Plaintiffs allege that one of the key selling features of the Debentures was the right of holders to tender the Debentures to Wherehouse in the case of certain triggering events that might endanger the value of the Debentures. One such triggering event would occur if Wherehouse "consolidated or merged . . . unless approved by a majority of the Independent Directors." "Independent Director" was defined in the offering materials as a director of the company who was not a recent employee but who either

was a member of **[**4]** the board of directors on the date of the offering, or who subsequently was elected to the board by the then-Independent Directors.

On November 19, 1987, Shamrock Holdings, Inc. announced that it planned to commence a tender offer for Wherehouse's common stock. Subsequently, defendant Adler & Shaykin, an investment partnership, formed defendants WEI Acquisition Corp. and WEI Holdings, Inc., and submitted a bid for the Wherehouse stock. On December 20, 1987, the Board of Directors of Wherehouse unanimously approved, with one abstention, a merger with WEI Acquisition Corp. and WEI Holdings, Inc. The Board's approval of the merger was announced the following day, December 21, 1987. This news seemed to have a positive effect on the Debentures, which traded on the open market. The price of the Debentures went from 47% of par on the previous trading day, December 18, to 49% of par on the announcement date, December 21. On December 23, 1987, Wherehouse filed a Schedule 14D-9 with the Securities and Exchange Commission in which the company advised that the right to tender would not be triggered by the merger.

Despite the company's announcement, plaintiffs attempted to tender their Debentures **[**5]** to Wherehouse following the merger, seeking a redemption price of 106.25% of par, pursuant to the right to tender. Wherehouse refused to redeem the Debentures at this price, claiming that the right to tender had **[*1047]** not been triggered because the Board had approved the merger. Instead, all debentureholders were given the opportunity to tender their securities at 50.72% of par, which represented the Debentures' conversion value on the date preceding the merger. Also, pursuant to a "Supplemental Indenture," the debentureholders no longer had a right to convert the Debentures into common stock.

Based on the foregoing, plaintiffs commenced two separate actions (the "McMahan" action and the "Thompson" action), which ultimately were consolidated. Plaintiffs claim that they were misinformed about the true nature of the right to tender, that the right was illusory, and that the registration statements and the prospectus, as well as oral representations made in connection therewith, were materially misleading. They contend that the right was portrayed as valuable to debentureholders, creating a duty on the part of the "Independent Directors" to act in the debentureholders' interest. They allege **[**6]** federal securities claims arising under, *inter alia*, section 11 of the 1933 Act, 15 U.S.C. § 77k, for a misleading registration statement and under section 10 of the 1934 Act, 15 U.S.C. § 78j, for fraud in connection with a sale of securities.

In the McMahan action, defendants made a motion to dismiss, which later was converted into a motion for summary judgment. The district court, adopting the recommendation of the magistrate judge, granted summary judgment in favor of defendants and dismissed the complaint. We reversed that decision, finding that there was a genuine issue of material fact as to whether a reasonable investor could have been misled by the offering materials. *See McMahan & Co. v. Wherehouse Entertainment, Inc.*, 900 F.2d 576, 578 (2d Cir. 1990) ("*McMahan I*"), *cert. denied*, 501 U.S. 1249, 115 L. Ed. 2d 1052, 111 S. Ct. 2887 (1991).

On remand, the defendants again moved for summary judgment. It is this second motion that gives rise to this appeal. As to the issues raised in this appeal, the district court denied defendants' motion,

ruling, *inter alia*, that (1) the no-action clause in the indenture did not operate to bar plaintiffs' federal securities law claims; (2) plaintiffs **[**7]** may recover benefit-of-the-bargain damages under section 11 of the 1933 Act and section 10 of the 1934 Act. *See McMahan & Co. v. Wherehouse Entertainment, Inc.*, 859 F. Supp. 743 (S.D.N.Y. 1994). Subsequently, the court certified an order delineating these two rulings for an interlocutory appeal, pursuant to 28 U.S.C. § 1292(b). A panel of this court granted leave to appeal on January 3, 1995.

DISCUSSION

I. Benefit-Of-The-Bargain Damages

Defendants contend that the district court erred in ruling that plaintiffs could recover benefit-of-the-bargain damages under section 11 of the 1933 Act and under section 10 of the 1934 Act. " [HN1] Summary judgment may be granted if, upon reviewing the evidence in the light most favorable to the nonmovant, the court determines that there is no genuine issue of material fact and that the movant is entitled to judgment as a matter of law." *Richardson v. Selsky*, 5 F.3d 616, 621 (2d Cir. 1993). " [HN2] We review a grant of summary judgment *de novo*." *Peoples Westchester Sav. Bank v. FDIC*, 961 F.2d 327, 330 (2d Cir. 1992). Each of defendants' claims will be discussed in turn.

A. Section 11 of the 1933 Act

[HN3] Section 11(a) of the **[**8]** 1933 Act imposes civil liability on issuers and other signatories of a registration statement if the registration statement contains material misstatements or omissions and the plaintiffs acquired the securities without knowledge of such misrepresentations. *See* 15 U.S.C. § 77k(a); *Akerman v. Oryx Communications, Inc.*, 810 F.2d 336, 340 (2d Cir. 1987); *see also Greenapple v. Detroit Edison Co.*, 618 F.2d 198, 203 n.9 (2d Cir. 1980). Section 11(e) of the 1933 Act specifically provides the measure of damages in such suits:

> [HN4] The suit . . . may be to recover such damages as shall represent the difference between the amount paid for the security (not exceeding the price at which the security was offered to the public) and (1) the value thereof as of the time such suit was **[*1048]** brought, or (2) the price at which such security shall have been disposed of in the market before suit, or (3) the price at which such security shall have been disposed of after suit but before judgment if such damages shall be less than the damages [as calculated under subsection (1), above] . . . .

15 U.S.C. § 77k(e). [HN5] While any decline in value is presumed to be caused by the misrepresentation **[**9]** in the registration statement, *see Greenapple*, 618 F.2d at 203 n.9, section 11(e) provides the following affirmative defense:

> If the defendant proves that any portion or all of such damages represents other than the depreciation in value of such security resulting from [the] part of the registration statement . . . [that contains the material misstatement or omission], such portion of or all such damages *shall not be recoverable*.

15 U.S.C. § 77k(e) (emphasis added). This defense is known as the defense of "negative causation." *See Akerman*, 810 F.2d at 340. Accordingly, where a defendant proves that the decline in the value of the security in question was not caused by the material omissions or misstatements in the registration statement, plaintiff is not entitled to recover any damages. *See id.*

Here, the district court erred in ruling that plaintiffs may recover benefit-of-the-bargain damages under section 11 and that the market value was "irrelevant to Plaintiffs' claimed economic losses." 859 F. Supp. at 751. "It is axiomatic that [HN6] the starting point in every case involving construction of a statute is the language itself." Landreth Timber Co. **[**10]** v. Landreth, 471 U.S. 681, 685, 85 L. Ed. 2d 692, 105 S. Ct. 2297 (1985) (internal quotations omitted). The plain language of section 11(e) prescribes the method of calculating damages, *see* 15 U.S.C. § 77k(e), and the court must apply that method in every case. *Cf. Versyss Inc. v. Coopers & Lybrand*, 982 F.2d 653, 657 (1st Cir. 1992) (recognizing that, in general, section 11 should not be "extended beyond its normal reading"), *cert. denied*, 125 L. Ed. 2d 665, 113 S. Ct. 2965 (1993). Plaintiffs' claim that section 11(e), like section 11(g), [2] only provides a "cap" on damages, rather than the "measure" of damages, is belied by the plain language of the statute. Indeed, section 11(e) is entitled "Measure of damages," and the statutory scheme requires courts to apply the prescribed formula in every section 11 case. The record indicates that there was a substantial decline in the market price of the Debentures between the date plaintiffs purchased the Debentures and the date of the merger. This decline in market value permits plaintiffs to recover damages under the statutory scheme.

2 [HN7] Section 11(g) provides that "in no case shall the amount recoverable under [section 11] exceed the price at which the security was offered to the public." 15 U.S.C. § 77k(g).

[11]** Defendants argue that the claim for damages under section 11 should be dismissed because they have established the defense of negative causation. The district court, however, ruled that negative causation was irrelevant to plaintiffs' section 11 claim in view of its determination that benefit-of-the-bargain damages were available and therefore failed to consider the defense. Because the plain language of section 11 allows this defense, the district court, on remand, must allow defendants the opportunity to prove that the decline in value was not caused by the alleged misstatements in the registration statements. *See Akerman*, 810 F.2d at 342. When considering defendants' defense, the district court should apply the following principles.

[HN8] First, the term "value" in section 11(e) was intended to mean the security's true value after the alleged misrepresentations are made public. Even plaintiffs have suggested that damages be measured by the difference between the amount paid and the amount that defendants were willing to redeem the Debentures for after the merger was announced, i.e., the value of the Debentures after the alleged misrepresentations were disclosed. Accordingly, the **[**12]** district court's reference to "promised value" was misplaced because promised value is irrelevant to this calculation.

Second, the value of a security may not be equivalent to its market price. Congress' **[*1049]** use of the term "value," as distinguished from the terms "amount paid" and "price" indicates that, under certain circumstances, the market price may not adequately reflect the security's value. *See Beecher v. Able*, 435 F. Supp. 397, 404-05 (S.D.N.Y. 1977) (adjusting the market price to account for panic

selling in the market that was unrelated to the misrepresentations in the registration statements); *Grossman v. Waste Management, Inc.*, 589 F. Supp. 395, 415-16 (N.D. Ill. 1984) (holding that subsequent fraud on the market may make market price an unreliable indication of the security's value). However, instances where the market price of a security will be different from its value are "unusual and rare" situations. *In re Fortune Sys. Sec. Litig.*, 680 F. Supp. 1360, 1370 (N.D. Cal. 1987). Indeed, in a market economy, when market value is available and reliable, "market value will always be the primary gauge of an enterprise's worth." *Mills v. Electric Auto-Lite Co.*, **[**13]** 552 F.2d 1239, 1247 (7th Cir.), *cert. denied*, 434 U.S. 922, 54 L. Ed. 2d 279, 98 S. Ct. 398 (1977). Moreover, even where market price is not completely reliable, it serves as a good starting point in determining value. *See Beecher*, 435 F. Supp. at 406. In this case, market price appears to be the most reliable gauge of the Debentures' true value and, at the very least, an excellent starting point. Thus, the district court, in applying the statutory damages formula, should begin with the market price to determine the true value of the Debentures.

Finally, [HN9] as a general rule, a "price decline before disclosure may not be charged to defendants." *Akerman*, 810 F.2d at 342; *see also Feit v. Leasco Data Processing Equip. Corp.*, 332 F. Supp. 544, 586-88 (E.D.N.Y. 1971). The defendant, however, bears the burden of proving that the price decline was not related to the misrepresentations in the registration statement. *See* 15 U.S.C. § 77k(e); *see also Akerman*, 810 F.2d at 340.

The district court should address these issues in the first instance, being most familiar with the circumstances of this case.

B. Section 10 of the 1934 Act

Plaintiffs' section 10 claim for damages stands on a different **[**14]** footing. [HN10] Section 28(a) of the 1934 Act provides that "no person permitted to maintain a suit for damages under the provisions of this chapter shall recover . . . a total amount in excess of his actual damages on account of the act complained of." 15 U.S.C. § 78bb. The statute does not prescribe a particular method of calculating damages, and, in fact, we have allowed benefit-of-the-bargain damages under section 10, *id.* § 78j(b), and Rule 10b-5, 17 C.F.R. § 240.10b-5, promulgated thereunder.

In *Osofsky v. Zipf*, 645 F.2d 107 (2d Cir. 1981), the plaintiffs were offered a specific price if they tendered their common stock in connection with a tender offer. Plaintiffs tendered their stock, but received a lesser amount than they originally had been offered. *Id.* at 109-10. We held that benefit-of-the-bargain damages, under Rule 10b-5, were particularly appropriate in the context of tender offers where, despite the fraud, the shareholders normally will receive an amount in excess of market value. *Id.* at 114. We noted that the key to awarding benefit-of-the-bargain damages is the degree of certainty to which they can be established. *Id.*

In Levine v. Seilon, Inc., **[**15]** 439 F.2d 328, 334 (2d Cir. 1971) (Friendly, J.), the court stated that, under Rule 10b-5, a defrauded buyer of securities was "entitled to recover only the excess of what he paid over the value of what he got, not, as some other courts had held, the difference

between the value of what he got and what it was represented he would be getting." In *Osofsky*, we noted that this language in *Levine* was dicta, and we distinguished *Levine* on the ground that damages sustained by a defrauded buyer of securities are more speculative and thus different from the damages of a defrauded seller who does not get what he was promised. *Osofsky*, 645 F.2d at 112. In cases following *Osofsky*, we have focused on the plaintiff's ability to establish benefit-of-the-bargain damages with some reasonable degree of certainty. For example, in *Barrows v. Forest Labs., Inc.*, 742 F.2d 54, 59-60 (2d Cir. 1984), we refused to allow benefit-of-the-bargain damages **[*1050]** where such damages were based on the speculation of what plaintiff's securities would have been worth if the company had disclosed its true financial forecast. More recently, **[**16]** in *Commercial Union Assurance Co. v. Milken*, 17 F.3d 608, 614-15 (2d Cir.), *cert. denied*, 130 L. Ed. 2d 130, 115 S. Ct. 198 (1994), we acknowledged the possibility of awarding benefit-of-the-bargain damages in a Rule 10b-5 case, but declined to do so because the plaintiff's claims were speculative.

In this case, we believe that plaintiffs could establish benefit-of-the-bargain damages with reasonable certainty. We acknowledge, however, that this is not a case like *Osofsky*, where plaintiffs were offered a certain price during a tender offer and then received some lesser amount. In this case, plaintiffs purchased debentures, allegedly relying in part on the possibility that a merger that was not approved by the Independent Directors might occur and thus trigger the right to tender. This possibility, we have previously held, could reasonably be considered a "valuable right" to plaintiffs. *See McMahan I*, 900 F.2d at 579. Whether plaintiffs can establish, with a reasonable degree of certainty, the amount of that value is a different question.

Plaintiffs contend that determining damages in this case is a simple task -- upon a merger, they are entitled to 106.25% of par for each Debenture. In reality, the matter is more complex than plaintiffs' **[**17]** contention would indicate. Because the value of plaintiffs' right to tender was contingent on the occurrence of certain events, the value of this right is somewhat speculative. Nevertheless, if plaintiffs could establish, under their theory of the case, that independent directors, acting on behalf of the debentureholders, would not have approved this merger, then damages could be assessed at the promised redemption of par plus 6.25%.

II. The No-Action Clause

Defendants contend that the district court erred in ruling, as a matter of law, that the no-action clause found in the Indenture cannot operate to waive plaintiffs' rights under the 1933 and 1934 Acts. The no-action clause is contained in section 8.06 of the Indenture and provides as follows:

> *Limitation on Suits*. A Securityholder may pursue any remedy with respect to this Indenture or the Securities only if:
>
> (1) the Holder gives to the [Indenture] Trustee written notice of a continuing Event of Default; [3]
>
> (2) the Holders of at least 25% in principal amount of the Securities make a written request to the Trustee to pursue the remedy;
>
> (3) such Holder or Holders offer to **[**18]** the Trustee indemnity satisfactory to the Trustee against any loss, liability or expense;
>
> (4) the Trustee does not comply with the request within 60 days after receipt of the request and the offer of indemnity; and

(5) during such 60-day period the Holders of a majority in principal amount of the Securities do not give the Trustee a direction inconsistent with the request.

Section 14 of the Debentures states in relevant part: "Securityholders may not enforce the Indenture or the Securities except as provided in the Indenture." [4]

3 Section 8.01 of the Indenture states that an event of default occurs if, *inter alia*, "the Company defaults in the payment of the principal of any Security when the same becomes due and payable, whether at maturity, upon redemption or otherwise[, or] the Company fails to comply with any of its other agreements in the Securities or this Indenture."

4 Section 8.07 of the Indenture provides that debentureholders are excused from complying with the No-Action clause in suits based on nonpayment of principal and interest on or after the due dates expressed in the Debenture and in suits based on the right to convert a Debenture to common stock. This is a requirement of section 316(b) of the Trust Indenture Act, 15 U.S.C. § 77ppp(b).

[19]** Such no-action clauses frequently are included in indentures to limit suits arising from those agreements. *See UPIC & Co. v. Kinder-Care Learning Ctrs., Inc.*, 793 F. Supp. 448, 454 (S.D.N.Y. 1992) (citing American Bar Foundation, *Commentaries on Model Debenture Indenture Provisions*, 232-34 (1971)). "These clauses are strictly construed," *Cruden v. Bank of New York*, 957 F.2d 961, 968 **[*1051]** (2d Cir. 1992), and have been enforced in a variety of contexts in both federal and state courts, *see, e.g., Friedman v. Chesapeake and Ohio Ry. Co.*, 261 F. Supp. 728, 729-31 (S.D.N.Y. 1966) (action to accelerate the time of payment on bonds), *aff'd*, 395 F.2d 663 (2d Cir. 1968), *cert. denied*, 393 U.S. 1016, 21 L. Ed. 2d 561, 89 S. Ct. 619 (1969); *Greene v. New York United Hotels, Inc.*, 236 A.D. 647, 260 N.Y.S. 405, 406-07 (1st Dep't 1932) (action based on non-payment of coupons on debenture bonds), *aff'd*, 261 N.Y. 698, 185 N.E. 798 (1933).

In this case, plaintiffs failed to comply with the no-action clause, and, as a result, the district court ruled that their state-law claims were barred. In regard to the federal securities law claims, however, the district court ruled that the no-action clause was inoperable because it infringed **[**20]** on plaintiffs' substantive rights under the securities laws. The court based its conclusion on [HN11] the anti-waiver provisions of both the 1933 and 1934 Acts, which provide, in pertinent part, that "any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of [the Acts or any rule or regulation of the Commission or an exchange] . . . shall be void." 15 U.S.C. §§ 77n; *id.* § 78cc(a).

Defendants argue that the no-action clause does not constitute a "waiver," but, rather, establishes a procedure that must be followed before an action may be brought. They attempt to analogize the no-action clause to an arbitration clause, and claim that both merely are procedural limitations. We

disagree.

[HN12] Arbitration clauses are enforceable under federal securities laws because they are procedural in nature and do not serve to waive compliance with the provisions of substantive law. *See Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 238, 96 L. Ed. 2d 185, 107 S. Ct. 2332 (1987) (stating that "the SEC has sufficient statutory authority to ensure that arbitration is adequate to vindicate Exchange Act rights"). The no-action clause in this case can operate to **[**21]** bar a minority plaintiff class from exercising its substantive rights under federal securities law upon the vote of a majority of the debentureholders. Further, a plaintiff's inability to indemnify the Trustee, as required by the no-action clause here, would bar that plaintiff from commencing a securities law claim. The statutory framework of the 1933 and 1934 Acts compels the conclusion that individual securityholders may not be forced to forego their rights under the federal securities laws due to a contract provision. *See Kusner v. First Pa. Corp.*, 531 F.2d 1234, 1239 (3rd Cir. 1976) (finding no "authority for the proposition that a 'no action' provision in an indenture effectively bars a direct action based upon the federal securities laws"). Thus, the district court properly found that actions based on federal securities laws may not be precluded by the no-action clause.

CONCLUSION

We affirm so much of the district court's order as determined that benefit-of-the-bargain damages are available under section 10 of the 1934 Act and as determined that the no-action provision in the Indenture could not bar plaintiffs' securities law claims. We reverse the district court's **[**22]** order to the extent that the court ruled that benefit-of-the-bargain damages were available under section 11 of the 1933 Act. On remand, the district court is to apply the measure of damages specifically provided under section 11(e) of the 1933 Act in accordance with this opinion.

749 F.Supp. 1419, Fed. Sec. L. Rep. P 95,453
(Cite as: 749 F.Supp. 1419)

United States District Court,
D. South Carolina,
Spartanburg Division.

The SOUTH CAROLINA NATIONAL BANK, as the Trustee, and Gordon K. Billipp and Elizabeth W. Billipp, on behalf of themselves and all other persons similarly situated, Plaintiffs,
v.
C. Donald STONE; James A. Stone; Buchanan & Co.; Robert M. Buchanan; Unico Development Services, Inc.; United Medical and Surgical Supply Corporation; C. Benjamin Smith; Ann H. Smith; Benan, Inc.; Retirement Horizons, Inc.; Tom L. Sizemore; John J. Bandy, Sr.; Kenny O. Merritt; Rickey Merritt; Horace C. Smith; J.W. Wakefield; Harold Fleming; Heritage Living Centers, Inc.; J.R. Randall; Joanne J. Randall; Parker & Kotouc, a Partnership; Thomas O. Kotouc; Low & Furby, a Partnership; John T.C. Low; Whiteside, Smith, Jones & Duncan, a Partnership; May Zima & Co., individually and as Class Representative of a Defendant Class described herein, Defendants.

Civ. A. No. 7:88–79117.
July 25, 1990.

Indenture trustee and two bond holders, on behalf of a purported class of approximately 1,765 bond holders, sued numerous persons and entities associated with the project to which proceeds from the sale of the bonds was loaned, seeking recovery under the Securities Exchange Act of 1934, and the South Carolina Uniform Securities Act and various principles of common law. Bond holders reached agreement with certain, but not all, of the defendants, and sought approval of the proposed settlement. The District Court, Joseph F. Anderson, Jr., J., held that: (1) the proposed settlement was fair, adequate, and reasonable to class members; (2) the court could provisionally certify the class for settlement purposes; and (3) the settling defendants were entitled to an order barring cross claims against them by the nonsettling defendants.

So ordered.

West Headnotes

[1] 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

Settlement in securities fraud class actions by which settling defendants would pay total of $2,931,387 into interest bearing escrow fund for benefit of class of holders of bonds from which action arose was accepted; counsel with substantial amount of litigation experience entered into settlement negotiations after becoming fully informed of all pertinent factual and legal issues in case, negotiations were conducted at arm's length, there was uncertainty associated with ultimate class certification, complexities and uncertainties characteristic of complex securities litigation made it appropriate for plaintiffs to compromise their claims pursuant to reasonable settlement, consideration obtained by plaintiffs was adequate, and notice of proposed settlement was properly given to all members of class, and no class member filed written objection to settlement or any of its terms. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); Fed.Rules Civ.Proc.Rule 23(c)(2), (e), 28 U.S.C.A.

[2] Compromise and Settlement 89 70

89 Compromise and Settlement
89II Judicial Approval
89k66 Proceedings
89k70 k. Evidence; Affidavits. Most Cited Cases

In assessing fairness and adequacy of proposed settlement in securities fraud litigation, there is strong initial presumption that compromise is fair and reasonable. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); Fed.Rules Civ.Proc.Rule 23(c)(2), (e), 28 U.S.C.A.

[3] Compromise and Settlement 89 57

89 Compromise and Settlement
89II Judicial Approval

749 F.Supp. 1419, Fed. Sec. L. Rep. P 95,453
(Cite as: 749 F.Supp. 1419)

89k56 Factors, Standards and Considerations; Discretion Generally
89k57 k. Fairness, Adequacy, and Reasonableness. Most Cited Cases

When comparing amount of settlement with potential liability of settling defendants, it is appropriate to consider such defendants' abilities to pay any subsequent judgment and availability or lack thereof of insurance proceeds. Fed.Rules Civ.Proc.Rule 23(e), 28 U.S.C.A.

[4] Federal Civil Procedure 170A 171

170A Federal Civil Procedure
170AII Parties
170AII(D) Class Actions
170AII(D)2 Proceedings
170Ak171 k. In General; Certification in General. Most Cited Cases

Even though court has not yet issued final ruling on plaintiffs' pending motion for class certification, court may provisionally certify class for settlement purposes. Fed.Rules Civ.Proc.Rule 23(b)(1, 3), (e), 28 U.S.C.A.

[5] Indemnity 208 64

208 Indemnity
208III Indemnification by Operation of Law
208k63 Particular Cases and Issues
208k64 k. In General. Most Cited Cases
(Formerly 208k13.2(4.1), 208k13.2(4))

One tort-feasor may not seek indemnification from another in securities fraud litigation under Securities Exchange Act of 1934, or under common law. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

[6] Compromise and Settlement 89 71

89 Compromise and Settlement
89II Judicial Approval
89k66 Proceedings
89k71 k. Determination; Findings. Most Cited Cases

In securities fraud actions, it is within court's discretion to impose order barring cross claims against settling defendants by nonsettling defendants. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

[7] Compromise and Settlement 89 71

89 Compromise and Settlement
89II Judicial Approval
89k66 Proceedings
89k71 k. Determination; Findings. Most Cited Cases

In securities fraud litigation, court could enter order barring nonsettling defendants from asserting cross claims against settling defendants, while reserving for determination at time of trial such other issues as method and amount of credit to be afforded nonsettling defendants in respect of settlements and releases of alleged joint tort-feasors. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); Fed.Rules Civ.Proc.Rule 54(b), 28 U.S.C.A.

[8] Jury 230 14(1)

230 Jury
230II Right to Trial by Jury
230k14 Particular Actions and Proceedings
230k14(1) k. In General. Most Cited Cases

Claims for contribution are equitable in nature and therefore not triable to jury.

[9] Securities Regulation 349B 157.1

349B Securities Regulation
349BI Federal Regulation
349BI(E) Remedies
349BI(E)1 In General
349Bk157 Costs and Expenses; Attorney Fees
349Bk157.1 k. In General. Most Cited Cases
(Formerly 349Bk157)

Attorneys for securities fraud class action plaintiffs were entitled to fees and expenses of $200,000 from proceeds of nearly $3,000,000 settlement. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

***1420** William Llewellyn Pope, Pope and Rogers, Columbia, S.C., Thomas Allen Hutcheson, Charleston, S.C., Michael Rediker, David Donaldson, David Guin, Ritchie & Rediker, Birmingham, Ala., for plaintiffs South Carolina Nat. Bank, Gordon K. Billipp and Elizabeth W. Billipp.

749 F.Supp. 1419, Fed. Sec. L. Rep. P 95,453
(Cite as: 749 F.Supp. 1419)

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Robert Erving Stepp, Columbia, S.C., for defendants Judith Baker, Maurice A. Barineau, William J. Boshell, Edwin Chase, Redford A. Cherry, Charles B. Eldridge, Rene G. Fernandez, William L. Gaddoni, Harry G. Harrell, David M. Johnston, Robert L. Johnson, Charles L. Lester, Robert D. May, Ronald R. Moats, Robert E. Salveson, William Schapley, Marvin Shams, John P. Thomas, John P. Vodennicker, Wallis L. Walker, Jr., David P. Yon, John A. Vonkosky, Richard M. Young and Donald A. Zima.

MEMORANDUM OPINION AND ORDER

JOSEPH F. ANDERSON, JR., District Judge.

On June 12, 1990, the Court conducted a final hearing in this cause with respect to whether the several settlement agreements by and between the Plaintiffs and certain Defendants described further herein should or should not be approved.

Prior to the June 12, 1990 hearing, the Court reviewed the extensive record in this action, including numerous affidavits filed by Plaintiffs' counsel and the indenture ***1421** trustee concerning the notice given to members of the Plaintiff Class by publication and by mail, briefs in support of the proposed settlement filed by the Plaintiffs, the Defendant Wyche, Burgess, Freeman & Parham, P.A., Defendant Whiteside, Smith, Jones & Duncan, and an objection to the settlement filed by certain non-settling Defendants to the extent that any order be issued barring claims for contribution.

STATEMENT OF FACTS

This case arises out of the issuance on May 30, 1985 of revenue bonds in the original principal amount of $16,000,000 by Spartanburg County, South Carolina. [FN1] The proceeds of the sale were loaned to Retirement Horizons, Inc. ("RHI"), a South Carolina non-profit corporation, to construct, equip, market, and finance a 240–unit retirement facility intended for persons aged 65 years and above ("Skylyn Hall" or "Project" herein) located near Spartanburg, South Carolina. The bonds were offered and sold through the underwriter Buchanan & Co. ("Buchanan"), pursuant to a Preliminary Official Statement ("POS") and an Official Statement ("OS") prepared primarily by Buchanan and its counsel, Low & Furby (the "Low firm"). The OS included a feasibility study of the Project prepared by an Atlanta accounting firm, May Zima & Co. The Defendant Wyche, Burgess, Freeman & Parham, P.A. (the "Wyche firm") acted as bond counsel in the transaction. The units in the Project were to be marketed by Benan, Inc. ("Benan"), whose principals were Ben Smith and his wife, Ann Smith (the "Smiths"); Benan was also to manage the Project. Settling Defendants J.W. Wakefield and Harold Fleming were, along with defendant Horace Smith (a member of the Whiteside firm, which served as Benan's counsel), alleged directors of Benan and received certain payments in connection with Benan or the Project. Defendants Sizemore and Bandy were directors of RHI and defendant Kotouc and his law firm (Parker & Kotouc) served as RHI's counsel.

> FN1. The bonds were not general obligations of the County; instead, principal and interest were payable from a pledge of revenues and receipts of the Project, and the bonds were secured by a first mortgage lien on the Project to be constructed and on various funds held by the indenture trustee under the indenture of trust.

On or about November 25, 1986, RHI failed to make certain payments required by its loan agreement. Plaintiff The South Carolina National Bank, as indenture trustee ("SCNB") issued a notice of default to bondholders on February 24, 1987 and on April 6, 1987, SCNB filed a

complaint in the South Carolina Court of Common Pleas on behalf of the bondholders to foreclose on the project. After receiving sealed bids and entering into a contract with a purchaser following a bondholder balloting process, in April, 1988, SCNB closed the sale of the Skylyn Hall facility, and in July, 1988 distributed approximately $7,370,000 to bondholders, consisting of the net cash proceeds of the sale as well as most of the undisbursed proceeds of the bond offering held by SCNB in various trust accounts, except for several hundred thousand dollars retained by it to defray certain administrative costs as well as costs of this litigation (pursuant to notice to, and voting ballots received from, the bondholders).

On March 25, 1988, SCNB and two bondholders, Mr. and Mrs. Gordon Billipp of New Hampshire, on behalf of a purported class of approximately 1,765 bondholders of record (and perhaps as many as 2300 current and former bondholders and beneficial owners), filed the original complaint in this action. In the complaint as last amended through the Second Amended Complaint, Plaintiffs allege that the Official Statement and the POS contained numerous omissions of material fact relating to, among other things: (1) the non-existence of (and certain deceptive practices concerning) 60 bona fide reservation agreements and deposits at the time of closing, as required by the underwriter as a precondition to closing; (2) alleged bond issue defaults or problems with other retirement facilities with which a number of the Defendants had previously been involved; (3) the existence of a prior report by Ernst & Whinney ("E & W") that recommended a higher level of pre-sale reservations (50%) than that recommended by the underwriter;***1422** (4) a number alleged flaws in the feasibility study prepared by May Zima and included as an Appendix to the Official Statement (primarily in the nature of assumptions which allegedly had no reasonable basis in fact or which various Defendants allegedly knew were unreasonable); (5) the existence of a prior feasibility study by American Retirement Corp. of Nashville for a project of this type in the same area which concluded that not more than 130 units, of a rental-only nature, were feasible in the relevant market and which also recommended a 50% pre-sale of units to prove the market; (6) the absence of a marketing person (Mary Lancaster) described in the OS as Director of Marketing, and generally the alleged omission of facts about certain Defendants' concerns over the lack of adequate marketing and management expertise for this Project; (7) alleged inadequacy of working capital and of reserve funds; (8) certain alleged kickbacks, transfers of money, and lack of arms' length dealings between Defendants other than the law firms; (9) pending grand jury investigation for federal law fraud against certain affiliated of the developers and certain affiliates; and (10) the lack of provisions for approximately $300,000 of kitchen equipment in the furniture, fixtures and equipment contract. The Complaint seeks recovery against all Defendants under section 10(b) of the Securities Exchange Act of 1934 and Rule 10b–5 thereunder, the South Carolina Uniform Securities Act and various principles of common law. In addition, a claim under the Federal Racketeering Influenced and Corrupt Organizations Act ("RICO") is asserted against certain of the Defendants. The Defendants vigorously dispute these allegations and any liability to the Plaintiffs.

Shortly after the initiation of the action, Plaintiffs and Defendants embarked on substantial pre-trial discovery. Discovery included both formal and informal production of documents by all parties to the case, entailing the production and examination of tens of thousands pages of documents by SCNB, the Whiteside firm, the Wyche firm, the Low firm, Buchanan & Co., May Zima, Kotouc and virtually all other parties as well as numerous non-parties. In addition, the parties took between 40 and 50 depositions of various party and non-party fact witnesses during the course of which more than 1400 exhibits were marked.

In December, 1989, subsequent to the completion of depositions of all fact witnesses, Plaintiffs entered into serious settlement discussions with a number of the settling Defendants.[FN2] Those most-recent, serious discussions, which also involved representatives of insurance carriers of some of the settling Defendants, continued for almost three months. Following earlier notice to the Court of impending settlement, on February 28, 1990 the Plaintiffs, the Wyche firm, the Whiteside firm and Kotouc and his firm filed with the Court their joint memorandum of pro tanto settlement. On March 1, 1990, the Court held an open court hearing on that motion, was advised by the parties of certain other settlements with Defendants Low firm and John Low, Fleming, Sizemore and Bandy that had been reached that day, gave preliminary approval to those settlements, and directed Plaintiffs and all remaining non-settling defendants forthwith to conduct efforts to settle the remaining claims. Thereafter, Plaintiffs and defendants Wakefield, Benan, Ben Smith and Ann Smith reached supplemental agreements incorporating in relevant part the terms of the February 28, 1990 memorandum of settlement. Pursuant to the Court's Orders of April 16, April 25 and April 27, 1990, individual notice was mailed and published notice was given to Class Members informing them of the settlements, of the scheduled settlement hearing, and of their right to opt out of or object to the

settlement, as well as related matters stated in the mailed notice.

> FN2. The Court has been advised that settlement demands by Plaintiffs upon numerous defendants were initiated in the Spring of 1989 and that settlement discussions continued from time to time thereafter as the case moved along.

The Low Firm	$925,000
The Wyche Firm	$925,000
The Whiteside Firm	$625,000
Parker & Kotouc	$150,000
J.W. Wakefield, Jr.	$125,000
Harold Fleming	$100,000
Ben and Ann Smith, Benan	$ 80,000
Tom L. Sizemore	$ 1,287
John J. Bandy, Jr.	$ 100

The parties to the settlement have made a condition of effectiveness of the settlement that the Court certify the Class as to claims against the Settling Defendants, only, for purposes of settlement and enter an Order ("Bar Order") barring the assertion of cross-claims by non-settling Defendants arising out of this case. The Bar Order would provide that, if a judgment is entered against non-settling Defendants, those Defendants would be entitled to a credit which shall be determined at the time of trial or judgment based on controlling legal principles in effect at that time. The memorandum of settlement provides for dismissal of all claims which Plaintiffs and the Class Members have brought, or could have brought, against the Settling Defendants, and for specified mutual releases among the Settling Defendants (including any subsequently-settling defendants).

DISCUSSION

[1] The standards to be applied in determining whether to approve settlement of class actions are well established. The voluntary resolution of litigation through settlement is strongly favored by the courts. *Williams v. First National Bank*, 216 U.S. 582, 30 S.Ct. 441, 54 L.Ed. 625 (1910); *City of Detroit v. Grinnell Corp.*, 495 F.2d 448 (2d Cir.1974); *Mashburn v. National Healthcare, Inc.*, 684 F.Supp. 660, 667–68 (M.D.Ala.1988). This policy is particularly appropriate than in class actions:

> In the class action context in particular, "there is an overriding public interest in favor of settlement" set-

TERMS OF THE PROPOSED SETTLEMENT

The memorandum of settlement and supplemental settlement agreements provide ***1423** that the Settling Defendants will pay a total of $2,931,387 into an interest bearing escrow fund for the benefit of the Class. The amounts to be contributed by each Settling Defendant are as follows:

> tlement of the complex disputes often involved in class actions minimizes the litigation expenses of both parties and also reduces the strains such litigation imposes upon already scarce judicial resources.

Armstrong v. Board of School Directors, 616 F.2d 305, 313 (7th Cir.1980) (citations omitted). See also *Weinburger v. Kendrick*, 698 F.2d 61, 73 (2d Cir.1982) (corrected on other grounds on petition for rehearing) [1982–83 Transfer Binder] F.Sec.L.Rep. (CCH) ¶ 99,074 (2d Cir.), *cert. denied*, 464 U.S. 818, 104 S.Ct. 77, 78 L.Ed.2d 89 (1983); *Van Bronkhorst v. SAFECO Corp.*, 529 F.2d 943, 950 (9th Cir.1976); *In re* ***Saxon Securities Litigation***, [1985–86 Transfer Binder] F.Sec.L.Rep. (CCH) ¶ 92,414, at 92,525 (S.D.N.Y.1985).

Rule 23(e) of the Federal Rules of Civil Procedure provides that "[a] class action shall not be dismissed or compromised without the approval of the Court ..." As a general matter, the Court's function in assessing a proposed settlement is to determine whether, as a whole, it is fair, adequate and reasonable to Class Members. See, e.g., *Reed v. General Motors Corp.*, 703 F.2d 170, 172 (5th Cir.1983); *Troncelliti v. Minolta Corp.*, 666 F.Supp. 750, 752–53 (D.Md.1987); *In re Mid–Atlantic Toyota Antitrust Litigation*, 605 F.Supp. 440, 441 (D.Md.1984). In making this evaluation, courts generally cite certain primary factors to consider:

1. the fairness of the settlement negotiations and the views and experience of counsel;

2. the relative strength of the parties' cases as well as the uncertainties of litigation on the merits;

3. the complexity, expense and likely duration of the litigation;

4. the adequacy of the settlement amount viewed against the risks and expenses of continued litigation; and

5. the stage of the litigation, including the factual record developed by the parties.

For the reasons set forth herein, the Court is satisfied that the proposed settlement satisfies each of these criteria.

[2] A. *The fairness of the settlement negotiations and the views and experience of counsel.* In assessing the fairness ***1424** and adequacy of a proposed settlement, "there is a strong initial presumption that the compromise is fair and reasonable." *In re* ***Saxon Securities Litigation***, *supra,* ¶ 92,414, at 92,525, quoting *Katz v. E.L.I. Computer Systems, Inc.,* [1970–71 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶ 92,994, at 90,676 1971 WL 251 (S.D.N.Y.1971). Thus, the courts have recognized that "[s]ettlements, by definition, are compromises which 'need not satisfy every single concern of the plaintiff class, but may fall anywhere within a broad range of upper and lower limits.' " *In re* ***Saxon Securities Litigation***, *supra,* ¶ 92,414, at 92,525 quoting *Alliance to End Repression v. City of Chicago*, 561 F.Supp. 537, 548 (N.D.Ill.1982). As has been stated by the Fourth Circuit:

> The trial court should not ... turn the settlement hearing "into a trial or a rehearsal of the trial 'nor need it' reach any dispositive conclusions on the admittedly unsettled legal issues" in the case. It is not part of its duty in approving a settlement to establish that "as a matter of legal certainty the subjects claim or counter-claim is or is not worthless or valuable."

Flinn v. F.M.C. Corp., 528 F.2d 1169, 1172–73 (4th Cir.1975) (footnotes omitted), *cert. denied*, 424 U.S. 967, 96 S.Ct. 1462, 47 L.Ed.2d 734 (1976).

In this context, in evaluating the terms of a proposed settlement, the courts have looked first to the fairness of the settlement negotiations and the views of counsel. The question posed is whether the settlement was achieved through "arm's length negotiations" by counsel who have "the experience and ability ... necessary to effect the representation of the class' interest." *Weinburger*, 698 F.2d at 74. See also, e.g., *Eltman v. Grandma Lee's, Inc.,* [1986–87 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶ 92,798, at 93,904 (E.D.N.Y.1986).

In the instant case, counsel for all the settling parties have advised the Court that the settlement discussions were difficult and at times tense, and in fact, that at times talks with various of the Defendants were broken off because both sides refused to budge. Even after the dollar amounts of the various individual settlements were agreed upon, the Bar Order and wording of mutual releases became significant issues in reaching a final agreement.

The negotiations in this case were conducted by able counsel who have a substantial amount of litigation experience, particularly in this sort of complex securities action. Counsel to both the Plaintiffs and the settling Defendants undertook these negotiations after completion of substantial written, deposition and document discovery, as well as massive briefing on certain key procedural and substantive issues arising out of the case. Accordingly, such counsel entered into settlement negotiations on behalf of their clients after becoming fully informed of all pertinent factual and legal issues in the case. In sum, counsel for the Plaintiff Class left no stone unturned in the case and it is appropriate to give great weight to their judgment that the proposed settlement is in the interest of all their clients.

[3] B. *The relative strengths of the parties cases as well as the uncertainties of litigation on the merits.* Although a court is not to decide the merits of the case or to attempt to resolve unsettled legal questions when reviewing the adequacy of a proposed settlement, see *Carson v. American Brands, Inc.*, 450 U.S. 79, 88 n. 14, 101 S.Ct. 993, 998 n. 14, 67 L.Ed.2d 59 (1981) (citing *Protected Committee for Independent Stockholders v. Anderson*, 390 U.S. 414, 424–25, 88 S.Ct. 1157, 1163–64, 20 L.Ed.2d 1 (1968), it is nonetheless necessary in order to evaluate the fairness and adequacy of a settlement to assess the relative strengths and weaknesses of the settling parties' positions. *See Flinn v. F.M.C. Corp., supra,* 528 F.2d at 1172. Of course, when comparing the amount of the settlement with the potential liability of the settling Defendants, it also is appropriate to consider such Defendants' abilities to pay any subsequent judgment and the availability or lack thereof of insurance proceeds. See *Mashburn v. National Healthcare, Inc.*, 684 F.Supp. 660, 670–71 (M.D.Ala.1988). After all, the purpose of settlements is "to

avoid the trial of sharply disputed issues and to dispense with wasteful***1425** litigation." *Jiffy–Lube Securities Litigation*, [1989–90 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶ 94,859, at 94,661, 1990 WL 39127 (D.Md.1990), quoting *In re Montgomery County Real Estate Antitrust Litigation*, 83 F.R.D. 305, 316 (D.Md.1979).

The critical issue to consider in connection with this factor is the distinction between the Defendants and their respective roles in the alleged wrongdoing. For example, a reading of the amended complaint indicates that Defendant Reverend Ben Smith spearheaded a number of aspects of the Project and played a direct role in a number of the problem areas. However, counsel have advised the Court that Reverend Smith is not in good health and Reverend Smith testified at the hearing that he was required to mortgage his house and to liquidate his investments and certain retirement funds to raise the money he is contributing to the settlement. Similarly, the Court was concerned with the small amounts of money contributed to the settlement by Defendants Reverend John Bandy and Tommy Sizemore, but both testified at the hearing that they have little money to contribute. Reverend Bandy is a retired minister living on social security with no investments or real estate. He simply has nothing else to give other than the $100 he has contributed. Similarly, Mr. Sizemore testified that he is insolvent and unable to obtain credit [FN3], and his contribution to the settlement is a check written to him by the purchaser of a portion of the inventory he owned in his last business. The law firm Defendants have made contributions from insurance coverage, in some cases at or close to policy limits.[FN4] Defendant Senator Horace Smith, in fact, is making a contribution over and above his insurance policy limits, from his personal resources. The Court is of the opinion that the negotiations were conducted at arms' length, based on full access to the relevant facts, and that the Plaintiffs properly agreed to the settlement amounts. At least some of these law firm Defendants could argue with significant force and support that their legal opinions and actions were correct or reasonable based upon the information that was available to them, and that if they were incorrect or unreasonable, it was because the developers of the project or others misled them as well as the investors.

> FN3. At the March 1, 1990 hearing Mr. Sizemore and Plaintiffs' counsel exhibited Sizemore's tax returns and financial statements and related information to substantiate his claims.

> FN4. In the case of the Wyche firm, the primary policy limits were reported to have been exhausted and additional funds were reported to be payable under arrangements that involve reservations of rights. In the case of the Kotouc firm, the Court has been informed that the amount paid may even slightly exceed policy limits, and Mr. Kotouc is now pro se, his defense counsel having withdrawn; Mr. Kotouc testified as to his lack of resources beyond his remaining coverage. In the case of the Low firm, the Court was informed that only a very small amount of the policy limits was not paid, so as to afford those parties some possibility of defense under the policy for any possible future claims. The parties informed the Court that one serious problem which accelerated settlement discussions was the discovery that certain of the insurance policies contained what the parties termed "erosion" clauses, under which costs of defense operated in some way to reduce available dollars to pay settlements or judgments.

Apart from the amounts paid in settlement, an evaluation of the relevant pleadings filed with the Court reveals that the strengths of the claims and defenses asserted have been the subject of substantial dispute since the inception of this litigation. The risks to Plaintiffs on the legal and factual issues raised also militate in favor of settlement.

Thus, to prevail on their Rule 10b–5 claims, Plaintiffs must establish, among other things, that Settling Defendants acted with scienter; that Plaintiffs relied on purported misrepresentations (or that the fraud-on-the-market theory is available in lieu of reliance); and that the alleged misstatements and omissions were the proximate cause of the project's failure. Settling Defendants strongly dispute Plaintiffs' ability to show scienter.

As to Plaintiffs' state common law claims, certain of the same elements which must be established to make a Rule 10b–5 claim, including reliance, proximate causation, and (as to fraud claims) intent, must be also established. Defendants assert that, as a legal and factual matter, Plaintiffs***1426** will be unable to establish any of the necessary elements at trial.

Apart from the substantive merits of the parties' claims and defenses, there is also a significant procedural dispute as to the propriety of class certification (in other than the settlement context) for both Plaintiffs' federal and state claims. These issues have been the subject of substantial briefing by the parties on which the Court has not yet ruled.

The uncertainties associated with ultimate certification also militate in favor of approving settlement. *See Eltman v. Grandma Lee's, Inc.*, [1986–87 Transfer Binder] F.Sec.L.Rep. (CCH) ¶ 92,798, at 93,905 (E.D.N.Y.1986).

These examples of the various Defendants' positions and defenses, though indicative of the obstacles and road blocks in the Plaintiffs' path, do not mean that the Court has determined that the Plaintiffs cannot overcome such difficulties and prove their case at trial. The Court need not resolve these issues for purposes of this motion, but notes that the ultimate resolution of the numerous and significant factual and legal issues poses risks to both sides. Based on these factors, the Court is satisfied that the amounts paid into the settlement by each of the Defendants falls within the "range of reasonableness" given the nature of the claims and defenses asserted and the Defendants' ability to pay should the judgment be obtained.

C. *The complexity, expense, and likely duration of the litigation.* "[A]n integral part of the strength of the case on the merits is a consideration of the various risks and costs that accompany continuation of the litigation." *Donovan v. Estate of Fitzsimmons*, 778 F.2d 298, 309 (7th Cir.1985), citing *Grunin v. International House of Pancakes*, 513 F.2d 114, 124 (8th Cir.1975). Although Plaintiffs in any case may firmly believe that their claims have merit, the complexities and uncertainties characteristic of complex securities litigation, and the concomitant costs that necessarily are entailed, make it appropriate for such Plaintiffs to compromise their claims pursuant to a reasonable settlement. Other courts recognize the fact "that stockholder litigation is notably difficult and notoriously uncertain." *Lewis v. Newman*, 59 F.R.D. 525, 528 (S.D.N.Y.1973). The uncertainty engendered by the complexity of this case is exacerbated by the number of participants involved in the transactions. Over twenty persons or entities are now Defendants and approximately 50 depositions (including those of various experts) and well over 1,400 exhibits already form the record in this case, much of which will become trial evidence.

The likely duration and associated expenses of continued litigation likewise favor approval of the settlement. See *Warren v. City of Tampa*, 693 F.Supp. 1051, 1059 (M.D.Fla.1988) (finding that duration, complexity and expenditures on continued litigation of claims supports approval of a proposed settlement), *aff'd*, 893 F.2d 347 (11th Cir.1989). In addition to the thousands of hours worked by counsel since the case was filed, substantial additional work can be expected if this case goes to trial against all these Defendants. Although Plaintiffs will continue to pursue their claims against the non-settling Defendants, many additional hours would have been required to complete discovery, to prepare and respond to anticipated summary judgment motions, and to try the case against the settling Defendants. Settlement under these circumstances clearly is appropriate.

D. *The adequacy of the settlement amount viewed against the risks and expenses of continued litigation.* As discussed, the Court is of the opinion that the consideration obtained by the Plaintiffs under this settlement is adequate and is wholly within the "range of reasonableness" given the circumstances surrounding this case. The original bond offering was in the amount of $16,000,000. Plaintiffs previously have received distributions of approximately $7.3 million from the indenture trustee. The settlements will provide an additional amount of almost $3,000,000 plus some potential amount of interest, from the settling Defendants. While Plaintiffs obviously seek recovery of the total amount of unpaid bond principal and interest from all Defendants, plus attorneys' fees and costs, the compromise reached with respect to these settling Defendants is well ***427** within reason. The total amount recovered to date from all sources on behalf of the bondholders is approximately 63% of the principal amount of the bond issue. This is a partial settlement; there still remain a number of Defendants in the case, who either through settlement or a Plaintiffs' judgment at trial, may be required to provide further contributions to the bondholders.[FN5]

> FN5. The Court has been advised that settlement discussions with certain other defendants are ongoing, and that a settlement with defendants J.R. Randall and Heritage Living Centers has recently been agreed to by counsel for those defendants and for Plaintiffs.

Many courts have held that a settlement can be approved even where the benefits amount to a small percentage of recovery sought. See, e.g., *City of Detroit v. Grinnell Corp.*, 495 F.2d at 455 (finding that there is no reason, at least in theory, why a satisfactory settlement could not amount to a hundredth or even a thousandth part of a single percent of the potential recovery); *Zerkle v. Cleveland–Cliffs Iron Co.*, 52 F.R.D. 151, 159 (S.D.N.Y.1971) (in shareholder litigation, "the courts have displayed a healthy skepticism in the face of optimistic forecast or large demands").

Given the fact that over 60% of the principal amount

of the bond issue, if the settlement is approved, will have been returned to the bond purchasers, and the fact that there still remain in the case a number of Defendants who may potentially be required to pay further sums to the bond purchasers, and the defenses and attendant litigation risk inherent in going forward against the settling Defendants, it is quite clear that this settlement ought to be approved.

E. *The stage of the proceedings, including the factual record developed by the parties.* A final factor to be considered in approving the proposed class settlement is the extent of pre-trial discovery and the state of the factual record:

> In reviewing the record and evaluating the strength of the case, the trial court should consider the extent of discovery that has taken place ... The fact that all discovery has been completed and the case is ready for trial is important, since it ordinarily assures sufficient development of the facts to permit a reasonable judgment on the possible merits of the case.

Flinn v. F.M.C. Corp., 528 F.2d 1169, 1173 (4th Cir.1975), *cert. denied*, 424 U.S. 967, 96 S.Ct. 1462, 47 L.Ed.2d 734 (1976).

Plaintiffs and their counsel in this case took or participated in approximately 50 depositions with over 1400 exhibits marked, and reviewed well over 30 boxes of documents in addition to substantial other informal discovery. Armed with that information, Plaintiffs' counsel took their best bargaining position available to their negotiations. Based on this extensive litigation and discovery, counsels' recommendation of the settlement is well supported in the record.

VIEWS OF THE PUTATIVE CLASS MEMBERS

Apart from the foregoing factors, one other issue also supports approval of the proposed settlement.

ADEQUACY OF NOTICE

Rule 23(e), Fed.R.Civ.P., provides that notice of the proposed dismissal or compromise be given to all members of the Class in such manner as the Court directs. Rule 23(c)(2) provides for notice advising class members of the right to opt out and certain other related matters, including the binding effect of class judgments and the right to make individual appearances. Pursuant to those provisions and as the result of the preliminary hearing held March 1, 1990, this Court entered orders prescribing and approving the form of notice and directing the method of its mailing and publication. Subsequently, the Plaintiffs have filed affidavits of counsel and of a corporate trust officer of Plaintiff The South Carolina National Bank, as Trustee, regarding the method of mailing and publishing the notice.

The Court finds that the Mailed Notice was properly mailed in accordance with the Court's orders and that the Publication Notice was duly published in *The Wall Street* ***1428** *Journal* in accordance with such orders. The Court finds that the Mailed Notice and the Publication Notice constituted the best notice practicable under the circumstances and adequately fulfilled all legal requirements.

As stated by the Fourth Circuit, "[t]he attitude of members of the Class, as expressed directly or by failure to object, after notice, to the settlement, is a proper consideration for the trial court...." *Flinn v. FMC Corp.*, 528 F.2d at 1173. See also *In re Mid–Atlantic Toyota Antitrust Litigation*, 605 F.Supp. at 445 ("The almost complete absence of opposition to the settlements also supports a finding of adequacy in this case.")

In this case, approximately 2300 copies of the detailed notice of pendency of class action and proposed settlement were mailed to Class Members identified to the Court by the indenture Trustee. In addition, a summary notice was published on page B–7 in the nationwide issue of the *Wall Street Journal* on May 7, 1990. The class notice describes a procedure by which Class Members may object to the settlement in any of its conditions or terms and no Class Members appeared at the June 12th hearing to raise objections to the settlement. The deadline for filing a written objection to the settlement was May 25, 1990. It is quite significant that no Class Member filed by May 25, 1990, or has ever filed, a written objection to the settlement or any of its terms. Moreover, as of the date of the hearing, only 21 Class Members had requested exclusion from the Class.[FN6]

> FN6. A form of Exclusion Request had been included in the package mailed to putative class members, along with the lengthy Notice and the form of Memorandum of Settlement and a court-approved form of Verified Proof of Claim.

Further, with the permission of the Magistrate, Plaintiffs' counsel attempted to contact the persons who had requested exclusion and were able to contact prior to the hearing all but five of the persons who had filed the forms which requested exclusion from the Class. In each case, the person who had filed a request for exclusion from the Class

had either done so mistakenly or had not realized a loss on their particular transactions in the Skylyn Hall bonds and accordingly did not wish to be bound by any judgment since they would obtain no recovery. The lack of either objections or significant opt-outs adds further support to these settlements.

PROVISIONAL CERTIFICATION OF THE CLASS FOR SETTLEMENT PURPOSES

[4] As a condition of the proposed settlement, the Settling Defendants have provided that the Court enter an Order certifying the Class solely for settlement purposes. While the Court has not yet issued a final ruling on Plaintiffs' pending motion for class certification, it is clear that the Court may provisionally certify the Class for settlement purposes. As the Fifth Circuit has noted:

> A blanket rule prohibiting the use of temporary settlement classes may render it virtually impossible for the parties to compromise class issues and reach a proposed class settlement before a class certification. Such as firm restriction does not appear necessary or desirable. The hallmark of Rule 23 is the flexibility it affords to the courts to utilize the class device in a particular case to best serve the ends of justice for the effected parties and to promote judicial efficiencies.
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> * * * * * *
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> Temporary settlement classes have proved to be quite useful in resolving major class action disputes. While their use may still be controversial, most courts have recognized their utility and have authorized the parties to seek to compromise their differences including class action issues, through this means.

In re Beef Industry AntiTrust Litigation, 607 F.2d 167, 177–78 (5th Cir.1979) (quoting III *Newburg on Class Actions*, § 5570c, at 246), *cert. denied*, 452 U.S. 905, 101 S.Ct. 3029, 69 L.Ed.2d 405 (1981); *Mashburn v. National Healthcare, Inc.*, 684 F.Supp. 660, 665 n. 4 (M.D.Ala.1988).

On the record before it, the Court finds that, for purposes of the proposed settlement, class certification is appropriate. The Plaintiffs' claims against the Settling ***1429** Defendants are entitled to, and will, be certified as class claims under Rules 23(b)(1) and 23(b)(3).

BAR ORDER

Because the proposed settlement does not include certain Defendants, the Settling Defendants have imposed as a requirement of the settlement that the Court enter an Order barring cross-claims against the settling Defendants. Understandably, the Settling Defendants have no desire to pay money to the Plaintiffs to settle their claims only to be brought back into the case to defend themselves on contribution or other cross-claims asserted by the non-settling Defendants.

Contribution Bar Order Under Federal Law

The Settling Defendants have demanded as a condition to the settlement that an Order be entered barring any and all claims against them by the non-settling Defendants. The settling parties urge, as the *Nucorp* court noted that if such a contribution bar order is not entered,

> then partial settlement of any federal securities question before trial is, as a practical matter, impossible. Any single Defendant who refuses to settle, for whatever reason, forces all others to trial. Anyone foolish enough to settle without barring contribution is courting disaster. They are allowing the total damages from which their ultimate share will be derived to be determined in a trial where they are not even represented.

In re Nucorp Energy Securities Litigation, 661 F.Supp. 1403, 1408 (S.D.Cal.1987), cited with approval in *Franklin v. Kapro Corp.*, 884 F.2d 1222, 1229 (9th Cir.1989).

Defendants C. Donald Stone, and Unico Development Corp. (the "Stone Group Defendants") have objected to the entry of a contribution bar order on two grounds: (1) that such a contribution bar order would bar their Seventh Amendment right to a jury trial determining their proportionate share of any liability to the Plaintiffs, and (2) said Defendants argue that some of the claims which they wish to assert are not claims for contribution or indemnification, but are independent causes of action. Non-settling Defendant May Zima & Co. and its former partners and accountants who are defendants ("May Zima") have not objected to the settlement and have advised the Court that they would not object to a contribution bar order, provided that such an order limits the non-settling Defendants' liabilities pursuant to a "proportional" rule whereby the non-settling Defendants at trial are required to pay only their share of damages to the Plaintiffs as determined by a method similar to comparable fault.

[5] A. *Overview of indemnification and contribution*

in securities law actions. Indemnification and contributions are separate concepts and have been summarized as follows:

> [contribution and indemnification] should be carefully distinguished. Contribution involves distributing losses among tortfeasors by requiring each to pay his proportionate share. Indemnity entails shifting the entire loss from one tort feasor who has been compelled to pay it to another who, for equitable reasons should bear it instead. In essence, contribution results in a sharing of the burden, whereas indemnity results in shifting it.

Ruder, *Multiple Defendants in Securities Law Fraud Cases: Aiding and Abetting, Conspiracy, in Pari Delicto, Indemnification and Contribution,* 120 U.Pa.L.Rev. 597, 647 (1972).

It is well settled that as a matter of public policy one tortfeasor may not seek indemnification from another under Rule 10b–5. As stated by the Fifth Circuit:

> [I]t may be noted that indemnification tends to frustrate the policy of securities legislation. "A securities wrongdoer should not be permitted to escape loss by shifting his entire responsibility to another party." The 1933 and 1934 Securities Acts "do not provide anywhere for indemnification under any circumstances."

Stowell v. Ted S. Finkel Investment Services, 641 F.2d 323, 325 (5th Cir.1981), quoting *Heizer Corp. v. Ross,* 601 F.2d 330, 334–35 (7th Cir.1979). See also, e.g., ***1430***In re Atlantic Financial Management, Inc. Securities Litigation,* 718 F.Supp. 1012, 1015 (D.Mass.1988); *In re Olympia Brewing Co. Securities Litigation,* 674 F.Supp. 597, 612–13 (N.D.Ill.1987); *Goldberg v. Touche Ross & Co.,* 531 F.Supp. 86, 88 (S.D.N.Y.1982); *Eacho v. N.D. Resources, Inc.,* [1984–85 Transfer Binder] CCH Fed.Sec.L.Rep. (CCH) ¶ 92,067, at 91,329, 1985 WL 1717 (D.D.C.1985).

Similarly, there is no right to indemnification at common law:

> Indemnity is similarly unavailable to the third-party plaintiffs on the common law claims. Indemnity is an equitable remedy that assigns responsibility to the true wrongdoer, that is, where the third-party plaintiff is liable to the plaintiff in the main action only vicariously. Evidence that the third-party plaintiff itself is at fault would bar indemnification. The [plaintiffs] here charge the broker-dealers with fraud, breach of contract, and breach of fiduciary duty independently of any purported misconduct on the part of the third-party defendants. Therefore, indemnity would be inappropriate.

In re Baldwin–United Corp. Securities Litigation, [1986–87 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶ 92,951, at 94,651, 1986 WL 358 (S.D.N.Y.1986). See also, e.g., *Stratton Group, Ltd. v. Sprayregen,* 466 F.Supp. 1180, 1185 n. 4 (S.D.N.Y.1979). Accordingly, the Stone Group Defendants, and for that matter all the remaining non-settling Defendants, have no viable claim for indemnification in this case.

The question of whether claims for contribution might be available to the non-settling Defendants in this case is more complex, at least as to the Rule 10b–5 claims. Because a right of action under section 10(b) of the Securities Act of 1934 and Rule 10b–5 promulgated thereunder is implied rather than written expressly into the statute, there is no express statutory right of contribution. While the majority of federal courts have found an implied right to contribution under Rule 10b–5, *see* 5C A. Jacobs, *Litigation and Practice Under Rule 10b–5,* § 264.02[c] at 11,441 and cases cited therein, other courts have reached a contrary conclusion. See *First Fin. Savings Bank v. American Ins. Co. of Florida,* [1989–90 Transfer Binder] Fed.Sec.L.Rep. ¶ 94,824 at 1, 1989 WL 168015 (E.D.N.C.1989); *In re Professional Fin. Mgmt., Ltd.,* 683 F.Supp. 1283 (D.Minn.1988). Cf. *Baker, Watts & Co. v. Miles & Stockbridge,* 876 F.2d 1101 (4th Cir.1989) (Contributions not available under § 12(2) of the Securities Act of 1933). This Court does not need to decide that issue today, based upon the terms of the settlements approved hereby and the Court's rulings hereafter.

The same is not true, however, as to the state common law claims. South Carolina common law provides that there is no right of contribution among tortfeasors. *Knight v. Autumn Co.,* 271 S.C. 112, 245 S.E.2d 602, 603–04 (1978); *M & T Chemicals, Inc. v. Barker Industries, Inc.,* 296 S.C. 103, 370 S.E.2d 886, 887 (Ct.App.1988); *Horton v. U.S.,* 622 F.2d 80 (4th Cir.1980). Also, South Carolina in 1988 adopted the Uniform Contribution Among Tortfeasors Act. South Carolina Code §§ 15–38–10, *et seq.*[FN7] The Act created a right of contribution and provided that a Settling Defendant is insulated from later contribution claims by co-tortfeasors if he obtains a good faith release or covenant not to sue from the Plaintiff. South Carolina Code § 15–38–10. Thus, under either the common law

rule, or the more recent provisions of the contribution among joint tortfeasors act, the Stone Group Defendants' state law contribution claims are unavailable.

> FN7. The effective date of that Act is later than the filing date of this action. Another judge of this District has construed the effective date provisions to preclude retroactive applicability of that Act in situations (as in this case) where the alleged liability-creating events occurred prior to the enactment but where the judgment against the Defendants in favor of the Plaintiffs (for which Defendants would then seek contribution) occurred after the enactment date. *See Lightner v. Duke Power*, 719 F.Supp. 1310 (D.S.C.1989) (Henderson, J.).

[6] B. *The propriety of a bar order in this case.* Federal courts have long recognized a strong public policy supporting settlement of class actions. *Franklin v. Kapro Corp.*, 884 F.2d 1222, 1229 (9th Cir.1989). Accordingly, federal courts have virtually without exception approved orders barring claims by non-settling Defendants against settling Defendants in ***1431** connection with both federal and state securities law claims. See, e.g., *Franklin v. Kaypro Corp.*, 884 F.2d 1222, 1226–27 (9th Cir.1989); *In re Washington Public Power Supply Sec. Litig.*, 720 F.Supp. 1379, 1399 (D.Ariz.1989); *In re Washington Public Power Supply Sec. Litig.*, [1988 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶ 94,326, 1988 WL 158947 (W.D.Wash.1988); *Langford v. Fox*, 1988 WL 70351 (S.D.N.Y.1988) (LEXIS 10650); *In re Sunrise Sec. Litig.*, 698 F.Supp. 1256, 1257 (E.D.Pa.1988); *In re Atlantic Fin. Mgmt. Sec. Litig.*, 718 F.Supp. 1012, 1015 (D.Mass.1988); *Kirkorian v. Borelli*, 695 F.Supp. 446, 452–54 (N.D.Cal.1988); *First Federal Savings & Loan v. Oppenheim, Appel, Dixon & Co.*, 631 F.Supp. 1029, 1036 (S.D.N.Y.1986); *In re Nucorp Sec. Litig.*, 661 F.Supp. 1403, 1408 (S.D.Cal.1987); *Nelson v. Bennett*, 662 F.Supp. 1324, 1334–39 (E.D.Cal.1987); *In re United Energy Sec. Litig.*, [1989 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶ 94,376, at 92,463–64, 1989 WL 73211 (C.D.Cal.1989); *Corrugated Container Antitrust Litig.*, 84 F.R.D. 40, 41–42 (S.D.Tex.1979); *Employers Ins. of Wausau v. Musick, Peeler & Garrett*, [Current Binder] CCH Fed.Sec.L.Rep. ¶ 95,208, 1990 WL 74371 (S.D.Cal.1990); *accord*, *Alvarado Partners LP v. Mehta*, 723 F.Supp. 540 [1989–1990 Transfer Binder] CCH Fed.Sec.L.Rep. ¶ 94,737 (D.Colo.1989); *In re Terra–Drill Partnership Securities Litigation*, 726 F.Supp. 655 (S.D.Tex.1989). In this context, courts recognized the propriety of orders barring non-settling Defendants' claims as a means of encouraging settlements involving fewer than all Defendants:

> Allowing contribution rights to be extinguished prior to trial will encourage settlement since a defendant may be confident that his pre-trial settlement has conclusively terminated his involvement in the litigation.

In re Nucorp Securities Litigation, 661 F.Supp. 1403, 1408 (S.D.Cal.1987). As stated by another district court:

> The reason to adopt settlement bar rules is that they further both strong federal policies of encouraging settlement, by insulating the settling defendant from further indeterminate liability, and the spreading liability for violations of securities law among violators.

In re Atlantic Financial Management Securities Litigation, 718 F.Supp. 1012, 1016 (D.Mass.1988), citing *Donovan v. Robbins*, 752 F.2d 1170, 1177 (7th Cir.1985). This Court agrees with the vast majority of other federal courts that have addressed the issue and agrees that it is within its discretion to impose an Order barring cross-claims against the settling Defendants by the non-settling Defendants.

C. *Objections of the non-settling Defendants.* Between them, the Stone Defendants and May Zima have raised three objections to the proposed Order barring contributions: (1) that a contribution bar would violate the Seventh Amendment right of the non-settling Defendants to have their proportionate share of any liability to the Plaintiffs determined by a jury; (2) that an Order barring cross-claims cannot bar independent causes of action; and (3) an objection to the contribution bar order that determines the extent of the non-settling Defendants' liabilities by any method other than a proportionate share determined on a compared default basis.

1. *The appropriate method of determining the extent of liabilities remaining by the non-settling Defendants after the settlement.* May Zima & Co. has advised the Court that it has no objection to entry of a contribution bar order so long as the order includes the so called proportionate rule. While federal courts have consistently supported bar orders in the context of partial settlements, the courts are divided on the amount of credit or reduction or offset to be given to the non-settling Defendants when damages are assessed at trial. Some courts, adopting what has been termed the "pro tanto" rule, require any judgment against the non-settling Defendant be reduced dollar for dollar by

the amount paid in settlement. See, e.g., *In re Atlantic Financial Management, Inc. Securities Litigation*, 718 F.Supp. 1012, 1016 (D.Mass.1988); *First Federal Savings & Loan v. Oppenheim, Appel, Dixon & Co.*, 631 F.Supp. 1029, 1035–36 (S.D.N.Y.1986). Another possible method, discussed especially in earlier cases, is the "pro rata" ***1432** rule, where liability is divided into equal "slices of the pie" represented by the aggregate judgment amount, one slice being allocated to each defendant (or group of related defendants). Other courts have adopted the "proportionate" rule urged here by May Zima & Co. and require the trier of fact to determine a total amount of damages owed to the Plaintiffs by all culpable parties and then to allocate relative culpability to all Defendants, including both those who did and did not settle the case. See, e.g., *Franklin v. Kaypro Corp.*, 884 F.2d 1222, 1229–32 (9th Cir.1989); *In re Sunrise Securities Litigation*, 698 F.Supp. 1256, 1261 (E.D.Pa.1988). Neither the Fourth Circuit nor this Court has addressed these issues (and if the Fourth Circuit or this Court were ultimately to hold that there is no right of contribution available here, these issues would not need to be addressed).

In recognition of the fact that the type of bar order appropriate to the settlement is an open question, the settling parties have provided that

> The amount of any judgment obtained by Plaintiffs against non-settling defendants shall be reduced by the amount, if any, for which the settling defendants would, in the absence of this bar order, be liable to the non-settling defendants by way of claims for contributions, indemnity, or otherwise, whether in this action or other actions relating to the bonds.

Memorandum of Settlement, Paragraph (V). The settlement further provides that the amount of the offset is to be determined "in accordance with principles of law and equity and procedure" applicable at the time the offset is determined; it does not purport to dictate the amount of credit or offset to which the non-settling Defendants might be entitled or which the Court must order.[FN8] Thus, the proposed bar order leaves open the judgment reduction or settlement-credit-amount issue to assure that non-settling Defendants obtain appropriate credit when, if ever, the issuer requires resolution.[FN9]

> FN8. Thus this case is to be distinguished from *Alvarado Partners*, cited *supra*, where the district court, although approving the principle of a uniform national federal bar order rule, had been presented with a settlement mandating by its terms a pro tanto approach, with which the court disagreed after an analysis. The court there implied that if the parties went back and rewrote the agreement (which it could not rewrite for them, see *Manual For Complex Litigation (Second)*, § 23.14, text at notes 15–16) to adopt a "proportional" rule, the court would be able to approve the settlement and bar order.
>
> FN9. In the event all the remaining non-settling Defendants reach settlements with Plaintiffs, the issue would not require a decision by this Court.

The relevant provisions of the foregoing paragraphs specify that any non-settling Defendant shall be entitled to a reduction in any judgment against it by the amount for which Settling Defendants would otherwise be liable to the non-settling Defendants. The judgment reduction mechanism is designed to insure that non-settling Defendants would pay no more than they would have "in the absence of the bar order," i.e., if non-settling Defendants had been free to pursue whatever claims they may have against the settling Defendants. Thus, the clear intent of the bar order is that non-settling Defendants' ultimate liability will not be greater than it would be absent the bar order.

[7] The Court is of the opinion that it is not necessary at this stage of the proceedings to determine whether to adopt a "pro rata" or a proportionate rule by which to determine how much reduction in judgment should be given to the non-settling Defendants if the Plaintiffs should obtain a verdict against them. The Court's order will adopt the language of the memorandum of settlement which defers consideration of that particular issue. The Court finds that it may enter the Bar Order requested, as a final judgment of the issues concluded thereby, under Rule 54(b), while still reserving for determination at the time of trial such other issues as the method and amount of credit to be afforded non-settling defendants in respect of these settlements and the releases of these alleged joint tortfeasors.

2. *Independent rights of action v. claims for contribution.* The Stone Defendants seek to assert cross-claims ***1433** against certain of the Settling Defendants for breach of contract, negligence, and fraud. The Stone Defendants contend that these claims are in the nature of independent rights of action rather than contribution and that such independent causes of action cannot be barred. The Stone Defendants also assert that, as to these claims, they are entitled to a jury trial.

Citing *Greene v. Emersons, Ltd.*, [1983–84 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶ 99,582, at 97,271, 1983 WL 1395 (S.D.N.Y.1983), the Settling Defendants persuasively argue that a rose by any other name is still a rose and that regardless of the title given to the claims the Stone Defendants seek to assert, the Stone Defendants' alleged damages arise only if the Stone Defendants were found liable to the Plaintiffs, and that, accordingly these purported causes of action are nothing more than claims for contribution or indemnification with a slight change in wording.

[8] As to the argument that the Stone Defendants are entitled to a jury trial on their cross-claims are construed as claims for indemnification or contribution, there can be no jury trial right. Claims for contribution are equitable in nature and therefore not triable to a jury. "Contribution is a remedy that developed in equity, and there is a considerable body of case law dealing with the equity rules governing it." Restatement (Second) of Torts § 886A, c (1979). *See also Pacific Indemnity Co. v. Linn*, 766 F.2d 754, 769 (3d Cir.1985); *Nelson v. Bennett*, 662 F.Supp. 1324, 1327 (E.D.Cal.1987). Common law courts did not recognize a right of contribution among joint tortfeasors. *Horton v. U.S.*, 622 F.2d 80 (4th Cir.1980); *Zapico v. Bucyrus–Erie Co.*, 579 F.2d 714, 718 (2d Cir.1978), and there is no "federal common law" right to contribution. *Northwest Airlines, Inc. v. Transport Workers Union*, 451 U.S. 77, 96–97, 101 S.Ct. 1571, 1583–84, 67 L.Ed.2d 750 (1981). As an equitable remedy, claims for contribution entail no right to a jury trial. *See Jones v. Shramm*, 436 F.2d 899, 901 (D.C.Cir.1970). Moreover, as the Court has previously noted, claims for indemnification as between co-tortfeasors are not cognizable under Rule 10b–5 or common law; the issue of a right to jury trial or such claims is therefore irrelevant.

As a final matter, even if the Court determines that the Stone Defendants are entitled to jury trial on their cross-claims, the proposed bar order does not abrogate that right. Thus, the bar order provides that the amount of this reduction be determined by the Court "in accordance with principles of law, and equity and procedures then applicable." The settlement memorandum does not specify that the amount of the reduction is determinable solely by the Court, as opposed to a jury. The proposed bar order itself, directing the Court to applicable principles of law, equity and procedures, does not foreclose the use of a jury if the Court determines that cross-claims are properly triable to a jury.

REIMBURSEMENT OF ATTORNEY FEES AND COSTS OF LITIGATION

[9] The Mailed Notice advised Class Members as follows:

> "Class Counsel for the plaintiff Class listed herein have advised the Court and the Settling Defendants that they have to date been compensated on an hourly basis and have been reimbursed litigation expenses out of (i) funds set aside by SCNB in 1988 pursuant to requisite majority approvals of bondholders, which have recently been exhausted, and (ii) additional funds advanced by SCNB. The Plaintiffs expect to file a joint application for reimbursement out of the Settlement Fund, before division into Funds A and B, of their out-of-pocket litigation expenses actually incurred to the date of the Final Hearing that have not been defrayed out of said 1988 set-aside funds, and for restoration to the litigation account that was set up in 1988 in the hands of SCNB a sum of $200,000 to defray costs and fees anticipated to be incurred hereafter in this action in preparation for trial against the non-settling defendants. The Plaintiffs may also apply to the Court for an order approving those fees and disbursements which have already been paid out of said 1988 set-***1434** aside funds or otherwise advanced, and have advised the Court that Class Counsel will not separately apply for any contingency fees payable out of the Settlement Fund since they have previously agreed that they will be compensated on an hourly basis."

No putative class member filed any objection to the above quoted proposal nor appeared at the June 12th hearing and voiced any objection.

Pursuant to the above notice, Plaintiffs and their counsel did file with the Court in advance of the hearing their motion for approval of fees and expenses and for setting aside of such further fund to defray litigation expenses and fees, supported by the detailed billings (including detailed time and services listings) of Plaintiffs' counsel and an accounting of fees and expenses.

Defendants C.D. Stone and others represented by his counsel lodged an objection to such application based upon a stated concern that the class members should not be paying for SCNB's cost of defending against Stone's and other defendants' counterclaims for alleged breaches or wrongs of SCNB. While the Court questions whether such defendants themselves have standing to object to such matters, this Court is the guardian of the rights of absent

class members and the Court accordingly made inquiry of Plaintiffs' counsel and of counsel for SCNB on that subject of paying for costs of defending counterclaims.

At the June 12, 1990 hearing the Court was advised by counsel, that all duties as to researching, moving to dismiss, answering, and otherwise defending against the counterclaims of Stone and other defendants had been entrusted to and conducted by Mr. William Pope and that Mr. Pope was retained by and separately paid by The South Carolina National Bank in its corporate or commercial capacity and not by the bond issue trust funds or by the corporate trust section of SCNB administering this bond issue, and that none of his fees were chargeable against bondholder funds, and that no reimbursement for his fees was being sought. Based upon such representations the Court determined that the application was not objectionable on the grounds asserted. While there was theoretically some overlap in services where Mr. Pope had attended some depositions and hearings (sometimes while Plaintiffs' counsel was also in attendance), or that Mr. Pope may have participated in ministerial acts relating to transmittal of documents or pleadings, such participation (which was not shown to be extensive) is a natural outgrowth of the situation engendered by the defendants' pleadings and was not such as to abuse any rights of class members, and accordingly the Court sees no need to require any allocation of costs on that account.

In connection with the class certification motions filed by Plaintiffs in April, 1989 and the Plaintiffs' responses filed in June, 1988 to certain defense motions, affidavits were filed with the Court listing the resumes, education, training, experience and expertise in the areas of bond law practice, securities law, and class action practice, on the part of Plaintiffs' counsel. Additionally, this Court has before it a record spanning more than two years of self-evident hard, competent work by Plaintiffs' counsel in the face of skilled and resourceful opposition of more than a dozen highly regarded firms of defense counsel. The Court is satisfied from the record that Plaintiffs' counsel have demonstrated the requisite skill, expertise and diligence to support the Plaintiffs' application for fees and expense reimbursements.

The Court was advised at the hearing that at the outset of the litigation, Plaintiffs' counsel offered to handle the case either on a contingency fee basis or on an hourly basis and that the Plaintiffs, on behalf of the class, determined that it would likely be more cost-advantageous to the class, in the event of a seven-figure recovery or more, to pay counsel on an hourly basis than on a contingency percentage basis. Thereupon, Plaintiffs' counsel agreed to handle the case on an hourly basis, as is reflected in the fee and reimbursement application papers filed with this court. The Court is also advised that deposition exhibits identified in this case include copies of the indenture trustee's notices to bondholders back in 1988 which, ***1435** among other things, advised the bondholders of the fee arrangement with counsel and of the setting aside of a litigation fund from trusteed funds held for the benefit of bondholders, and that the records of the trustee produced for inspection by defendants include the originals of the bondholders' ballots by which they authorized, by a substantial majority, the setting aside of such litigation funds by the trustee.

There is no issue here that Plaintiffs' counsel are not entitled to a fee nor that such fees may not be borne, or reimbursed, out of a common fund created by the attorneys' efforts, which in this instance approaches $3 million in size.

The Court determines that the Plaintiffs' application for reimbursement of fees and expenses, and for setting aside of the requested $200,000 fund, is fair, reasonable and adequate and should be approved.

FINAL JUDGMENT AND ORDER

This matter having come on for hearing before this Court on June 12, 1990 on the matters set forth in the Mailed Notice, the Publication Notice, the accompanying Memorandum Opinion, and the orders and judgments set forth below, and the Court having examined the record and having been duly advised, it is, for the reasons stated in the Memorandum Opinion filed contemporaneously herewith, hereby FOUND, ORDERED, ADJUDGED AND DECREED as follows:

1. The several pro tanto Settlement Stipulations and agreements filed with this Court between Plaintiffs, on behalf of themselves and all class members, and the settling defendants listed hereafter, are hereby found to be fair, reasonable, and adequate and are hereby APPROVED, as relating to settling defendants Wyche, Burgess, Freeman & Parham, P.A. and Eric B. Amstutz, Parker & Kotouc and Thomas O. Kotouc, Whiteside, Smith, Jones & Duncan and Horace C. Smith, John T.C. Low, Tommy E. Furby, and Low & Furby, Harold Fleming, M.D., J.W. Wakefield, C. Benjamin Smith and Ann Smith and Benan, Inc., Tom Sizemore, and John J. Bandy, Sr. (hereafter, together with their respective partners, princi-

pals, members, stockholders, employees, agents, heirs, executors, successors and assigns, collectively referred to as the "Settling Defendants").

2. The notice of the pendency of this action and of the settlement of this action pursuant to the terms of the above mentioned Settlement Stipulations heretofore given by mail and by publication to members of the class is hereby found to be the best notice practicable under the circumstances, and is hereby found to meet all the requirements of due process and of Rule 23, Fed.R.Civ.P.

3. (a) *Plaintiffs' Release of Settling Defendants.* Without any further action by anyone, each of the Plaintiffs and each member of the Plaintiff Class defined in this Final Judgment shall be deemed to have released each of the Settling Defendants as above defined, and each of such Settling Defendant's insurers and attorneys, of and from all complaints and claims of such Plaintiffs and members of the Plaintiff class, known or unknown, arising out of any issuance, purchase or sale of the Skylyn Hall bonds which are the subject of this case (the "Bonds") or arising out of or related to any of the matters or transactions alleged in, or which could have been raised in, this action, or arising out of or related to the conduct of this action or its settlement or arising under any factual setting or theory of law relating to the Bonds, whether it be pursuant to securities law, trust law, contract law or tort law, or otherwise, that either have been or might have been or are now asserted or could have been asserted in this action, or that relate to or arise out of the actions and events alleged in the Complaint on file in this case.

(b) *Settling Defendants' Release of Plaintiffs and Members of the Class.* Without any further action by anyone, each of the Settling Defendants, as defined herein, shall be deemed to have released each Plaintiff and each member of the Plaintiff class, and their respective officers, directors, partners, employees and attorneys, past and present, from all counterclaims (permissive or compulsory), known or unknown, arising out of any issuance, purchase or sale of the Skylyn Hall bonds which are the subject of this case or arising ***1436** out of or related to any of the matters or transactions alleged in, or which could have been raised in, this action, or arising out of or related to the conduct of this action or its settlement.

(c) *Settling Defendants' Release of Defendants.* Without any further action by anyone, each of the Settling Defendants, as defined herein, shall be deemed to have released each other Settling Defendant, as defined herein, and all attorneys for and insurers of any Settling Defendant, and (in consideration of the provisions of the Settlement Stipulations therefor and of the Bar Order contained in this Final Judgment), each other Defendant herein and their respective officers, directors, partners, employees and attorneys, past and present, from all claims, cross-claims, third party claims, counterclaims (permissive or compulsory), known or unknown, arising out of any issuance, purchase or sale of the Skylyn Hall bonds which are the subject of this case or arising out of or related to any of the matters or transactions alleged in, or which could have been raised in, this action, or arising out of or related to the conduct of this action or its settlement, including without limitation claims for contribution or indemnity or any form of recoupment, reimbursement, liability or recovery under any provision of federal or state law in respect of any judgment, settlement or recovery or in respect of any fees and expenses incurred by any defendant(s), for claims asserted or which may in the future be asserted in this action or in any other action relating to the Bonds. (The Settling Defendants may agree among themselves as to further assurances and/or documentation with regard to the aforesaid mutual release, as between and among said defendants, but the Plaintiffs and class members shall have no responsibility to see to the effectuation of any mutual releases, nor shall the failure of any such delivery of releases be a condition to effectuation of the settlement or the finality of this order and judgment.)

(d) *Release is Pro Tanto.* Nothing herein shall be construed as a dismissal of, adjudication of, or release of any claims of Plaintiffs and Class Members against any persons not among the Settling Defendants, as defined above, or of any claims of any defendant who is not a Settling Defendant, except as may be enjoined and concluded by the Bar Order provisions of this Final Judgment.

(e) *Dismissal with Prejudice and Bar as to suing on released claims.* All claims which are released by this Final Judgment as set forth in this paragraph 3 above, and all claims barred by the provisions of the Bar Order contained in paragraph 6 below, are hereby DISMISSED with prejudice to refiling, and all parties to this action and all members of the plaintiff class are hereby barred and enjoined from instituting and maintaining in this and any other jurisdiction any action based on the claims dismissed and released herein.

4. Pursuant to Rule 23(c)(3) of the Federal Rules of Civil Procedure, this Court finds and determines that the members of the Plaintiff Class who are bound by this Final

749 F.Supp. 1419, Fed. Sec. L. Rep. P 95,453
(Cite as: 749 F.Supp. 1419)

Judgment are:

(i) all persons (including entities) who purchased, or entered into and performed their part of a contract to purchase, any of the Bonds at any time from the date of the Preliminary Official Statement (April 15, 1985) up to the date of SCNB's January 12, 1988 Notice as Trustee of the results of the foreclosure sale of the Project and other matters (said time span from April 15, 1985 through January 12, 1988 being defined as the Class Period), and who still hold such Bonds or any of such Bonds; (ii) all persons (including entities) who purchased any of the Bonds during the Class Period and who have resold at a loss any of the same prior to the date of final judgment in this action; (iii) all persons (including entities) who are now holders of the Bonds but who did not purchase during the Class Period; and (iv) all persons who are, at any time up to entry of final judgment herein, successors in interest to persons described in (i), (ii) and (iii) above and thus now the holders of such prior holders' Bonds, including transferees by operation of law or by inheritance, bequest, transfer in trust or gift. Claims are deemed made under Rule 23(b)(1) with respect to all persons who are in categories***1437** (i) and (iii) above and those persons in category (iv) who are successors in interest to persons in categories (i) and (ii). Claims are deemed asserted under Rule 23(b)(3) with respect to all persons who are in categories (i) and (ii) above and those persons in category (iv) who are successors in interest to persons in categories (i) and (ii). *Excluded from* the Class are (a) all Defendants (including all Settling Defendants as defined herein) and all persons who aided and abetted any Defendant with notice or knowledge of such Defendant's wrongful actions or omissions to act, and all persons who controlled or presently control a Defendant or were under common control of or with a Defendant within the meaning of 15 U.S.C. § 78*o* or otherwise; (b) all persons who acted or participated as underwriters, salesmen, brokers or dealers in connection with the offer or sale or distribution or resale or marketing of the Bonds, and all persons who controlled or presently control any such underwriter, salesman, broker or dealer within the meaning of the 1934 Act or otherwise; (c) all persons who received any fees, compensation, moneys, kickbacks or other payments directly or indirectly out of, or referable to, the proceeds of the Bond issue, earnings thereon, or receipts or revenues of the Project, which payments were not disclosed in or expressly provided for in the Official Statement dated May 28, 1985 or the Bond issue disclosure documents; (d) any officers, directors, principals, employees, partners or agents of Defendants May Zima, Arthur Young & Co., CPA's, Low Firm, Parker Firm, Buchanan & Co., Inc. or Whiteside Firm or Wyche Firm; and (e) transferees of any such Excluded Persons who acquired or took any Bonds without paying full and adequate consideration (free of agreements to re-purchase or reimburse) or with notice or knowledge of, or participation in, the conduct of an Excluded Person.

Also excluded from the Plaintiff Class are those persons who have timely filed an Exclusion (opt-out) Request which has not been revoked or rescinded. The Court reserves the right, by separate order, to admit (or readmit) any Class Members that come within the above definition and who filed an exclusion request or opt-out request and who notify or have notified the Court they wish to rescind such opt-out request.

Pursuant to the Mailed Notice which advised Class Members of the proposed Plan of Allocation of Settlement Funds, and the absence of any objection by any Class Member thereto, and based upon the record in this action, the Court finds as fair, reasonable and adequate, and will establish and does hereby order the establishment of, only for purpose of distribution of the Settlement Funds, two sub-funds, Fund A (consisting of 90% of the net proceeds of the entire Settlement Funds remaining after deduction of any court-approved expenses or fees), and Fund B (consisting of 10% of the net proceeds of the entire Settlement Funds remaining after deduction of any court-approved expenses or fees), and three subclasses of Class Members, and allocations therefrom shall be made as follows:

Subclass One: Class members who purchased or acquired their Bonds during the Class Period as above defined and who still hold such Bonds are in this subclass. Such Subclass One members shall share in the both Fund A and Fund B of the Settlement Fund based upon the difference between their cost basis in their Bonds (as determined from the Proof of Claim and other materials obtained or submitted) and any amounts they have previously been distributed by The South Carolina National Bank as Trustee (“SCNB”) since January 1, 1988 with respect to such Bonds. No one who does not have a loss, or who has already recovered an amount equal to or exceeding his, her or its cost basis in such Bonds, shall be entitled to receive any further distribution from the Settlement Fund.

Subclass Two: Class Members who purchased or acquired their Bonds during the Class Period as above defined and who have, prior to the date of distribution, sold

such Bonds are in this subclass. Such Subclass Two members shall share solely in Fund A of the Settlement Fund based upon ***1438** the difference between their cost basis in their Bonds (as determined from the Proof of Claim and other materials obtained or submitted) and the sum of (i) any amounts they have previously been distributed by SCNB with respect to such Bonds after January 1, 1988 plus (ii) the gross proceeds of sale of their Bonds (again, as determined from the Proof of Claim and other materials obtained or submitted). No one who does not have a loss, or who has already recovered an amount equal to or exceeding his, her or its cost basis in such Bonds, shall be entitled to receive any further distribution from the Settlement Fund once such cost basis has been recovered.

Subclass Three: Any Class Member not falling into either Subclass One or Two. Such Subclass Three members shall share solely in Fund B of the Settlement Fund based upon the difference between their cost basis in their Bonds (as determined from the Proof of Claim and other materials obtained or submitted) and the sum of any amounts they have previously been distributed by SCNB with respect to such Bonds after January 1, 1988. No one who does not have a loss, or who has already recovered an amount equal to or exceeding his, her or its cost basis in such Bonds, shall be entitled to receive any further distribution from the Settlement Fund once such cost basis has been recovered. Any sums in Fund B not needed to compensate Class members in Subclass Three shall be reallocated to and added to Fund A.

5. *Settlement Bar Order.* There are hereby barred and extinguished, and all non-settling Defendants in or to this action, as more particularly defined below (and any heirs, executors, representatives, successors and assigns of any non-settling defendant), are hereby permanently barred and enjoined from instituting, filing, maintaining, prosecuting or continuing to prosecute, either directly, indirectly, representatively, or in any other means or capacity, any and all existing and future claims against, and liability of, every Settling Defendant by and to any non-settling Defendant (including within said term as used herein Defendants C.D. Stone, James A. Stone, UNICO Development Services, Inc., United Medical Surgical & Supply Corp., JoAnne J. Randall, James R. Randall, Heritage Living Centers, Kenny O. Merritt, Robert M. Buchanan, Buchanan & Co., Inc., May Zima & Co. and its former partners and employees named in the First Amended Complaint and not heretofore dismissed, and Retirement Horizons, Inc.) now or hereafter named in this action or any other action relating to the Bonds, and by and to any successor, assign, heir, predecessor, representative, principal, employee, insurer, or subrogee of any such non-settling Defendant, for contribution or indemnity or any form of recoupment, reimbursement, liability or recovery under any provision of federal or state law in respect of any judgment, settlement or recovery obtained by Plaintiffs or the Class or any subclass thereof from any or all of the non-settling Defendants, or in respect of any fees and expenses incurred by such non-settling Defendant(s), for claims asserted or which may in the future be asserted in this action or in any other action relating to the Bonds. This injunction and bar applies to any form of such action or attempted action, including without limitation any claim by way of third-party or subsequent-party complaint, cross-claim, separate action, or otherwise. There is also barred and extinguished, as to Settling Defendants, any liability, claim or action, relating to the Bonds, based upon a non-settling Defendant's alleged purchase or ownership of any Bonds, or a non-settling Defendant's alleged status as a client of a Settling Defendant or as a person to whom such Settling Defendant owed a legal duty which allegedly was breached by any Settling Defendant. Any and all claims by the Settling Defendants against such non-settling parties shall be and are reciprocally barred, extinguished and enjoined with respect to the Settlement Consideration provided for in the Settlement Stipulations and the costs and expenses of this litigation, to the same extent that claims of such non-settling parties are barred against the Settling Defendants. The amount of any judgment obtained by Plaintiffs against non-settling defendants shall be reduced by the amount, if any, for which the Settling Defendants would, in the absence of this ***1439** Bar Order and Final Judgment, be liable to the non-settling Defendants by way of claims for contribution, indemnity, or otherwise, whether in this action or in any other actions relating to the Bonds. The amount of such reduction or credit, if any, to which any non-settling Defendant shall or may be entitled shall be determined by this Court (or such other court where such claims are pending) in accordance with principles of law and equity and procedures then applicable, the Court having decided that it is not necessary for the purposes of, or the finality of, or the effectiveness of, this Bar Order that such reduction or credit determination (or the procedures and methods of making such reduction or credit determination, including right to jury trial issues) be adjudicated at this time.

6. The applications of Plaintiffs and their counsel for approval and reimbursement of fees and expenses and for setting aside, in the custody of SCNB, of a further litigation fund of $200,000 out of the aggregate Settlement Consideration on hand in the registry of this Court are hereby

APPROVED as fair, reasonable and adequate, and the Clerk is ordered and directed to take the necessary and appropriate steps to carry out the payment of such amounts applied for.

7. This Court expressly finds and determines that there is no just reason for delay in the entry of this Order as a Final Judgment approving said Settlement Stipulations pursuant to paragraph 1 above, dismissing with prejudice and releasing claims, on a pro tanto basis, as specified in paragraph 3 above, barring certain claims by non-settling Defendants and by Settling Defendants as provided in paragraph 6 above, determining a final Class and certain subclasses for fund allocation purposes with respect to claims against the Settling Defendants as provided in paragraph 5 above, approving reimbursement of fees and expenses and setting aside of a litigation fund as provided in paragraph 7 above, and approving the notice to the class under paragraph 2 above. Accordingly, the Clerk of this Court is hereby expressly ORDERED and DIRECTED to enter this Order and Final Judgment as a Final Judgment pursuant to Rule 54(b), Federal Rules of Civil Procedure.

D.S.C.,1990.
South Carolina Nat. Bank v. Stone
749 F.Supp. 1419, Fed. Sec. L. Rep. P 95,453

END OF DOCUMENT

CITATION: Smith v Sino-Forest Corporation, 2012 ONSC24
COURT FILE NO.: 11-CV-428238CP
COURT FILE NO.: 11-CV-431153CP
COURT FILE NO.: 11-CV-435826CP
DATE: January 6, 2012

ONTARIO
SUPERIOR COURT OF JUSTICE

BETWEEN:

Douglas Smith and Zhongjun Goa

Plaintiffs

- and -

Sino-Forest Corporation, Allen T.Y. Chan, James M.E. Hyde, Edmund Mak, W. Judson Martin, Simon Murray, Peter D.H. Wang, David J. Horsley, Ernst & Young LLP, BDO 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., and Maison Placements Canada Inc.

Defendants

Proceeding under the *Class Proceedings Act, 1992*

AND BETWEEN:

The Trustees of the Labourers' Pension Fund of Central and Eastern Canada and the Trustees of the International Union of Operating Engineers Local 793 Pension Plan for Operating Engineers in Ontario

Plaintiffs

- and -

Sino-Forest Corporation, Ernst & Young LLP, Allen T.Y. Chan, W. Judson Martin, Kai Kit Poon, David J. Horsley, William E. Ardell, Kai Kit Poon, David J. Horsley, 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., and Maison Placements Canada Inc.

Defendants

Proceeding under the *Class Proceedings Act, 1992*

AND BETWEEN:

Northwest & Ethical Investments L.P., Comité Syndical National de Retraite Bâtirente Inc.

Plaintiffs

- and -

Sino-Forest Corporation, Allen T.Y. Chan, W. Judson Martin, Kai Kit Poon, David J. Horsley, Hua Chen, Wei Mao Zhao, Alfred C.T. Hung, Albert Ip, George Ho, Thomas M. Maradin, William E. Ardell, James M.E. Hyde, Simon Murray, Garry J. West, James P. Bowland, Edmund Mak, Peter Wang, Kee Y. Wong, The Estate of John Lawrence, Simon Yeung, Ernst & Young LLP, BDO Limited, Pöyry Forest Industry PTE Limited, Pöyry (Beijing) Consulting Company Limited, JP Management Consulting (Asia-Pacific) PTE Ltd., Dundee Securities Corporation, UBS Securities Canada Inc., Haywood Securities Inc., Credit Suisse Securities (Canada), Inc., TD Securities Inc., RBC Dominion Securities Inc., Scotia Capital Inc., CIBC World Markets Inc., Merrill Lynch Canada, Inc. Canaccord Financial Ltd., Maison Placements Canada Inc., Morgan Stanley & Co. Incorporated, Credit Suisse Securities (USA), LLC, Merrill Lynch, Pierce, Fenner & Smith, Inc.

Defendants

Proceeding under the *Class Proceedings Act, 1992*

COUNSEL:

- J.P. Rochon, J. Archibald, and S. Tambakos for the Plaintiffs in 11-CV-428238CP
- K.M. Baert, J. Bida, and C.M. Wright for the Plaintiffs in 11-CV-431153CP
- J.C. Orr, V. Paris, N. Mizobuchi, and A. Erfan for the Plaintiffs in 11-CV-435826CP
- M. Eizenga for the defendant Sino-Forest Corporation
- P. Osborne and S. Roy for the defendant Ernst & Young LLP
- E. Cole for the defendant Allen T.Y. Chan
- J. Fabello for the defendant underwriters

HEARING DATES: December 20 and 21, 2011

PERELL, J.

REASONS FOR DECISION

A. INTRODUCTION

[1] This is a carriage motion under the *Class Proceedings Act, 1992*, S.O. 1992, c. 6. In this particular carriage motion, four law firms are rivals for the carriage of a class action against Sino-Forest Corporation. There are currently four proposed Ontario class

actions against Sino-Forest to recover losses alleged to be in the billions of dollars arising from the spectacular crash in value of its shares and notes.

[2] Practically speaking, carriage motions involve two steps. First, the rival law firms that are seeking carriage of a class action extoll their own merits as class counsel and the merits of their client as the representative plaintiff. During this step, the law firms explain their tactical and strategic plans for the class action, and, thus, a carriage motion has aspects of being a casting call or rehearsal for the certification motion.

[3] Second, the rival law firms submit that with their talent and their litigation plan, their class action is the better way to serve the best interests of the class members, and, thus, the court should choose their action as the one to go forward. No doubt to the delight of the defendants and the defendants' lawyers, which have a watching brief, the second step also involves the rivals hardheartedly and toughly reviewing and criticizing each other's work and pointing out flaws, disadvantages, and weaknesses in their rivals' plans for suing the defendants.

[4] The law firms seeking carriage are: Rochon Genova LLP; Koskie Minsky LLP; Siskinds LLP; and Kim Orr Barristers P.C., all competent, experienced, and veteran class action law firms.

[5] For the purposes of deciding the carriage motions, I will assume that all of the rivals have delivered their Statements of Claim as they propose to amend them.

[6] Koskie Minsky and Siskinds propose to act as co-counsel and to consolidate two of the actions. Thus, the competition for carriage is between three proposed class actions; namely:

- *Smith v. Sino-Forest Corp.* (11-CV-428238CP) ("*Smith v. Sino-Forest"*) with Rochon Genova as Class Counsel
- *The Trustees of Labourers' Pension Fund of Central and Eastern Canada v. Sino-Forest Corp.* (11-CV-431153CP) ("*Labourers v. Sino-Forest*") with Koskie Minsky and Siskinds as Class Counsel (This action would be consolidated with "*Grant. v. Sino- Forest"* (CV-11-439400-00CP)
- *Northwest & Ethical Investments L.P. v. Sino-Forest Corp.* (11-CV-435826CP) ("*Northwest v. Sino-Forest*") with Kim Orr as Class Counsel.

[7] It has been a very difficult decision to reach, but for the reasons that follow, I stay *Smith v. Sino-Forest* and *Northwest v. Sino-Forest*, and I grant carriage to Koskie Minsky and Siskinds in *Labourers v. Sino-Forest.*

[8] I also grant leave to the plaintiffs in *Labourers v. Sino-Forest* to deliver a Fresh as Amended Statement of Claim, which may include the joinder of the plaintiffs and the causes of action set out in *Grant v. Sino-Forest, Smith v. Sino-Forest,* and *Northwest v. Sino-Forest,* as the plaintiffs may be advised.

[9] This order is without prejudice to the rights of the Defendants to challenge the Fresh as Amended Statement of Claim as they may be advised. In any event, nothing in

these reasons is intended to make findings of fact or law binding on the Defendants or to be a pre-determination of the certification motion.

B. METHODOLOGY

[10] To explain my reasons, first, I will describe the jurisprudence about carriage motions. Second, I will describe the evidentiary record for the carriage motions. Third, I will describe the factual background to the claims against Sino-Forest, which is the principal but not the only target of the various class actions. Fourth, deferring my ultimate conclusions, I will analyze the rival actions that are competing for carriage under twelve headings and describe the positions and competing arguments of the law firms competing for carriage. Fifth, I will culminate the analysis of the competing actions by explaining the carriage order decision. Sixth and finally, I will finish with a concluding section.

[11] Thus, the organization of these Reasons for Decision is as follows:

- Introduction
- Methodology
- Carriage Orders Jurisprudence
- Evidentiary Background
- Factual Background to the Claims against Sino-Forest
- Analysis of the Competing Class Actions
    - The Attributes of Class Counsel
    - Retainer, Legal and Forensic Resources, and Investigations
    - Proposed Representative Plaintiffs
    - Funding
    - Conflicts of Interest
    - Definition of Class Membership
    - Definition of Class Period
    - Theory of the Case against the Defendants
    - Joinder of Defendants
    - Causes of Action
    - The Plaintiff and the Defendant Correlation
    - Prospects of Certification
- Carriage Order
    - Introduction
    - Neutral or Non-Determinative Factors
    - Determinative Factors
- Conclusion

C. CARRIAGE ORDERS JURISPRUDENCE

[12] There should not be two or more class actions that proceed in respect of the same putative class asserting the same cause(s) of action, and one action must be selected: *Vitapharm Canada Ltd. v. F. Hoffman-Laroche Ltd.*, [2000] O.J. No. 4594

(S.C.J.) at para. 14. See also *Vitapharm Canada Ltd. v. F. Hoffmann-La Roche Ltd.*, [2001] O.J. No. 3682 (S.C.J.), aff'd [2002] O.J. No. 2010 (C.A.). When counsel have not agreed to consolidate and coordinate their actions, the court will usually select one and stay all other actions: *Lau* v. *Bayview Landmark*, [2004] O.J. No. 2788 (S.C.J.) at para. 19.

[13] Where two or more class proceedings are brought with respect to the same subject matter, a proposed representative plaintiff in one action may bring a carriage motion to stay all other present or future class proceedings relating to the same subject matter: *Setterington v. Merck Frosst Canada Ltd.*, [2006] O.J. No. 376 (S.C.J.) at paras. 9-11; *Ricardo v. Air Transat A.T. Inc.*, [2002] O.J. No. 1090 (S.C.J.), leave to appeal dismissed [2002] O.J. No. 2122 (S.C.J.).

[14] The *Class Proceedings Act, 1992*, confers upon the court a broad discretion to manage the proceedings. Section 13 of the Act authorizes the court to "stay any proceeding related to the class proceeding," and s. 12 authorizes the court to "make any order it considers appropriate respecting the conduct of a class proceeding to ensure its fair and expeditious determination." Section 138 of the *Courts of Justice Act*, R.S.O. 1990, c. 43 directs that "as far as possible, multiplicity of legal proceedings shall be avoided." See: *Setterington v. Merck Frosst Canada Ltd.*, *supra*, at paras. 9-11.

[15] The court also has its normal jurisdiction under the *Rules of Civil Procedure*. Section 35 of the *Class Proceedings Act, 1992*, provides that the rules of court apply to class proceedings. Among the rules that are available is Rule 6, the rule that empowers the court to consolidate two or more proceedings or to order that they be heard together.

[16] In determining carriage of a class proceeding, the court's objective is to make the selection that is in the best interests of class members, while at the same time being fair to the defendants and being consistent with the objectives of the *Class Proceedings Act, 1992*: *Vitapharm Canada Ltd. v. F. Hoffman-La Roche Ltd.*, [2000] O.J. No. 4594 (S.C.J.) at para. 48; *Setterington v. Merck Frosst Canada Ltd.*, *supra*, at para. 13 (S.C.J.); *Sharma v. Timminco Ltd.* (2009), 99 O.R. (3d) 260 (S.C.J.) at para. 14. The objectives of a class proceeding are access to justice, behaviour modification, and judicial economy for the parties and for the administration of justice.

[17] Courts generally consider seven non-exhaustive factors in determining which action should proceed: (1) the nature and scope of the causes of action advanced; (2) the theories advanced by counsel as being supportive of the claims advanced; (3) the state of each class action, including preparation; (4) the number, size and extent of involvement of the proposed representative plaintiffs; (5) the relative priority of the commencement of the class actions; (6) the resources and experience of counsel; and (7) the presence of any conflicts of interest: *Sharma v. Timminco Ltd.*, *supra* at para. 17.

[18] In these reasons, I will examine the above factors under somewhat differently-named headings and in a different order and combination. And, I will add several more factors that the parties made relevant to the circumstances of the competing actions in the cases at bar, including: (a) funding; (b) definition of class membership; (c) definition of class period; (d) joinder of defendants; (e) the plaintiff and defendant correlation; and, (f) prospects of certification.

[19] In addition to identifying relevant factors, the carriage motion jurisprudence provides guidance about how the court should determine carriage. Although the determination of a carriage motion will decide which counsel will represent the plaintiff, the task of the court is not to choose between different counsel according to their relative resources and expertise; rather, it is to determine which of the competing actions is more, or most, likely to advance the interests of the class: *Tiboni v. Merck Frosst Canada Ltd.*, [2008] O.J. No. 2996 (S.C.J.), sub. nom *Mignacca v. Merck Frosst Canada Ltd.*, leave to appeal granted [2008] O.J. No. 4731 (S.C.J.), aff'd [2009] O.J. No. 821 (Div. Ct.), application for leave to appeal to C.A. ref'd May 15, 2009, application for leave to appeal to S.C.C. ref'd [2009] S.C.C.A. No. 261.

[20] On a carriage motion, it is inappropriate for the court to embark upon an analysis as to which claim is most likely to succeed unless one is "fanciful or frivolous": *Setterington v. Merck Frosst Canada Ltd., supra,* at para. 19.

[21] In analysing whether the prohibition against a multiplicity of proceedings would be offended, it is not necessary that the multiple proceedings be identical or mirror each other in every respect; rather, the court will look at the essence of the proceedings and their similarities: *Setterington v. Merck Frosst Canada Ltd., supra,* at para. 11.

[22] Where there is a competition for carriage of a class proceeding, the circumstance that one competitor joins more defendants is not determinative; rather, what is important is the rationale for the joinder and whether or not it is advantageous for the class to join the additional defendants: *Joel v Menu Foods Gen-Par Limited,* [2007] B.C.J. No. 2159 (B.C.S.C.); *Genier v. CCI Capital Canada Ltd.,* [2005] O.J. No. 1135 (S.C.J.); *Setterington v. Merck Frosst Canada Ltd., supra*.

[23] In determining which firm should be granted carriage of a class action, the court may consider whether there is any potential conflict of interest if carriage is given to one counsel as opposed to others: *Joel v. Menu Foods Gen-Par Limited, supra* at para. 16; *Vitapharm Canada Ltd. v. F. Hoffman-Laroche Ltd.*, [2000] O.J. No. 4594 (S.C.J.) and [2001] O.J. No. 3673 (S.C.J.).

D. EVIDENTIARY BACKGROUND

Smith v. Sino-Forest

[24] In support of its carriage motion in *Smith v. Sino-Forest*, Rochon Genova delivered affidavits from:

- Ken Froese, who is Senior Managing Director of Froese Forensic Partners Ltd., a forensic accounting firm
- Vincent Genova, who is the managing partner of Rochon Genova
- Douglas Smith, the proposed representative plaintiff

Labourers v. Sino-Forest

[25] In support of their carriage motion in *Labourers v. Sino-Forest*, Koskie Minsky and Siskinds delivered affidavits from:

- Dimitri Lascaris, who is a partner at Siskinds and the leader of its class action team
- Michael Gallagher, who is the Chair of the Board of Trustees of Operating Engineers Local 793 Pension Plan for Operating Engineers in Ontario ("Operating Engineers Fund"), a proposed representative plaintiff
- David Grant, a proposed representative plaintiff
- Richard Grottheim, who is the Chief Executive Officer of Sjunde AP-Fonden, a proposed representative plaintiff
- Joseph Mancinelli, who is the Chair of the Board of Trustees of The Trustees of the Labourers' Pension Fund of Central and Eastern Canada ("Labourers' Fund"), a proposed representative plaintiff. He also holds senior positions with the Labourers International Union of North America, which has more than 80,000 members in Canada
- Ronald Queck, who is Director of Investments of the Healthcare Employee Benefits Plans of Manitoba ("Healthcare Manitoba"), which would be a prominent class member in the proposed class action
- Frank Torchio, who is a chartered financial analyst and an expert in finance and economics who was retained to opine, among other things, about the damages suffered under various proposed class periods by Sino-Forest shareholders and noteholders under s. 138.5 of the *Ontario Securities Act*
- Robert Wong, who is a proposed representative plaintiff
- Mark Zigler, who is the managing partner of Koskie Minsky

Northwest v. Sino-Forest

[26] In support of its carriage motion in *Northwest v. Sino-Forest*, Kim Orr delivered affidavits from:

- Megan B. McPhee, a principal of the firm
- John Mountain, who is the Senior Vice President, Legal and Human Resources, the Chief Compliance Officer and Corporate Secretary of Northwest Ethical Investments L.P. ("Northwest"), a proposed representative plaintiff
- Zachary Nye, a financial economist who was retained to respond to Mr. Torchio's opinion
- Daniel Simard, who is General Co-Ordinator and a non-voting ex-officio member of the Board of Directors and Committees of Comité syndical national de retraite Bâtirente inc. ("Bâtirente"), a proposed representative plaintiff
- Michael C. Spencer, a lawyer qualified to practice in New York, California, and Ontario, who is counsel to Kim Orr and a partner and member of the executive committee at the American law firm of Milberg LLP

- Brian Thomson, who is Vice-President, Equity Investments for British Columbia Investment Management Corporation ("BC Investment"), a proposed representative plaintiff

E. FACTUAL BACKGROUND TO THE CLAIMS AGAINST SINO-FOREST

[27] The following factual background is largely an amalgam made from the unproven allegations in the Statements of Claim in the three proposed class actions and unproven allegations in the motion material delivered by the parties.

[28] The Defendant, Sino-Forest is a Canadian public company incorporated under the *Canada Business Corporations Act*, R.S.C., 1985, c. C-44 with its registered office in Mississauga, Ontario, and its head office in Hong Kong. Its shares have traded on the Toronto Stock Exchange ("TSX") since 1995. It is a forestry plantation company with operations centered in the People's Republic of China. Its trading of securities is subject to the regulation of the *Ontario Securities Act*, R.S.O. 1990, c. S.5, under which it is a "reporting issuer" subject to the continuous disclosure provisions of Part XVIII of the Act and a "responsible issuer" subject to civil liability for secondary market misrepresentation under Part XXIII.1 of the Act.

[29] The Defendant, Ernst & Young LLP ("E&Y") has been Sino-Forest's auditor from 1994 to date, except for 1999, when the now-defunct Arthur Andersen LLP did the audit, and 2005 and 2006, when the predecessor of what is now the Defendant, BDO Limited ("BDO") was Sino-Forest's auditor. BDO is the Hong Kong member of BDO International Ltd., a global accounting and audit firm.

[30] E&Y and BDO are "experts" within the meaning of s. 138.1 of the *Ontario Securities Act*.

[31] From 1996 to 2010, in its financial statements, Sino-Forest reported only profits, and it appeared to be an enormously successful enterprise that substantially outperformed its competitors in the forestry industry. Sino-Forest's 2010 Annual Report issued in May 2011 reported that Sino-Forest had net income of $395 million and assets of $5.7 billion. Its year-end market capitalization was $5.7 billion with approximately 246 million common shares outstanding.

[32] It is alleged that Sino-Forest and its auditors E&Y and BDO repeatedly misrepresented that Sino-Forest's financial statements complied with GAAP ("generally accepted accounting principles").

[33] It is alleged that Sino-Forest and its officers and directors made other misrepresentations about the assets, liabilities, and performance of Sino-Forest in various filings required under the *Ontario Securities Act*. It is alleged that these misrepresentations appeared in the documents used for the offerings of shares and bonds in the primary market and again in what are known as Core Documents under securities legislation, which documents are available to provide information to purchasers of shares and bonds in the secondary market. It is also alleged that misrepresentations were made in oral statements and in Non-Core Documents.

[34] The Defendant, Allen T.Y. Chan was Sino-Forest's co-founder, its CEO, and a director until August 2011. He resides in Hong Kong.

[35] The Defendant, Kai Kit Poon, was Sino-Forest's co-founder, a director from 1994 until 2009, and Sino-Forest's President. He resides in Hong Kong.

[36] The Defendant, David J. Horsley was a Sino-Forest director (from 2004 to 2006) and was its CFO. He resides in Ontario.

[37] The Defendants, William E. Ardell (resident of Ontario, director since 2010), James P. Bowland (resident of Ontario, director since 2011), James M.E. Hyde (resident of Ontario, director since 2004), John Lawrence (resident of Ontario, deceased, director 1997 to 2006), Edmund Mak (resident of British Columbia, director since 1994), W. Judson Martin (resident of Hong Kong, director since 2006, CEO since August 2011), Simon Murray (resident of Hong Kong, director since 1999), Peter Wang (resident of Hong Kong, director since 2007) and Garry J. West (resident of Ontario, director since 2011) were members of Sino-Forest's Board of Directors.

[38] The Defendants, Hua Chen (resident of Ontario), George Ho (resident of China), Alfred C.T. Hung (resident of China), Alfred Ip (resident of China), Thomas M. Maradin (resident of Ontario), Simon Yeung (resident of China) and Wei Mao Zhao (resident of Ontario) are vice presidents of Sino-Forest. The defendant Kee Y. Wong was CFO from 1999 to 2005.

[39] Sino-Forest's forestry assets were valued by the Defendant, Pöyry (Beijing) Consulting Company Limited, ("Pöyry"), a consulting firm based in Shanghai, China. Associated with Pöyry are the Defendants, Pöyry Forest Industry PTE Limited ("Pöyry-Forest") and JP Management Consulting (Asia-Pacific) PTE Ltd. ("JP Management"). Each Pöyry Defendant is an expert as defined by s. 138.1 of the *Ontario Securities Act.*

[40] Pöyry prepared technical reports dated March 8, 2006, March 15, 2007, March 14, 2008, April 1, 2009, and April 23, 2010 that were filed with SEDAR (the System of Electronic Document Analysis and Retrieval) and made available on Sino-Forest's website. The reports contained a disclaimer and a limited liability exculpatory provision purporting to protect Pöyry from liability.

[41] In China, the state owns the forests, but the Chinese government grants forestry rights to local farmers, who may sell their lumber rights to forestry companies, like Sino-Forest. Under Chinese law, Sino-Forest was obliged to maintain a 1:1 ratio between lands for forest harvesting and lands for forest replantation.

[42] Sino-Forest's business model involved numerous subsidiaries and the use of authorized intermediaries or "AIs" to assemble forestry rights from local farmers. Sino-Forest also used authorized intermediaries to purchase forestry products. There were numerous AIs, and by 2010, Sino-Forest had over 150 subsidiaries, 58 of which were formed in the British Virgin Islands and at least 40 of which were incorporated in China.

[43] It is alleged that from at least March 2003, Sino-Forest used its business model and non-arm's length AIs to falsify revenues and to facilitate the misappropriation of Sino-Forest's assets.

[44] It is alleged that from at least March 2004, Sino-Forest made false statements about the nature of its business, assets, revenue, profitability, future prospects, and compliance with the laws of Canada and China. It is alleged that Sino-Forest and other Defendants misrepresented that Sino-Forest's financial statements complied with GAPP ("generally accepted accounting principles"). It is alleged that Sino-Forest misrepresented that it was an honest and reputable corporate citizen. It is alleged that Sino-Forest misrepresented and greatly exaggerated the nature and extent of its forestry rights and its compliance with Chinese forestry regulations. It is alleged that Sino-Forest inflated its revenue, had questionable accounting practices, and failed to pay a substantial VAT liability. It is alleged that Sino-Forest and other Defendants misrepresented the role of the AIs and greatly understated the risks of Sino-Forest utilizing them. It is alleged that Sino-Forest materially understated the tax-related risks from the use of AIs in China, where tax evasion penalties are severe and potentially devastating.

[45] Starting in 2004, Sino-Forest began a program of debt and equity financing. It amassed over $2.1 billion from note offerings and over $906 million from share issues.

[46] On May 17, 2004, Sino-Forest filed its Annual Information Form for the 2003 year. It is alleged in *Smith v. Sino-Forest* that the 2003 AIF contains the first misrepresentation in respect of the nature and role of the authorized intermediaries, which allegedly played a foundational role in the misappropriation of Sino-Forest's assets.

[47] In August 2004, Sino-Forest issued an offering memorandum for the distribution of 9.125% guaranteed senior notes ($300 million (U.S.)). The Defendant, Morgan Stanley & Co. Incorporated ("Morgan") was a note distributor that managed the note offering in 2004 and purchased and resold notes.

[48] Under the Sino-Forest note instruments, in the event of default, the trustee may sue to collect payment of the notes. A noteholder, however, may not pursue any remedy with respect to the notes unless, among other things, written notice is given to the trustee by holders of 25% of the outstanding principal asking the trustee to pursue the remedy and the trustee does not comply with the request. The notes provide that no noteholder shall obtain a preference or priority over another noteholder. The notes contain a waiver and release of Sino-Forest's directors, officers, and shareholders from all liability "for the payment of the principal of, or interest on, or other amounts in respect of the notes or for any claim based thereon or otherwise in respect thereof." The notes are all governed by New York law and include non-exclusive attornment clauses to the jurisdiction of New York State and United States federal courts.

[49] On March 19, 2007, Sino-Forest announced its 2006 financial results. The appearance of positive results caused a substantial increase in its share price which moved from $10.10 per share to $13.42 per share ten days later, a 33% increase.

[50] In May 2007, Sino-Forest filed a Management Information Circular that represented that it maintained a high standard of corporate governance. It indicated that its Board of Directors made compliance with high governance standards a top priority.

[51] In June 2007, Sino-Forest made a share prospectus offering of 15.9 million common shares at $12.65 per share ($201 million offering). Chan, Horsley, Martin, and Hyde signed the prospectus. The underwriters (as defined by s. 1. (1) of the *Ontario Securities Act*) were the Defendants, CIBC World Markets Inc. ("CIBC"), Credit Suisse Securities Canada (Inc.) ("Credit Suisse"), Dundee Securities Corporation ("Dundee"), Haywood Securities Inc. ("Haywood"), Merrill Lynch Canada, Inc. ("Merrill") and UBS Securities Canada Inc. ("UBS").

[52] In July 2008, Sino-Forest issued a final offering memorandum for the distribution of 5% convertible notes ($345 million (U.S)) due 2013. The Defendants, Credit Suisse Securities (USA), LLC ("Credit Suisse (USA)"), and Merrill Lynch, Fenner & Smith Inc. ("Merrill-Fenner") were note distributors.

[53] In June 2009, Sino-Forest made a share prospectus offering of 34.5 million common shares at $11.00 per share ($380 million offering). Chan, Horsley, Martin, and Hyde signed the prospectus. The underwriters (as defined by s. 1. (1) of the *Ontario Securities Act*) were Credit Suisse, Dundee, Merrill, the Defendant, Scotia Capital Inc. ("Scotia"), and the Defendant, TD Securities Inc. ("TD").

[54] In June 2009, Sino-Forest issued a final offering memorandum for the exchange of senior notes for new guaranteed senior 10.25% notes ($212 million (U.S.) offering) due 2014. Credit Suisse (USA) was the note distributor.

[55] In December 2009, Sino-Forest made a share prospectus offering of 22 million common shares at $16.80 per share ($367 million offering). Chan, Horsley, Martin, and Hyde signed the prospectus. The underwriters (as defined by s. 1. (1) of the *Ontario Securities Act*) were Credit Suisse, the Defendant, Canaccord Financial Ltd. ("Canaccord"), CIBC, Dundee, the Defendant, Maison Placements Canada Inc. ("Maison"), Merrill, the Defendant, RBC Dominion Securities Inc. ("RBC"), Scotia, and TD.

[56] In December 2009, Sino-Forest issued an offering memorandum for 4.25% convertible senior notes ($460 million (U.S.) offering) due 2016. The note distributors were Credit Suisse (USA), Merrill-Fenner, and TD.

[57] In October 2010, Sino-Forest issued an offering memorandum for 6.25% guaranteed senior notes ($600 million (U.S.) offering) due 2017. The note distributors were Banc of America Securities LLC ("Banc of America") and Credit Suisse USA.

[58] Sino-Forest's per-share market price reached a high of $25.30 on March 31, 2011.

[59] It is alleged that all the financial statements, prospectuses, offering memoranda, MD&As (Management Discussion and Analysis), AIFs (Annual Information Forms) contained misrepresentations and failures to fully, fairly, and plainly disclose all

material facts relating to the securities of Sino-Forest, including misrepresentations about Sino-Forest's assets, its revenues, its business activities, and its liabilities.

[60] On June 2, 2011, Muddy Waters Research, a Hong Kong investment firm that researches Chinese businesses, released a research report about Sino-Forest. Muddy Waters is operated by Carson Block, its sole full-time employee. Mr. Block was a short-seller of Sino-Forest stock. His Report alleged that Sino-Forest massively exaggerates its assets and that it had engaged in extensive related-party transactions since the company's TSX listing in 1995. The Report asserted, among other allegations, that a company-reported sale of $231 million in timber in Yunnan Province was largely fabricated. It asserted that Sino-Forest had overstated its standing timber purchases in Yunnan Province by over $800 million.

[61] The revelations in the Muddy Waters Report had a catastrophic effect on Sino-Forest's share price. Within two days, $3 billion of market capitalization was gone and the market value of Sino-Forest's notes plummeted.

[62] Following the release of the Muddy Waters Report, Sino-Forest and certain of its officers and directors released documents and press releases and made public oral statements in an effort to refute the allegations in the Report. Sino-Forest promised to produce documentation to counter the allegations of misrepresentations. It appointed an Independent Committee of Messrs. Ardell, Bowland and Hyde to investigate the allegations contained in the Muddy Waters Report. After these assurances, Sino-Forest's share price rebounded, trading as high as 60% of its previous day's close, eventually closing on June 6, 2011 at $6.16, approximately 18% higher from its previous close.

[63] On June 7, the Independent Committee announced that it had appointed PricewaterhouseCoopers ("PWC") to assist with the investigation. Several law firms were also hired to assist in the investigation.

[64] However, bad news followed. Reporters from the *Globe and Mail* travelled to China, and on June 18 and 20, 2011, the newspaper published articles that reported that Yunnan Province forestry officials had stated that their records contradicted Sino-Forest's claim that it controlled almost 200,000 hectares in Yunnan Province.

[65] On August 26, 2011, the Ontario Securities Commission ("OSC") issued an order suspending trading in Sino-Forest's securities and stated that: (a) Sino-Forest appears to have engaged in significant non-arm's length transactions that may have been contrary to Ontario securities laws and the public interest; (b) Sino-Forest and certain of its officers and directors appear to have misrepresented in a material respect, some of its revenue and/or exaggerated some of its timber holdings in public filings under the securities laws; and (c) Sino-Forest and certain of its officers and directors, including its CEO, appear to be engaging or participating in acts, practices or a course of conduct related to its securities which it and/or they know or reasonably ought to know perpetuate a fraud.

[66] The OSC named Chan, Ho, Hung, Ip, and Yeung as respondents in the proceedings before the Commission. Sino-Forest placed Messrs. Hung, Ho and Yeung on administrative leave. Mr. Ip may only act on the instructions of the CEO.

[67] Having already downgraded its credit rating for Sino-Forest's securities, Standard & Poor withdrew its rating entirely, and Moody's reduced its rating to "junk" indicating a very high credit risk.

[68] On September 8, 2011, after a hearing, the OSC continued its cease-trading order until January 25, 2012, and the OSC noted the presence of evidence of conduct that may be harmful to investors and the public interest.

[69] On November 10, 2011, articles in the *Globe and Mail* and the *National Post* reported that the RCMP had commenced a criminal investigation into whether executives of Sino-Forest had defrauded Canadian investors.

[70] On November 13, 2011, at a cost of $35 million, Sino-Forest's Independent Committee released its Second Interim Report, which included the work of the committee members, PWC, and three law firms. The Report refuted some of the allegations made in the Muddy Waters Report but indicated that evidence could not be obtained to refute other allegations. The Committee reported that it did not detect widespread fraud, and noted that due to challenges it faced, including resistance from some company insiders, it was not able to reach firm conclusions on many issues.

[71] On December 12, 2011, Sino-Forest announced that it would not file its third-quarter earnings' figures and would default on an upcoming interest payment on outstanding notes. This default may lead to the bankruptcy of Sino-Forest.

[72] The chart attached as Schedule "A" to this judgment shows Sino- Forest's stock price on the TSX from January 1, 2004, to the date that its shares were cease-traded on August 26, 2011.

F. ANALYSIS OF THE COMPETING CLASS ACTIONS

1. The Attributes of Class Counsel

Smith v. Sino-Forest

[73] Rochon Genova is a boutique litigation firm in Toronto focusing primarily on class action litigation, including securities class actions. It is currently class counsel in the CIBC subprime litigation, which seeks billions in damages on behalf of CIBC shareholders for the bank's alleged non-disclosure of its exposure to the U.S. subprime residential mortgage market. It is currently the lawyer of record in *Fischer v. IG Investment Management Ltd* and *Frank v. Farlie Turner*, both securities cases, and it is acting for aggrieved investors in litigation involving two multi-million dollar Ponzi schemes. It acted on behalf of Canadian shareholders in relation to the Nortel securities litigation, as well as, large scale products liability class actions involving Baycol, Prepulsid, and Maple Leaf Foods, among many other cases.

[74] Rochon Genova has a working arrangement with Lieff Cabrasser Heimann & Bernstein, one of the United States' leading class action firms.

[75] Lead lawyers for *Smith v. Sino-Forest* are Joel Rochon and Peter Jervis, both senior lawyers with considerable experience and proficiency in class actions and securities litigation.

Labourers v. Sino-Forest

[76] Koskie Minsky is a Toronto law firm of 43 lawyers with a diverse practice including bankruptcy and insolvency, commercial litigation, corporate and securities, taxation, employment, labour, pension and benefits, professional negligence and insurance litigation.

[77] Koskie Minsky has a well-established and prominent class actions practice, having been counsel in every sort of class proceeding, several of them being landmark cases, including *Hollick v Toronto (City), Cloud v The Attorney General of Canada*, and *Caputo v Imperial Tobacco*. It is currently representative counsel on behalf of all former Canadian employees in the multi-billion dollar Nortel insolvency.

[78] Siskinds is a London and Toronto law firm of 70 lawyers with a diverse practice including bankruptcy and insolvency, business law, and commercial litigation. It has an association with the Québec law firm Siskinds, Desmeules, avocats.

[79] At its London office, Siskinds has a team of 14 lawyers that focus their practice on class actions, in some instances exclusively. The firm has a long and distinguished history at the class actions bar, being class counsel in the first action certified as a class action, *Bendall v. McGhan Medical Corp*. (1993), 14 O.R. (3d) 734, and it has almost a monopoly on securities class actions, having filed approximately 40 of this species of class actions, including 24 that advance claims under Part XXX.1 of the *Ontario Securities Act*.

[80] As mentioned again later, for the purposes of *Labourers' Fund v. Sino-Forest*, Koskie Minsky and Siskinds have a co-operative arrangement with the U.S. law firm, Kessler Topaz Meltzer & Check LLP ("Kessler Topaz"), which is a 113-lawyer law firm specializing in complex litigation with a very high profile and excellent reputation as counsel in securities class action lawsuits in the United States.

[81] Lead lawyers for *Labourers' v. Sino-Forest* are Kirk M. Baert, Jonathan Ptak, Mark Ziegler, and Michael Mazzuca of Koskie Minsky and A. Dimitri Lascaris of Siskinds, all senior lawyers with considerable experience and proficiency in class actions and securities litigation.

Northwest v. Sino-Forest

[82] Kim Orr is a boutique litigation firm in Toronto focusing primarily on class action litigation, including securities class actions. It also has considerable experience on the defence side of defending securities cases.

[83] As I described in *Sharma v. Timminco Ltd., supra*, where I choose Kim Orr in a carriage competition with Siskinds in a securities class action, Kim Orr has a fine pedigree as a class action firm and its senior lawyers have considerable experience and proficiency in all types of class actions. It was comparatively modest in its self-promotional material for the carriage motion, but I am aware that it is currently class

counsel in substantial class actions involving claims of a similar nature to those in the case at bar.

[84] Kim Orr has an association with Milberg, LLP, a prominent class action law firm in the United States. It has 75 attorneys, most of whom devote their practice to representing plaintiffs in complex litigations, including class and derivative actions. It has a large support staff, including investigators, a forensic accountant, financial analysts, legal assistants, litigation support analysts, shareholder services personnel, and information technology specialists.

[85] Michael Spencer, who is a partner at Milberg and called to the bar in Ontario, offers counsel to Kim Orr.

[86] Lead lawyers for *Northwest v. Sino-Forest* are James Orr, Won Kim, and Mr. Spencer.

2. Retainer, Legal and Forensic Resources, and Investigations

Smith v. Sino-Forest

[87] Following the release of the Muddy Waters Report, on June 6, 2011, Mr. Smith contacted Rochon Genova. Mr. Smith, who lost much of his investment fortune, was one of the victims of the wrongs allegedly committed by Sino-Forest. Rochon Genova accepted the retainer, and two days later, a notice of action was issued. The Statement of Claim in *Smith v. Sino-Forest* followed on July 8, 2011.

[88] Following their retainer by Mr. Smith, Rochon Genova hired Mr. X (his name was not disclosed), as a consultant. Mr. X, who has an accounting background, can fluently read, write, and speak English, Cantonese, and Mandarin. He travelled to China from June 19 to July 3, 2011and again from October 31 to November 18, 2011. The purpose of the trips was to gather information about Sino-Forest's subsidiaries, its customers, and its suppliers. While in China, Mr. X secured approximately 20,000 pages of filings by Sino-Forest with the provincial branches of China's State Administration for Industry and Commerce (the "SAIC Files").

[89] In August 2011, Rochon Genova retained Froese Forensic Partners Ltd., a Toronto-based forensic accounting firm, to analyze the SAIC files.

[90] Rochon Genova also retained HAIBU Attorneys at Law, a full service law firm based in Shenzhen, Guangdong Province, China, to provide a preliminary opinion about Sino-Forest's alleged violations of Chinese accounting and taxation laws.

[91] Exclusive of the carriage motion, Rochon Genova has already incurred approximately $350,000 in time and disbursements for the proposed class action.

Labourers v. Sino-Forest

[92] On June 3, 2011, the day after the release of the Muddy Waters Report, Siskinds retained the Dacheng Law Firm in China to begin an investigation of the allegations contained in the report. Dacheng is the largest law firm in China with offices throughout China and Hong Kong and also offices in Los Angeles, New York, Paris, Singapore, and Taiwan.

[93] On June 9, 2011, Guining Liu, a Sino-Forest shareholder, commenced an action in the Québec Superior Court on behalf of persons or entities domiciled in Québec who purchased shares and notes. Siskinds' Québec affiliate office, Siskinds, Desmeules, avocats, is acting as class counsel in that action.

[94] On June 20, 2011, Koskie Minsky, which had a long standing lawyer-client relationship with the Labourers' Fund, was retained by it to recover its losses associated with the plummet in value of its holdings in Sino-Forest shares. Koskie Minsky issued a notice of action in a proposed class action with Labourers' Fund as the proposed representative plaintiffs.

[95] The June action, however, is not being pursued, and in July 2011, Labourers' Fund was advised that Operating Engineers Fund, another pension fund, also had very significant losses, and the two funds decided to retain Koskie Minsky and Siskinds to commence a new action, which followed on July 20, 2011, by notice of action. The Statement of Claim in *Labourers v. Sino-Forest* was served in August, 2011.

[96] Before commencing the new action, Koskie Minsky and Siskinds retained private investigators in Southeast Asia and received reports from them, along with information received from the Dacheng Law Firm. Koskie Minsky and Siskinds also received information from an unnamed expert in Suriname about the operations of Sino-Forest in Suriname and the role of Greenheart Group Ltd., which is a significant aspect of its Statement of Claim in *Labourers v. Sino-Forest.*

[97] On November 4, 2011, Koskie Minsky and Siskinds served the Defendants in *Labourers v. Sino-Forest* with the notice of motion for an order granting leave to assert the causes of action under Part XXIII.l of the *Ontario Securities Act.*

[98] On October 26, 2011, Robert Wong, who had lost a very large personal investment in Sino-Forest shares, retained Koskie Minsky and Siskinds to sue Sino-Forest for his losses, and the firms decided that he would become another representative plaintiff.

[99] On November 14, 2011, Koskie Minsky and Siskinds commenced *Grant v. Sino-Forest Corp*., which, as already noted above, they intend to consolidate with *Labourers v. Sino-Forest.*

[100] *Grant v. Sino-Forest* names the same defendants as in *Labourers v. Sino-Forest*, except for the additional joinder of Messrs. Bowland, Poon, and West, and it also joins as defendants, BDO, and two additional underwriters, Banc of America and Credit Suisse Securities (USA).

[101] Koskie Minsky and Siskinds state that *Grant v. Sino-Forest* was commenced out of an abundance of caution to ensure that certain prospectus and offering memorandum claims under the *Ontario Securities Act*, and under the equivalent legislation of the other Provinces, will not expire as being statute-barred.

[102] Exclusive of the carriage motion, Koskie Minsky has already incurred approximately $350,000 in time and disbursements for the proposed class action, and

exclusive of the carriage motion, Siskinds has already incurred approximately $440,000 in time and disbursements for the proposed class action.

Northwest v. Sino-Forest

[103] Immediately following the release of the Muddy Waters Report, Kim Orr and Milberg together began an investigation to determine whether an investor class action would be warranted. A joint press release on June 7, 2011, announced the investigation.

[104] For the purposes of the carriage motion, apart from saying that their investigation included reviewing all the documents on SEDAR and the System for Electronic Disclosure for Insiders (SEDI), communicating with contacts in the financial industry, and looking into Sino-Forest's officers, directors, auditors, underwriters and valuation experts, Kim Orr did not disclose the details of its investigation. It did indicate that it had hired a Chinese forensic investigator and financial analyst, a market and damage consulting firm, Canadian forensic accountants, and an investment and market analyst and that its investigations discovered valuable information.

[105] Meanwhile, lawyers at Milberg contacted Bâtirente, which was one of its clients and also a Sino-Forest shareholder, and Won Kim of Kim Orr contacted Northwest, another Sino-Forest shareholder. Bâtirente already had a retainer with Milberg to monitor its investment portfolio on an ongoing basis to detect losses due to possible securities violations.

[106] Northwest and Bâtirente agreed to retain Kim Orr to commence a class action, and on September 26, 2011, Kim Orr commenced *Northwest v. Sino-Forest*.

[107] In October 2011, BC Investments contacted Kim Orr about the possibility of it becoming a plaintiff in the class proceeding commenced by Northwest and Bâtirente, and BC Investments decided to retain the firm and the plan is that BC Investments is to become another representative plaintiff.

[108] Exclusive of the carriage motion, Kim Orr and Milberg have already incurred approximately $1,070,000 in time and disbursement for the proposed class action.

3. Proposed Representative Plaintiffs

Smith v. Sino-Forest

[109] In *Smith v. Sino-Forest*, the proposed representative plaintiffs are Douglas Smith and Frederick Collins.

[110] Douglas Smith is a resident of Ontario, who acquired approximately 9,000 shares of Sino-Forest during the proposed class period. He is married, 48 years of age, and employed as a director of sales. He describes himself as a moderately sophisticated investor that invested in Sino-Forest based on his review of the publicly available information, including public reports and filings, press releases, and statements released by or on behalf of Sino-Forest. He lost $75,345, which was half of his investment fortune.

[111] Frederick Collins is a resident of Nanaimo, British Columbia. He purchased shares in the primary market. His willingness to act as a representative plaintiff was

announced during the reply argument of the second day of the carriage motion, and nothing was discussed about his background other than he is similar to Mr. Smith in being an individual investor. He was introduced to address a possible *Ragoonanan* problem in *Smith v. Sino-Forest;* namely, the absence of a plaintiff who purchased in the primary market, of which alleged problem I will have more to say about below.

Labourers v. Sino-Forest

[112] In *Labourers v. Sino-Forest*, the proposed representative plaintiffs are: David Grant, Robert Wong, The Trustees of the Labourers' Pension Fund of Central and Eastern Canada ("Labourers' Fund"), the Trustees of the International Union of Operating Engineers Local 793 Pension Plan for Operating Engineers in Ontario ("Operating Engineers Fund"), and Sjunde AP-Fonden.

[113] David Grant is a resident of Alberta. On October 21, 2010, he purchased 100 Guaranteed Senior Notes of Sino-Forest at a price of $101.50 ($U.S.), which he continues to hold.

[114] Robert Wong, a resident of Ontario, is an electrical engineer. He was born in China, and in addition to speaking English, he speaks fluent Cantonese. He was a substantial shareholder of Sino-Forest from July 2002 to June 2011. Before making his investment, he reviewed Sino-Forest's Core Documents, and he also made his own investigations, including visiting Sino-Forest's plantations in China in 2005, where he met a Sino-Forest vice-president.

[115] Mr. Wong's investment in Sino-Forest comprised much of his net worth. In September 2008, he owned 1.4 million Sino-Forest shares with a value of approximately $26.1 million. He purchased more shares in the December 2009 prospectus offering. Around the end of May 2011, he owned 518,700 shares, which, after the publication of the Muddy Waters Report, he sold on June 3, 2011 and June 10, 2011, for $2.8 million.

[116] The Labourers' Fund is a multi-employer pension fund for employees in the construction industry. It is registered with the Financial Services Commission in Ontario and has 52,100 members in Ontario, New Brunswick, Nova Scotia, Prince Edward Island, and Newfoundland and Labrador. It is a long-time client of Koskie Minsky.

[117] Labourers' Fund manages more than $2.5 billion in assets. It has a fiduciary and statutory responsibility to invest pension monies on behalf of thousands of employees and pensioners in Ontario and in other provinces.

[118] Labourer's Fund acted as representative plaintiff in a U.S. class actions against Fortis, Pitney Bowes Inc., Synovus Financial Corp., and Medea Health Solutions, Inc. Those actions involved allegations of misrepresentation in the statements and filings of public issuers.

[119] The Labourers' Fund purchased Sino-Forest shares on the TSX during the class period, including 32,300 shares in a trade placed by Credit Suisse under a prospectus. Most of its purchases of Sino-Forest shares were made in the secondary market.

[120] On June 1, 2011, the Labourers' Fund held a total of 128,700 Sino-Forest shares with a market value of $2.3 million, and it also had an interest in pooled funds that had $1.4 million invested in Sino-Forest shares. On June 2 and 3, 2011, the Labourers' Fund sold its holdings in Sino-Forest for a net recovery of $695,993.96. By June 30, 2011, the value of the Sino-Forest shares in the pooled funds was $291,811.

[121] The Operating Engineers Fund is a multi-employer pension fund for employed operating engineers and apprentices in the construction industry. It is registered with the Financial Services Commission in Ontario, and it has 20,867 members. It is a long-time client of Koskie Minsky.

[122] The Operating Engineers Fund manages $1.5 billion in assets. It has a fiduciary and statutory responsibility to invest pension monies on behalf of thousands of employees and pensions in Ontario and in other provinces.

[123] The Operating Engineers Fund acquired shares of Sino-Forest on the TSX during the class period. The Operating Engineers Fund invested in Sino-Forest shares through four asset managers of a segregated fund. One of the managers purchased 42,000 Sino-Forest shares between February 1, 2011, and May 24, 2011, which had a market value of $764,820 at the close of trading on June 1, 2011. These shares were sold on June 21, 2011 for net $77,170.80. Another manager purchased 181,700 Sino-Forest shares between January 20, 2011 and June 1, 2011, which had a market value of $3.3 million at the close of trading on June 1, 2011. These shares were sold and the Operating Engineers Fund recovered $1.5 million. Another asset manager purchased 100,400 Sino-Forest shares between July 5, 2007 and May 26, 2011, which had a market value of $1.8 million at the close of trading on June 1, 2011. Many of these shares were sold in July and August, 2011, but the Operating Engineers Fund continues to hold approximately 37,350 shares. Between June 15, 2007 and June 9, 2011, the Operating Engineers Fund also purchased units of a pooled fund managed by TD that held Sino-Forest shares, and it continues to hold these units. The Operating Engineers Fund has incurred losses in excess of $5 million with respect to its investment in Sino-Forest shares.

[124] Sjunde AP-Fonden is the Swedish Nation Pension Fund, and part of Sweden's national pension system. It manages $15.3 billion in assets. It has acted as lead plaintiff in a large securities class action and a large stockholder class action in the United States.

[125] In addition to retaining Koskie Minsky and Siskinds, Sjunde AP-Fonden also retained the American law firm Kessler Topaz to provide assistance, if necessary, to Koskie Minsky and Siskinds.

[126] Sjunde AP-Fonden purchased Sino-Forest shares on the TSX from outside Canada between April 2010 and January 2011. It was holding 139,398 shares with a value of $2.5 million at the close of trading on June 1, 2011. It sold 43,095 shares for $188,829.36 in August 2011 and holds 93,303 shares.

[127] Sjunde AP-Fonden is prepared to be representative plaintiff for a sub-class of non-Canadian purchasers of Sino-Forest shares who purchased shares in Canada from outside of Canada.

[128] Messrs. Mancinelli, Gallagher, and Grottheim each deposed that Labourers' Fund, the Operating Engineers Fund, and Sjunde AP-Fonden respectively sued because of their losses and because of their concerns that public markets remain healthy and transparent.

[129] Although it does not seek to be a representative plaintiff, the Healthcare Employee Benefits Plans of Manitoba ("Healthcare Manitoba") is a major class member that supports carriage being granted to Koskie Minsky and Siskinds, and its presence should also be mentioned here because it actively supports the appointment of the proposed representative plaintiffs in *Labourers v. Sino-Forest*.

[130] Healthcare Manitoba provides pensions and other benefits to eligible healthcare employees and their families throughout Manitoba. It has 65,000 members. It is a long-time client of Koskie Minsky. It manages more than $3.9 billion in assets.

[131] Healthcare Manitoba, invested in Sino-Forest shares that were purchased by one of its asset managers in the TSX secondary market. Between February and May, 2011, it purchased 305,200 shares with a book value of $6.7 million. On June 24, 2011, the shares were sold for net proceeds of $560,775.48.

Northwest v. Sino-Forest

[132] In *Northwest v. Sino-Forest*, the proposed representative plaintiffs are: British Columbia Investment Management Corporation ("BC Investment"); Comité syndical national de retraite Bâtirente inc. ("Bâtirente") and Northwest & Ethical Investments L.P. ("Northwest").

[133] BC Investment, which is incorporated under the British Columbia *Public Sector Pension Plans Act*, is owned by and is an agent of the Government of British Columbia. It manages $86.9 billion in assets. Its investment activities help to finance the retirement benefits of more than 475,000 residents of British Columbia, including public service employees, healthcare workers, university teachers, and staff. Its investment activities also help to finance the WorkSafeBC insurance fund that covers approximately 2.3 million workers and over 200,000 employers in B.C., as well as, insurance funds for public service long term disability and credit union deposits.

[134] BC Investment, through the funds it managed, owned 334,900 shares of Sino-Forest at the start of the Class Period, purchased 6.6 million shares during the Class Period, including 50,200 shares in the June 2009 offering and 54,800 shares in the December 2009 offering; sold 5 million shares during the Class Period; disposed of 371,628 shares after the end of the Class Period; and presently holds 1.5 million shares.

[135] Bâtirente is a non-profit financial services firm initiated by the Confederation of National Trade Unions to establish and promote a workplace retirement system for affiliated unions and other organizations. It is registered as a financial services firm regulated in Quebec by the Autorité des marchés financiers under *the Act Respecting the Distribution of Financial Products and Services*, R.S.Q., chapter D-9.2. It has assets of about $850 million.

[136] Bâtirente, through the funds it managed, did not own any shares of Sino-Forest before the class period, purchased 69,500 shares during the class period, sold 57,625 shares during the class period, and disposed of the rest of its shares after the end of the class period.

[137] Northwest is an Ontario limited partnership, owned 50% by the Provincial Credit Unions Central and 50% by Federation des caisses Desjardin du Québec. It is registered with the British Columbia Securities Commission as a portfolio manager, and it is registered with the OSC as a portfolio manager and as an investment funds manager. It manages about $5 billion in assets.

[138] Northwest, through the funds it managed, did not own any shares of Sino-Forest before the class period, purchased 714,075 shares during the class period, including 245,400 shares in the December 2009 offering, sold 207,600 shares during the class period, and disposed of the rest of its shares after the end of the class period.

[139] Kim Orr touts BC Investment, Bâtirente, and Northwest as candidates for representative plaintiff because they are sophisticated "activist shareholders" that are committed to ethical investing. There is evidence that they have all raised governance issues with Sino-Forest as well as other companies. Mr. Mountain of Northwest and Mr. Simard of Bâtirente are eager to be actively involved in the litigation against Sino-Forest.

4. Funding

[140] Koskie Minsky and Siskinds have approached Claims Funding International, and subject to court approval, Claims Funding International has agreed to indemnify the plaintiffs for an adverse costs award in return for a percentage of any recovery from the class action.

[141] Koskie Minsky and Siskinds state that if the funding arrangement with Claims Funding International is refused, they will, in any event, proceed with the litigation and will indemnify the plaintiffs for any adverse costs award.

[142] Similarly, Kim Orr has approached Bridgepoint Financial Services, which subject to court approval, has agreed to indemnify the plaintiffs for an adverse costs award in return for a percentage of any recovery in the class action. If this arrangement is not approved, Kim Orr intends to apply to the Class Proceedings Fund, which would be a more expensive approach to financing the class action.

[143] Kim Orr states that if these funding arrangements are refused, it will, in any event, proceed with the litigation and it will indemnify the plaintiffs for any adverse costs award.

[144] Rochon Genova did not mention in its factum whether it intends to apply to the Class Proceedings Fund on behalf of Messrs. Smith and Collins, but for the purposes of the discussion later about the carriage order, I will assume that this may be the case. I will also assume that Rochon Genova has agreed to indemnify Messrs. Smith and Collins for any adverse costs award should funding not be granted by the Fund.

5. Conflicts of Interest

[145] One of the qualifications for being a representative plaintiff is that the candidate does not have a conflict of interest in representing the class members and in bringing an action on their behalf. All of the candidates for representative plaintiff in the competing class actions depose that they have no conflicts of interest. Their opponents disagree.

[146] Rochon Genova submits that there are inherent conflicts of interests in both *Labourers v. Sino-Forest* and in *Northwest v. Sino-Forest* because the representative plaintiffs bring actions on behalf of both shareholders and noteholders. Rochon Genova submits that these conflicts are exacerbated by the prospect of a Sino-Forest bankruptcy.

[147] Relying on *Casurina Ltd. Partnership v. Rio Algom Ltd.* [2004] O.J. No. 177 (C.A.) at paras. 35-36, aff'g [2002] O.J. No. 3229 (S.C.J.), leave to appeal to the S.C.C. denied, [2004] S.C.C.A. No. 105 and *Amaranth LLC. v. Counsel Corp.*, [2003] O.J. No. 4674 (S.C.J.), Rochon Genova submits that a class action by the bondholders is precluded by the pre-conditions in the bond instruments, but if it were to proceed, it might not be in the best interests of the bondholders, who might prefer to have Sino-Forest capable of carrying on business. Further still, Rochon Genova submits that, in any event, an action by the bondholders' trustee may be the preferable way for the noteholders to sue on their notes. Further, Rochon Genova submits that if there is a bankruptcy, the bondholders may prefer to settle their claims in the context of the bankruptcy rather than being connected in a class action to the shareholder's claims over which they would have priority in a bankruptcy.

[148] Further still, Rochon Genova submits that a bankruptcy would bring another conflict of interest between bondholders and shareholders because under s. 50(14) of the *Bankruptcy and Insolvency Act*, R.S.C., 1985, c. B-3, and 5.1(2) of the *Companies' Creditors Arrangement Act*, R.S.C., 1985, c. C-36 the claims of creditors against directors that are based on misrepresentation or oppression may not be compromised through a plan or proposal. In contrast, *Allen-Vanguard Corp., Re*, 2011 ONSC 5017 (S.C.J.) at paras. 48-52 is authority that shareholders are not similarly protected, and, therefore, Rochon Genova submits that the noteholders would have a great deal more leverage in resolving claims against directors than would the shareholder members of the class in a class action.

[149] Kim Orr denies that there is a conflict in the representative plaintiffs acting on behalf of both shareholders and bondholders. It submits that while boldholders may have an additional claim in contract against Sino-Forest for repayment of the debt outside of the class action, both shareholders and bondholders share a misrepresentation claim against Sino-Forest and there is no conflict in advancing the misrepresentation claim independent of the debt repayment claim.

[150] Koskie Minsky and Siskinds also deny that there is any conflict in advancing claims by both bondholders and shareholders. They say that the class members are on common ground in advancing misrepresentation, tort, and the various statutory causes of action. Koskie Minsky and Siskinds add that if there was a conflict, then it is manageable because they have a representative plaintiff who was a bondholder, which is not the case for the representative plaintiffs in *Northwest v. Sino-Forest*. It submits

that, if necessary, subclasses can be established to manage any conflicts of interest among class members.

[151] Leaving the submitted shareholder and bondholder conflicts of interest, Rochon Genova submits that Labourers' Fund has a conflict of interest because BDO Canada is its auditor. Rochon Genova submits that Koskie Minsky also has a conflict of interest because it and BDO Canada have worked together on a committee providing liaison between multi-employer pension plans and the Financial Services Commission of Ontario and have respectively provided services as auditor and legal counsel to the Union Benefits Alliance of Construction Trade Unions. Rochon Genova submits that it is telling that these conflicts were not disclosed and that BDO, which is an entity that is an international associate with BDO Canada was a late arrival as a defendant in *Labourers v. Sino-Forest*, although this can be explained by changes in the duration of the class period.

[152] For their part, Koskie Minsky and Siskinds raise a different set of conflicts of interest. They submit that Northwest, Bâtirente, and BC Investments have a conflict of interest with the other class members who purchased Sino-Forest securities because of their role as investment managers.

[153] Koskie Minsky and Siskinds' argument is that as third party financial service providers, BC Investment, Bâtirente, and Northwest did not suffer losses themselves but rather passed the losses on to their clients. Further, Koskie Minsky and Siskinds submit that, in contrast to BC Investment, Bâtirente, and Northwest, their clients, Labourers' Fund and Operating Engineers Fund, are acting as fiduciaries to recover losses that will affect their members' retirements. This arguably makes Koskie Minsky and Siskinds better representative plaintiffs.

[154] Further still, Koskie Minsky and Siskinds submit that the class members in *Northwest v. Sino-Forest* may question whether Northwest, Bâtirente, and BC Investments failed to properly evaluate the risks of investing in Sino-Forest. Koskie Minsky and Siskinds point out that the Superior Court of Québec in *Comité syndical national de retraite Bâtirente inc. c. Société financière Manuvie*, 2011 QCCS 3446 at paras. 111-119 disqualified Bâtirente as a representative plaintiff because there might be an issue about Bâtirente's investment decisions. Thus, Koskie, Minsky and Siskinds attempt to change Northwest, Bâtirente, and BC Investments' involvement in encouraging good corporate governance at Sino-Forest from a positive attribute into the failure to be aware of ongoing wrongdoing at Sino-Forest and a negative attribute for a proposed representative plaintiff.

6. Definition of Class Membership

Smith v. Sino-Forest

[155] In *Smith v. Sino-Forest*, the proposed class action is: (a) on behalf of all persons who purchased shares of Sino-Forest from May 17, 2004 to August 26, 2011 on the TSX or other secondary market; and (b) on behalf of all persons who acquired shares of Sino-Forest during the offering distribution period relating to Sino-Forest's share prospectus offerings on June 1, 2009 and December 10, 2009 excluding the Defendants,

members of the immediate families of the Individual Defendants, or the directors, officers, subsidiaries and affiliates of the corporate Defendants.

[156] Both Koskie Minsky and Siskinds and Kim Orr challenge this class membership as inadequate for failing to include the bondholders who were allegedly harmed by the same misconduct that harmed the shareholders.

Labourers v. Sino-Forest

[157] In *Labourers v. Sino-Forest*, the proposed class action is on behalf of all persons and entities wherever they may reside who acquired securities of Sino-Forest during the period from and including March 19, 2007 to and including June 2, 2011 either by primary distribution in Canada or an acquisition on the TSX or other secondary markets 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.

[158] The class membership definition in *Labourers v. Sino-Forest* includes non-Canadians who purchased shares or notes in Canada but excludes non-Canadians who purchased in a foreign marketplace.

[159] Challenging this definition, Kim Orr submits that it is wrong in principle to exclude persons whose claims will involve the same facts as other class members and for whom it is arguable that Canadian courts may exercise jurisdiction and provide access to justice.

Northwest v. Sino-Forest,

[160] In *Northwest v. Sino-Forest*, the proposed class action is on behalf of purchasers of shares or notes of Sino-Forest during the period from August 17, 2004 through June 2, 2011, except: Sino-Forest's past and present subsidiaries and affiliates; the past and present officers and directors of Sino-Forest and its subsidiaries and affiliates; members of the immediate family of any excluded person; the legal representatives, heirs, successors, and assigns of any excluded person or entity; and any entity in which any excluded person or entity has or had a controlling interest.

[161] Challenging this definition, Koskie Minsky and Siskinds submit that the proposed class in *Northwest* has no geographical limits and, therefore, will face jurisdictional and choice of law challenges that do not withstand a cost benefit analysis. It submits that Sino-Forest predominantly raised capital in Canadian capital markets and the vast majority of its securities were either acquired in Canada or on a Canadian market, and, in this context, including in the class non-residents who purchased securities outside of Canada risks undermining and delaying the claims of the great majority of proposed class members whose claims do not face such jurisdictional obstacles.

7. Definition of Class Period

Smith v. Sino-Forest

[162] In *Smith v. Sino-Forest*, the class period is May 17, 2004 to August 26, 2011. This class period starts with the release of Sino-Forest's release of its 2003 Annual Information Form, which indicated the use of authorized intermediaries, and it ends on the day of the OSC's cease-trade order.

[163] For comparison purposes, it should be noted that this class period has the earliest start date and the latest finish date. *Labourers v. Sino-Smith* and *Northwest v. Sino-Forest* both use the end date of the release of the Muddy Waters Report.

[164] In making comparisons, it is helpful to look at the chart found at Schedule A of this judgment.

[165] Rochon Genova justifies its extended end date based on the argument that the Muddy Waters Report was a revelation of Sino-Forest's misrepresentation but not a corrective statement that would end the causation of injuries because Sino-Forest and its officers denied the truth of the Muddy Waters Report.

[166] Kim Orr's criticizes the class definition in *Smith v. Sino-Forest* and submits that purchasers of shares or notes after the Muddy Waters Report was published do not have viable claims and ought not be included as class members.

[167] Koskie Minsky and Siskinds' submission is similar, and they regard the extended end date as problematic in raising the issues of whether there were corrective disclosures and of how Part XXIII.1 of the *Ontario Securities Act* should be interpreted.

Labourers v. Sino-Forest

[168] In *Labourers v. Sino-Forest*, the class period is March 19, 2007 to June 2, 2011.

[169] This class period starts with the date Sino-Forest's 2006 financial results were announced, and it ends on the date of the publication of the Muddy Waters Report.

[170] The March 19, 2007, commencement date was determined using a complex mathematical formula known as the "multi-trader trading model." Using this model, Mr. Torchio estimates that 99.5% of Sino-Forest's shares retained after June 2, 2011, had been purchased after the March 19, 2007 commencement date. Thus, practically speaking, there is almost nothing to be gained by an earlier start date for the class period.

[171] The proposed class period covers two share offerings (June 2009 and December 2009). This class period does not include time before the coming into force of Part XXIII.1 of the *Ontario Securities Act* (December 31, 2005), and, thus, Koskie Minsky and Siskinds submit that this aspect of their definition avoids problems about the retroactive application, if any, of Part XXIII.1 of the Act.

[172] For comparison purposes, the *Labourers* class period has the latest start date and shares the finish date used in the *Northwest v. Sino-Forest* action, which is sooner than the later date used in *Smith v. Sino-Forest*. It is the most compressed of the three definitions of a class period.

[173] Based on Mr. Torchio's opinion, Koskie Minsky and Siskinds submit that there are likely no damages arising from purchases made during a substantial portion of the class periods in *Smith v. Sino-Forest* and in *Northwest v. Sino-Forest.* Koskie Minsky and Siskinds submit that given that the average price of Sino's shares was approximately $4.49 in the ten trading days after the Muddy Waters report, it is likely that any shareholder that acquired Sino-Forest shares for less than $4.49 suffered no damages, particularly under Part XXIII.1 of the *Ontario Securities Act*.

[174] In part as a matter of principle, Kim Orr submits that Koskie Minsky and Siskinds' approach to defining the class period is unsound because it excludes class members who, despite the mathematical modelling, may have genuine claims and are being denied any opportunity for access to justice. Kim Orr submits it is wrong in principle to abandon these potential class members.

[175] Rochon Genova also submits that Koskie Minsky and Siskinds' approach to defining the class period is wrong. It argues that Koskie Minsky and Siskinds' reliance on a complex mathematical model to define class membership is arbitrary and unfair to share purchasers with similar claims to those claimants to be included as class members. Rochon Genova criticizes Koskie Minsky and Siskinds' approach as being the condemned merits based approach to class definitions and for being the sin of excluding class members because they may ultimately not succeed after a successful common issues trial.

[176] Relying on what I wrote in *Fischer v. IG Investment Management Ltd.*, 2010 ONSC 296 at para. 157, Rochon Genova submits that the possible failure of an individual class member to establish an individual element of his or her claim such as causation or damages is not a reason to initially exclude him or her as a class member. Rochon Genova submits that the end date employed in *Labourers v. Sino-Forest* and *Northwest v. Sino-Forest* is wrong.

Northwest v. Sino-Forest

[177] In *Northwest v. Sino-Forest*, the class period is August 17, 2004 to June 2, 2011.

[178] This class period starts from the day Sino-Forest closed its public offering of long-term notes that were still outstanding at the end of the class period and ends on the date of the Muddy Waters Research Report. This period covers three share offerings (June 2007, June 2009, and December 2009) and six note offerings (August 2004, July 2008, July 2009, December 2009, February 2010, and October 2010).

[179] For comparison purposes, the *Northwest v. Sino-Forest* class period begins 3 months later and ends three months sooner than the class period in *Smith v. Sino-Forest.* The *Northwest v. Sino-Forest* class period begins approximately two-and-a-half years earlier and ends at the same time as the class period in *Labourers v. Sino-Forest.*

[180] Kim Orr submits that its start date of August 17, 2004 is satisfactory, because on that date, Sino-Forest shares were trading at $2.85, which is below the closing price of Sino-Forest shares on the TSX for the ten days after June 3, 2011 ($4.49), which indicates that share purchasers before August 2004 would not likely be able to claim loss or damages based on the public disclosures on June 2, 2011.

[181] However, Koskie Minsky and Siskinds point out that Kim Orr's submission actually provides partial support for the theory for a later start date (March 19, 2007) because, there is no logical reason to include in the class persons who purchased Sino-Forest shares between May 17, 2004, the start date of the *Smith Action* and December 1, 2005, because with the exception of one trading day (January 24, 2005), Sino-Forest's shares never traded above $4.49 during that period.

8. Theory of the Case against the Defendants

Smith v. Sino-Forest

[182] In *Smith v. Sino-Forest*, the theory of the case rests on the alleged non-arms' length transfers between Sino-Forest and its subsidiaries and authorized intermediaries, that purported to be suppliers and customers. Rochon Genova's investigations and analysis suggest that there are numerous non-arms length inter-company transfers by which Sino-Forest misappropriated investors' funds, exaggerated Sino-Forest's assets and revenues, and engaged in improper tax and accounting practices.

[183] Mr. Smith alleges that Sino-Forest's quarterly interim financial statements, audited annual financial statements, and management's discussion and analysis reports, which are Core Documents as defined under the *Ontario Securities Act*, misrepresented its revenues, the nature and scope of its business and operations, and the value and composition of its forestry holdings. He alleges that the Core Documents failed to disclose an unlawful scheme of fabricated sales transactions and the avoidance of tax and an unlawful scheme through which hundreds of millions of dollars in investors' funds were misappropriated or vanished.

[184] Mr. Smith submits that these misrepresentations and failures to disclose were also made in press releases and in public oral statements. He submits that Chan, Hyde, Horsley, Mak, Martin, Murray, and Wang authorized, permitted or acquiesced in the release of Core Documents and that Chan, Horsley, Martin, and Murray made the misrepresentations in public oral statements.

[185] In *Smith v. Sino-Forest*, Mr. Smith (and Mr. Collins) brings different claims against different combinations of Defendants; visualize:

- misrepresentation in a prospectus under Part XXIII of the *Ontario Securities Act*, against all the Defendants
- subject to leave being granted, misrepresentation in secondary market disclosure under Part XXIII.1 of the Ontario *Securities Act* as against the defendants: Sino-Forest, Chan, Horsley, Hyde, Mak, Martin, Murray, Wang, BDO and E&Y
- negligent, reckless, or fraudulent misrepresentation against Sino-Forest, Chan, Horsley, Hyde, Mak, Martin, Murray, and Wang. This claim would appear to cover sales of shares in both the primary and secondary markets.

[186] It is to be noted that *Smith v. Sino-Forest* does not make a claim on behalf of noteholders, and, as described and explained below, it joins the fewest number of defendants.

[187] *Smith* also does not advance a claim on behalf of purchasers of shares through Sino-Forest's prospectus offering of June 5, 2007, because of limitation period concerns associated with the absolute limitation period found in 138.14 of the *Ontario Securities Act*. See: *Coulson v. Citigroup Global Markets Canada Inc.*, 2010 ONSC 1596 at paras. 98-100.

Labourers v. Sino-Forest

[188] The theory of *Labourers v. Sino-Forest* is that Sino-Forest, along with its officers, directors, and certain of its professional advisors, falsely represented that its financial statements complied with GAAP, materially overstated the size and value of its forestry assets, and made false and incomplete representations regarding its tax liabilities, revenue recognition, and related party transactions.

[189] The claims in *Labourers v. Sino-Forest* are largely limited to alleged misrepresentations in Core Documents as defined in the *Ontario Securities Act* and other Canadian securities legislation. Core Documents include prospectuses, annual information forms, information circulars, financial statements, management discussion & analysis, and material change reports.

[190] The representative plaintiffs advance statutory claims and also common law claims that certain defendants breached a duty of care and committed the torts of negligent misrepresentation and negligence. There are unjust enrichment, conspiracy, and oppression remedy claims advanced against certain defendants.

[191] In *Labourers v. Sino-Forest*, different combinations of representative plaintiffs advance different claims against different combinations of defendants; visualize:

- Labourers' Fund and Mr. Wong, purchasers of shares in a primary market distribution, advance a statutory claim under Part XXIII of the *Ontario Securities Act* against Sino-Forest, Chan, Horsley, Hyde, Mak, Martin, Murray, Poon, Wang, E&Y, BDO, CIBC, Canaccord, Credit Suisse, Dundee, Maison, Merrill, RBC, Scotia, TD and Pöyry
- Labourers' Fund and Mr. Wong, purchasers of shares in a primary market distribution, advance a common law negligent misrepresentation claim against Sino-Forest, Chan, Horsley, Hyde, Mak, Martin, Murray, Poon, Wang, E&Y, BDO, CIBC, Canaccord, Credit Suisse, Dundee, Maison, Merrill, RBC, Scotia, and TD based on the common misrepresentation that Sino-Forest's financial statements complied with GAPP
- Labourers' Fund and Mr. Wong, purchasers of shares in a primary market distribution, advance a common law negligence claim against Sino-Forest, Chan, Hyde, Horsley, Mak, Martin, Murray, Poon, Wang, E&Y, BDO, CIBC, Canaccord, Credit Suisse, Dundee, Maison, Merrill, RBC, Scotia, TD and Pöyry
- Grant, who purchased bonds in a primary market distribution, advances a statutory claim under Part XXIII of the *Ontario Securities Act* against Sino-Forest

- Grant, who purchased bonds in a primary market distribution, advances a common law negligent misrepresentation claim against Sino-Forest, E&Y and BDO based on the common misrepresentation that Sino-Forest's financial statements complied with GAPP
- Grant, who purchased bonds in a primary market distribution, advances a common law negligence claim against Sino-Forest, E&Y, BDO, Banc of America, Credit Suisse USA, and TD
- All the representative plaintiffs, subject to leave being granted, advance claims of misrepresentation in secondary market disclosure under Part XXIII.1 of the *Ontario Securities Act* and, if necessary, equivalent provincial legislation. This claim is against Sino-Forest, Ardell, Bowland, Chan, Hyde, Horsley, Mak, Martin, Murray, Poon, Wang, West, E &Y, BDO, and Pöyry
- All of the representative plaintiffs, who purchased Sino-Forest securities in the secondary market, advance a common law negligent misrepresentation claim against all of the Defendants except the underwriters based on the common misrepresentation contained in the Core Documents that Sino-Forest's financial statements complied with GAAP
- All the representative plaintiffs sue Sino-Forest, Chan, Horsley, and Poon for conspiracy. It is alleged that Sino-Forest, Chan, Horsley, and Poon conspired to inflate the price of Sino-Forest's shares and bonds and to profit by their wrongful acts to enrich themselves by, among other things, issuing stock options in which the price was impermissibly low
- While it is not entirely clear from the Statement of Claim, it seems that all the representative plaintiffs sue Chan, Horsley, Mak, Martin, Murray, and Poon for unjust enrichment in selling shares to class members at artificially inflated prices
- While it is not entirely clear from the Statement of Claim, it seems that all the representative plaintiffs sue Sino-Forest for unjust enrichment for selling shares at artificially inflated prices
- While it is not entirely clear from the Statement of Claim, it seems that all the representative plaintiffs sue Banc of America, Canaccord, CIBC, Credit Suisse, Credit Suisse USA, Dundee, Maison, Merrill, RBC, Scotia, and TD for unjustly enriching themselves from their underwriters fees
- All the representative plaintiffs sue Sino-Forest, Chan, Horsley, Hyde, Mak, Martin, Murray, Poon, and Wang for an oppression remedy under the *Canada Business Corporations Act*

[192] Koskie Minsky and Siskinds submit that *Labourers v. Sino-Forest* is more focused than *Smith* and *Northwest* because: (a) its class definition covers a shorter time period and is limited to securities acquired by Canadian residents or in Canadian markets; (b) the material documents are limited to Core Documents under securities legislation; (c) the named individual defendants are limited to directors and officers with statutory obligations to certify the accuracy of Sino-Forest's public filings; and (d) the

causes of action are tailored to distinguish between the claims of primary market purchasers and secondary market purchasers and so are less susceptible to motions to strike.

[193] Koskie Minsky and Siskinds submit that save for background and context, little is gained in the rival actions by including claims based on non-Core Documents, which confront a higher threshold to establish liability under Part XXIII.1 of the *Ontario Securities Act*.

Northwest v. Sino-Forest

[194] The *Northwest v. Sino-Forest* Statement of Claim focuses on an "Integrity Representation," which is defined as: "the representation in substance that Sino-Forest's overall reporting of its business operations and financial statements was fair, complete, accurate, and in conformity with international standards and the requirements of the *Ontario Securities Act* and National Instrument 51-102, and that its accounts of its growth and success could be trusted."

[195] The *Northwest v. Sino-Forest* Statement of Claim alleges that all Defendants made the Integrity Representation and that it was a false, misleading, or deceptive statement or omission. It is alleged that the false Integrity Representation caused the market decline following the June 2, 2011, disclosures, regardless of the truth or falsity of the particular allegations contained in the Muddy Waters Report.

[196] In *Northwest v. Sino-Forest*, the representative plaintiffs advance statutory claims under Parts XXIII and XXIII.1 of the *Ontario Securities Act* and a collection of common law tort claims. Kim Orr submits that to the extent, if any, that the statutory claims do not provide complete remedies to class members, whether due to limitation periods, liability caps, or other limitations, the common law claims may provide coverage.

[197] In *Northwest v. Sino-Forest*, the plaintiffs advance different claims against different combinations of defendants; visualize:

- With respect to the June 2009 and December 2009 prospectus, a cause of action for violation of Part XXIII of the *Ontario Securities Act* against Sino-Forest, the underwriter Defendants, the director Defendants, the Defendants who consented to disclosure in the prospectus and the Defendants who signed the prospectus
- Negligent misrepresentation against all of the Defendants for disseminating material misrepresentations about Sino-Forest in breach of a duty to exercise appropriate care and diligence to ensure that the documents and statements disseminated to the public about Sino-Forest were complete, truthful, and accurate.
- Fraudulent misrepresentation against all of the Defendants for acting knowingly and deliberately or with reckless disregard for the truth making misrepresentations in documents, statements, financial statements, prospectus,

offering memoranda, and filings issued and disseminated to the investing public including Class Members.

- Negligence against all the Defendants for a breach of a duty of care to ensure that Sino-Forest implemented and maintained adequate internal controls, procedures and policies to ensure that the company's assets were protected and its activities conformed to all legal developments.
- Negligence against the underwriter Defendants, the note distributor Defendants, the auditor Defendants, and the Pöyry Defendants for breach of a duty to the purchasers of Sino-Forest securities to perform their professional responsibilities in connection with Sino-Forest with appropriate care and diligence.
- Subject to leave being granted, a cause of action for violation of Part XXIII.1 of the *Ontario Securities Act* against Sino-Forest, the auditor Defendants, the individual Defendants who were directors and officers of Sino-Forest at the time one or more of the pleaded material misrepresentations was made, and the Pöyry Defendants.

[198] Kim Orr submits that *Northwest v. Sino-Forest* is more comprehensive than its rivals and does not avoid asserting claims on the grounds that they may take time to litigate, may not be assured of success, or may involve a small portion of the total potential class. It submits that its conception of Sino-Forest's wrongdoing better accords with the factual reality and makes for a more viable claim than does Koskie Minsky and Siskinds' focus on GAAP violations and Rochon Genova's focus on the misrepresentations associated with the use of authorized intermediaries. It denies Koskie Minsky and Siskinds' argument that it has pleaded overbroad tort claims.

[199] Koskie Minsky and Siskinds submit that its conspiracy claim against a few defendants is focused and narrow, and it criticizes the broad fraud claim advanced in *Northwest v. Sino-Forest* against all the defendants as speculative, provocative, and unproductive.

[200] Relying on *McKenna v. Gammon Gold Inc*., 2010 ONSC 1591 at para. 49; *Corfax Benefits Systems Ltd. v. Fiducie Desjardins Inc*., [1997] O.J. No. 5005 (Gen. Div.) at paras. 28-36; *Hughes v. Sunbeam Corp. (Canada)*, [2000] O.J. No. 4595 (S.C.J.) at paras. 25 and 38; and *Toronto-Dominion Bank v. Leigh Instruments Ltd. (Trustee of)*, [1998] O.J. No. 2637 (Gen. Div.) at para. 477, Koskie Minsky and Siskinds submit that the speculative fraud action in *Northwest v. Sino-Forest* is improper and would not advance the interests of class members. Further, the task of proving that each of some twenty defendants had a fraudulent intent, which will be vehemently denied by the defendants, and the costs sanction imposed for pleading and not providing fraud make the fraud claim a negative and not a positive feature of *Northwest v. Sino-Forest*.

9. Joinder of Defendants

Smith v. Sino-Forest

[201] In *Smith v. Sino-Forest*, the Defendants are: Sino-Forest; seven of its directors and officers; namely: Chan, Horsley, Hyde, Mak, Martin, Murray, and Wang; nine underwriters; namely, Canaccord, CIBC, Credit Suisse, Dundee, Maison, Merrill, RBC, Scotia, and TD; and Sino-Forest's two auditors during the Class Period, E &Y and BDO.

[202] The *Smith v. Sino-Forest* Statement of Claim does not join Pöyry because Rochon Genova is of the view that the disclaimer clause in Pöyry's reports likely insulates it from liability, and Rochon Genova believes that its joinder would be of marginal utility and an unnecessary complication. It submits that joining Pöyry would add unnecessary expense and delay to the litigation with little corresponding benefit because of its jurisdiction and its potential defences.

Labourers v. Sino-Forest

[203] In *Labourers v. Sino-Forest*, the Defendants are the same as in *Smith v. Sino-Forest* with the additional joinder of Ardell, Bowland, Poon, West, Banc of America, Credit Suisse (USA), and Pöyry.

[204] The *Labourers v. Sino-Forest* action does not join Chen, Ho, Hung, Ip, Maradin, Wong, Yeung, Zhao, Credit Suisse (USA), Haywood, Merrill-Fenner, Morgan and UBS, which are parties to *Northwest v. Sino-Forest.*

[205] Koskie Minsky and Siskinds' explanation for these non-joinders is that the activities of the underwriters added to *Northwest v. Sino-Forest* occurred outside of the class period in *Labourers v. Sino-Forest* and neither Lawrence nor Wong held a position with Sino-Forest during the proposed class period and the action against Lawrence's Estate is probably statute-barred. (See *Waschkowski v. Hopkinson Estate*, [2000] O.J. No. 470 (C.A.).)

[206] Wong left Sino-Forest before Part XXIII.1 of the *Ontario Securities Act* came into force, and Koskie Minsky and Siskinds submit that proving causation against Wong will be difficult in light of the numerous alleged misrepresentations since his departure. Moreover, the claim against him is likely statute-barred.

[207] Koskie Minsky and Siskinds submit that Chen, Maradin, and Zhao did not have statutory duties and allegations that they owed common law duties will just lead to motions to strike that hinder the progress of an action.

[208] Further, Koskie Minsky and Siskinds submit that it is not advisable to assert claims of fraud against all defendants, which pleading may raise issues for insurers that potentially put available coverage and thus collection for plaintiffs at risk.

[209] Kim Orr submits that it is a mistake in *Labourers v. Sino-Forest*, which is connected to the late start date for the class period, which Kim Orr also regards as a mistake, that those underwriters that may be liable and who may have insurance to indemnify them for their liability, have been left out of *Labourers v. Sino-Forest*.

Northwest v. Sino-Forest

[210] In *Northwest v. Sino-Forest*, with one exception, the defendants are the same as in *Labourers v. Sino-Forest* with the additional joinder of various officers of Sino-Forest; namely: Chen, Ho, Hung, Ip, The Estate of John Lawrence, Maradin, Wong, Yeung, and Zhao; the joinder of Pöyry Forest and JP Management; and the joinder of more underwriters; namely: Haywood, Merrill- Fenner, Morgan, and UBS.

[211] The one exception where *Northwest v. Sino-Forest* does not join a defendant found in *Labourers v. Sino-Forest* is Banc of America.

[212] Kim Orr's submits that its joinder of all defendants who might arguably bear some responsibility for the loss is a positive feature of its proposed class action because the precarious financial situation of Sino-Forest makes it in the best interests of the class members that they be provided access to all appropriate routes to compensation. It strongly denies Koskie Minsky and Siskinds' allegation that *Northwest v. Sino-Forest* takes a "shot-gun" and injudicious approach by joining defendants that will just complicate matters and increase costs and delay.

[213] Kim Orr submits that Rochon Genova has no good reason for not adding Pöyry, Pöyry Forest, and JP Management as defendants to *Smith v. Sino-Forest* and that Koskie Minsky and Siskinds have no good reason in *Labourers v. Sino-Forest* for suing Pöyry but not also suing its associated companies, all of whom are exposed to liability and may be sources of compensation for class members.

[214] While not putting it in my blunt terms, Kim Orr submits, in effect, that Koskie Minsky and Siskinds' omission of the additional defendants is just laziness under the guise of feigning a concern for avoiding delay and unnecessarily complicating an already complex proceeding.

10. Causes of Action

Smith v. Sino-Forest

[215] In *Smith v. Sino-Forest,* the causes of action advanced by Mr. Smith on behalf of the class members are:

- misrepresentation in a prospectus under Part XXIII of the *Ontario Securities Act*
- negligent, reckless, or fraudulent misrepresentation
- subject to leave being granted, misrepresentation in secondary market disclosure under Part XXIII.1 of the *Ontario Securities Act* and, if necessary, equivalent provincial legislation

Labourers v. Sino-Forest

[216] In *Labourers v. Sino-Forest*, the causes of action advanced by various combinations of plaintiffs against various combinations of defendants are:

- misrepresentation in a prospectus under Part XXIII of the *Ontario Securities Act*
- negligent misrepresentation

- negligence
- subject to leave being granted misrepresentation in secondary market disclosure under Part XXIII.1 of the *Ontario Securities Act* and, if necessary, equivalent provincial legislation
- conspiracy
- unjust enrichment
- oppression remedy.

[217] Kim Orr submits that the unjust enrichment claims and oppression remedy claims seemed to be based on and add little to the misrepresentation causes of action. It concedes that the conspiracy action may be a tenable claim but submits that its connection to the disclosure issues that comprise the nucleus of the litigation is unclear.

Northwest v. Sino-Forest

[218] In *Northwest v. Sino-Forest*, the causes of action are:

- misrepresentation in a prospectus in violation of Part XXIII the *Ontario Securities Act*
- misrepresentation in an offering memorandum in violation of Part XXIII the *Ontario Securities Act*
- negligent misrepresentation
- fraudulent misrepresentation
- negligence
- subject to leave being granted misrepresentation in secondary market disclosure under Part XXIII.1 of the *Ontario Securities Act* and, if necessary, equivalent provincial legislation

[219] The following chart is helpful in comparing and contrasting the joinder of various causes of action and the joinder of defendants in *Smith v. Sino-Forest*, *Labourers v. Sino-Forest* and *Northwest v. Sino-Forest.*

Cause of Action	***Smith v. Sino-Forest,***	***Labourers v. Sino-Forest,***	***Northwest v. Sino-Forest,***
Part XXIII of the *Ontario Securities Act* – primary market shares	Sino-Forest, Chan, Horsley, Hyde, Mak, Martin, Murray, Wang, Canaccord, CIBC, Credit Suisse, Dundee, Maison, Merrill, RBC, Scotia, TD, E&Y, BDO	Sino-Forest, Chan, Horsley, Hyde, Mak, Martin, Murray, Poon, Wang, Canaccord, CIBC, Credit Suisse, Dundee, Maison, Merrill, RBC, Scotia, TD, E&Y, BDO, Pöyry	Sino-Forest, Ardell, Bowland, Chan Horsley, Hyde, Mak, Martin, Murray, Poon, Wang, West, Canaccord, CIBC Credit Suisse, Credit Suisse (USA), Dundee, Haywood, Maison, Merrill, Merrill-Fenner Morgan, RBC,Scotia, TD, UBS, E&Y, BDO, Pöyry, Pöyry Forest, JP Management [for June 2009 and Dec. 2009 prospectus]
Part XXIII of the *Ontario Securities Act* – primary		Sino-Forest [two bond issues]	Sino-Forest [six bond issues]

market bonds			
Negligent misrepresentation – primary market shares	Sino-Forest, Chan, Horsley, Hyde, Mak, Martin, Murray, Wang, E&Y, BDO	Sino-Forest, Chan, Horsley, Hyde, Mak, Martin, Murray, Poon, Wang, Canaccord, CIBC, Credit Suisse, Dundee, Maison, Merrill, RBC, Scotia, TD, E&Y, BDO, Pöyry	Sino-Forest, Ardell, Bowland, Chan, Horsley, Hyde, Mak, Martin, Murray, Poon, Wang, West, Chen, Ho, Hung, Ip, Lawrence Estate, Maradin, Wong,Yeung, Zhao, Canaccord, CIBC, Credit Suisse, Credit Suisse (USA), Dundee, Haywood, Maison, Merrill, Merrill-Fenner, Morgan, RBC, Scotia, TD, UBS, E&Y, BDO, Pöyry, Pöyry Forest. JP Management,
Negligent misrepresentation – primary market bonds		Sino-Forest, E&Y, BDO	Sino-Forest, Ardell, Bowland, Chan, Horsley, Hyde, Mak, Martin, Murray, Poon, Wang, West, Chen, Ho, Hung, Ip, Lawrence Estate, Maradin, Wong, Yeung, Zhao, Canaccord, CIBC, Credit Suisse, Credit Suisse (USA), Dundee, Haywood, Maison, Merrill, Merrill-Fenner, Morgan, RBC, Scotia, TD, UBS, E&Y, BDO, Pöyry, Pöyry Forest, JP Management
Negligence – primary market shares		Sino-Forest, Chan, Hyde, Horsley, Mak, Martin, Murray, Poon, Wang, E &Y, BDO, CIBC, Canaccord, Credit Suisse, Dundee, Maison, Merrill, RBC, Scotia,TD, Pöyry,	[see negligence, professional negligence]
Negligence – primary market bonds		Sino-Forest, E&Y, BDO, Banc of America, Credit Suisse USA, TD	[See negligence, professional negligence]
Negligence			Sino-Forest, Ardell, Bowland, Chan, Horsley, Hyde, Mak, Martin, Murray, Poon, Wang, West, Chen, Ho, Hung, Ip, Lawrence Estate, Maradin, Wong, Yeung, Zhao, Canaccord, CIBC, Credit Suisse, Credit Suisse (USA), Dundee, Haywood, Maison, Merrill, Merrill-Fenner, Morgan, RBC, Scotia, TD, UBS, E&Y, BDO, Pöyry, Pöyry Forest, JP Management
Professional Negligence			Canaccord, CIBC, Credit Suisse, Credit Suisse (USA), Dundee, Haywood, Maison, Merrill, Merrill-Fenner, Morgan, RBC, Scotia, TD, UBS, E&Y, BDO, Pöyry, Pöyry Forest, JP Management

Part XXIII.1 of the *Ontario Securities Act* – secondary market shares	Sino-Forest, Chan, Horsley, Hyde, Mak, Martin, Murray, Wang, E&Y, BDO	Sino-Forest, Ardell, Bowland, Chan, Hyde , Horsley, Mak, Martin, Murray, Poon , Wang, West, E &Y, BDO, Pöyry	Sino-Forest, Ardell, Bowland, Chan, Horsley, Hyde, Mak, Martin, Murray, Poon, Wang, West, Chen, Ho, Hung, Ip, Lawrence Estate, Maradin, Wong, Yeung, Zhao, Canaccord, CIBC, Credit Suisse, Credit Suisse (USA), Dundee, Haywood, Maison, Merrill, Merrill-Fenner, Morgan, RBC,Scotia, TD, UBS, E&Y, BDO, Pöyry, Pöyry Forest, JP Management
Part XXIII.1 of the *Ontario Securities Act* – secondary market bonds		Sino-Forest, Ardell, Bowland, Chan, Hyde , Horsley, Mak, Martin, Murray, Poon, Wang, West, E &Y, BDO, Pöyry	Sino-Forest, Ardell, Bowland, Chan, Horsley, Hyde, Mak, Martin, Murray, Poon, Wang, West, Chen, Ho, Hung, Ip, Lawrence Estate, Maradin, Wong, Yeung, Zhao, Canaccord, CIBC, Credit Suisse, Credit Suisse (USA), Dundee, Haywood, Maison, Merrill, Merrill-Fenner, Morgan, RBC, Scotia, TD, UBS, E&Y, BDO, Pöyry, Pöyry Forest, JP Management
Negligent misrepresentation – secondary market shares	Sino-Forest, Chan, Horsley, Hyde, Mak, Martin, Murray, Wang, E&Y, BDO	Sino-Forest, Ardell, Bowland, Chan, Horsley, Hyde, Mak, Martin, Murray, Poon, Wang, E&Y, BDO, Pöyry	Sino-Forest, Ardell, Bowland, Chan, Horsley, Hyde, Mak, Martin, Murray, Poon, Wang, West, Chen, Ho, Hung, Ip, Lawrence Estate, Maradin, Wong, Yeung, Zhao, Canaccord, CIBC, Credit Suisse, Credit Suisse (USA), Dundee, Haywood, Maison, Merrill, Merrill-Fenner, Morgan, RBC, Scotia, TD, UBS, E&Y, BDO, Pöyry, Pöyry Forest, JP Management
Negligent misrepresentation – secondary market bonds		Sino-Forest, Ardell, Bowland, Chan, Horsley, Hyde, Mak, Martin, Murray, Poon, Wang, E&Y, BDO, Pöyry	Sino-Forest, Ardell, Bowland, Chan, Horsley, Hyde, Mak, Martin, Murray, Poon, Wang, West, Chen, Ho, Hung, Ip, Lawrence Estate, Maradin, Wong, Yeung, Zhao, Canaccord, CIBC, Credit Suisse, Credit Suisse (USA), Dundee, Haywood, Maison, Merrill, Merrill-Fenner, Morgan, RBC, Scotia, TD, UBS, E&Y, BDO, Pöyry, Pöyry Forest, JP Management
Negligence - secondary market shares		Sino-Forest, Chan, Horsley, Hyde, Mak, Martin, Murray, Poon, Wang, Canaccord, CIBC,	[see negligence, professional negligence]

		Credit Suisse, Dundee, Maison, Merrill, RBC, Scotia, TD, E&Y, BDO, Pöyry	
Conspiracy		Sino-Forest, Chan, Horsley, Poon,	
Fraudulent Misrepresentation - Bonds, shares			Sino-Forest, Ardell, Bowland, Chan, Horsley, Hyde, Mak, Martin, Murray, Poon, Wang, West, Chen, Ho, Hung, Ip, Lawrence Estate, Maradin, Wong, Yeung, Zhao, Canaccord, CIBC, Credit Suisse, Credit Suisse (USA), Dundee, Haywood, Maison, Merrill, Merrill-Fenner, Morgan, RBC, Scotia, TD,UBS, E&Y, BDO, Pöyry, Pöyry Forest, JP Management
Unjust Enrichment		Chan, Horsley, Mak, Martin, Murray, Poon,	
Unjust Enrichment		Sino-Forest,	
Unjust Enrichment		Banc of America, Canaccord, CIBC, Credit Suisse, Credit Suisse USA, Dundee, Maison, Merrill, RBC, Scotia, TD	
Oppression Remedy		Sino-Forest, Chan, Horsley, Hyde, Mak, Martin, Murray, Poon, Wang	

11. The Plaintiff and Defendant Correlation

[220] In class actions in Ontario, for every named defendant there must be a named plaintiff with a cause of action against that defendant: *Ragoonanan v. Imperial Tobacco Canada Ltd.*, [2000] O.J. No. 4597 (S.C.J.) at para. 55 (S.C.J.); *Hughes v. Sunbeam Corp. (Canada)* (2002), 61 O.R. (3d) 433 (C.A.) at para. 18.

[221] As an application of the *Ragoonanan* rule, a purchaser in the secondary market cannot be the representative plaintiff for a class member who purchased in the primary market: *Menegon v. Philip Services Corp.*, [2001] O.J. No. 5547 (S.C.J.) at paras. 28-30 aff'd [2003] O.J. No. 8 (C.A.).

[222] Where the class includes non-resident class members, they must be represented by a representative plaintiff that is a non-resident: *McKenna v. Gammon Gold Inc.*, 2010 ONSC 1591 at paras. 109, 117 and 184; *Currie v. McDonald's Restaurants of Canada Ltd.* (2005), 74 O.R. (3d) 321 at para. 30 (C.A.).

[223] Koskie Minsky and Siskinds submit that *Labourers v. Sino-Forest* has no *Ragoonanan* problems. However, they submit that the other actions have problems. For example, until Mr. Collins volunteered, there was no representative plaintiff in *Smith v. Sino-Forest* who had purchased shares in the primary market, and at this juncture, it is not clear that Mr. Collins purchased in all of the primary market distributions. Mr. Smith and Mr. Collins may have timing-of-purchase issues. Mr. Smith made purchases

during periods when some of the Defendants were not involved; viz. BDO, Canaccord CIBC, Credit Suisse, Dundee, Maison, Merrill, RBC, Scotia, and TD.

[224] Koskie Minsky and Siskinds submit that none of the representative plaintiffs in *Northwest v. Sino-Forest* purchased notes in the primary market for the 2007 prospectus offering and that the plaintiffs in *Northwest* may have timing issues with respect to their claims against Wong, Lawrence, JP Management, UBS, Haywood and Morgan.

[225] Rochon Genova's and Kim Orr's response is that there are no *Ragoonanan* problems or no irremediable *Ragoonanan* problems.

12. Prospects of Certification

[226] Koskie Minsky and Siskinds framed part of their argument in favour of their being selected for carriage in terms of the comparative prospects of certification of the rival actions. They submitted that *Labourers v. Sino-Forest* was carefully designed to avoid the typical road blocks placed by defendants on the route to certification and to avoid inefficiencies and unproductive claims or claims that on a cost-benefit analysis would not be in the interests of the class to pursue. One of the typical roadblocks that they referred to was challenges to the jurisdiction of the Ontario Court over foreign class members and foreign defendants who have not attorned to the Ontario Superior Court of Justice's territorial jurisdiction.

[227] Koskie Minsky and Siskinds submitted that their representative plaintiffs focus their claims on a single misrepresentation to avoid the pitfalls of seeking to certify a negligent misrepresentation claim with multiple misrepresentations over a long period of time. Such a claim apparently falls into a pit because it is often not certified. Koskie Minsky and Siskinds say it is better to craft a claim that has higher prospects of certification and leave some claims behind. They submit that the Supreme Court of Canada accepted that a representative plaintiff is entitled to restrict their causes of action to make their claims more amenable to class proceedings: *Rumley v. British Columbia*, [2001] 3 S.C.R. 184 at para. 30.

[228] Although *Smith v. Sino-Forest* is even more focused that *Labourers v. Sino-Forest*, Koskie Minsky and Siskinds still submit that their approach is better because *Smith v. Sino-Forest* goes too far in cutting out the bondholders' claims and then loses focus by extending its claims beyond the release of the Muddy Waters Report.

[229] In any event, Koskie Minsky and Siskinds submit that *Labourers v. Sino-Forest* is better because the named plaintiffs are able to advance statutory and common law claims against all of the named defendants, which arguably is not the case for the plaintiffs in the other actions, who may have *Ragoonanan* problems or no tenable claims against some of the named defendants. Further, *Labourers* arguably is better because of a more focussed approach to maximize class recovery while avoiding the costs and delays inevitably linked with motions to strike.

[230] Kim Orr submits that its more comprehensive approach, where there are more defendant parties and expansive tort claims, is preferable to *Labourers v. Sino-Forest* and *Smith v. Sino-Forest.* Kim Orr submits that it does not shirk asserting claims

because they may be difficult to litigate and it does not abandon class members who may not be assured of success or who comprise a small portion of the class.

[231] Kim Orr submits that *Northwest v. Sino-Forest* is comprehensive and also cohesive and corresponds to the factual reality. It submits that the theories of the competing actions do not capture the wrongdoing at Sino-Forest for which many are culpable and who should be held responsible. It submits that its approach will meet the challenges of certification and yield an optimum recovery for the class.

[232] Rochon Genova submits that *Smith v. Sino-Forest* is much more cohesive that the other actions. It submits that the more expansive class definitions and causes of action in *Labourers v. Sino-Forest* and *Northwest v. Sino-Forest* will present serious difficulties relating to manageability, preferability, and potential conflicts of interest amongst class members that are not present in *Smith v. Sino-Forest*. Rochon Genova submits that it has developed a solid, straightforward theory of the case and made a great deal of progress in unearthing proof of Sino-Forest's wrongdoing.

G. CARRIAGE ORDER

1. Introduction

[233] With the explanation that follows, I stay *Smith v. Sino-Forest* and *Northwest v. Sino-Forest*, and I award carriage to Koskie Minsky and Siskinds in *Labourers v. Sino-Forest.* In the race for carriage of an action against *Sino-Forest*, I would have ranked Rochon Genova second and Kim Orr third.

[234] This is not an easy decision to make because class members would probably be well served by any of the rival law firms. Success in a carriage motion does not determine which is the best law firm, it determines that having regard to the interests of the plaintiffs and class members, to what is fair to the defendants, and to the policies that underlie the class actions regime, there is a constellation of factors that favours selecting one firm or group of firms as the best choice for a particular class action.

[235] Having regard to the constellation of factors, in the circumstances of this case, several factors are neutral or non-determinative of the choice for carriage. In this group are: (a) attributes of class counsel; (b) retainer, legal, and forensic resources; (c) funding; (d) conflicts of interest; and (e) the plaintiff and defendant correlation.

[236] In the case at bar, the determinative factors are: definition of class membership, definition of class period, theory of the case, causes of action, joinder of defendants, and prospects of certification.

[237] Of the determinative factors, the attributes of the representative plaintiffs is a standalone factor. The other determinative factors are interrelated and concern the rival conceptualizations of what kind of class action would best serve the class members' need for access to justice and the policies of fairness to defendants, behaviour modification, and judicial economy.

[238] Below, I will first discuss the neutral or non-determinative factors. Then, I will discuss the determinative factors. After discussing the attributes of the representative plaintiffs, I will discuss the related factors in two groups. One group of related factors is about class membership, and the second group of factors is about the claims against the defendants.

2. Neutral or Non-Determinative Factors

(a) Attributes of Class Counsel

[239] In the circumstances of the cases at bar, the attributes of the competing law firms along with their associations with prestigious and prominent American class action firms is not determinative of carriage, since there is little difference among the rivals about their suitability for bringing a proposed class action against Sino-Forest.

[240] With respect to the attributes of the law firms, although one might have thought that Mr. Spencer's call to the bar would diminish the risk, Koskie and Minsky and Siskinds, particularly Siskinds, raised a question about whether Milberg might cross the line of what legal services a foreign law firm may provide to the Ontario lawyers who are the lawyers of record, and Siskinds alluded to the spectre of violations of the rules of professional conduct and perhaps the evil of champerty and maintenance. It suggested that it was unfair to class members to have to bear this risk associated with the involvement of Milberg.

[241] However, at this juncture, I have no reason to believe that any of the competing law firms, all of which have associations with notable American class action firms, will shirk their responsibilities to control the litigation and not to condone breaches of the rules of professional conduct or tortious conduct.

(b) Retainer, Legal, and Forensic Resources

[242] The circumstances of the retainers and the initiative shown by the law firms and their efforts and resources expended by them are also not determinative factors in deciding the carriage motions in the case at bar, although it is an enormous shame that it may not be possible to share the fruits of these efforts once carriage is granted to one action and not the others.

[243] As I have already noted above, the aggregate expenditure to develop the tactical and strategic plans for litigation not including the costs of preparing for the carriage motion are approximately $2 million. It seems that this effort by the respective law firms has been fruitful and productive. All of the law firms claim that their respective efforts have yielded valuable information to advance a claim against Sino-Forest and others.

[244] All of the law firms were quickly out of the starting blocks to initiate investigations about the prospects and merits of a class action against Sino-Forest. For different reasonable reasons, the statements of claim were filed at different times.

[245] In the case at bar, I do not regard the priority of the commencement of the actions as a meaningful factor, given that from the publication of the Muddy Waters Report, all the firms responded immediately to explore the merits of a class action and given that all the firms plan to amend their original pleadings that commenced the actions. In any event, I do not think that a carriage motion should be regarded as some sort of take home exam where the competing law firms have a deadline for delivering a statement of claim, else marks be deducted.

(c) Funding

[246] In my opinion, another non-determinative factor is the circumstances that: (a) the representative plaintiffs in *Labourers v. Sino-Forest* may apply for court approval for third-party funding; (b) the plaintiffs in *Northwest v. Sino-Forest* may apply for court approval for third-party funding or they may apply to the Class Proceedings Fund to be protected from an adverse costs award; (c) Messrs. Smith and Collins in *Smith v. Sino-Forest* may apply to the Class Proceedings Fund to be protected from an adverse costs award; and (d) each of the law firms have respectively undertaken with their respective clients to indemnify them from an adverse costs award.

[247] In the future, the court or the Ontario Law Foundation may have to deal with the funding requests, but for present purposes, I do not see how these prospects should make a difference to deciding carriage, although I will have something more to say below about the significance of the state of affairs that clients with the resources of Labourers' Fund, Operating Engineers Fund, Sjunde AP-Fonden, BC Investment, Bâtirente, and Northwest would seek an indemnity from their respective class counsel.

[248] In any event, in my opinion, standing alone, the funding situation is not a determinative factor to carriage, although it may be relevant to other factors that are discussed below.

(d) Conflicts of Interest

[249] In the circumstances of the case at bar, I also do not regard conflicts of interest as a determinative factor.

[250] I do not see how the fact that Northwest, Bâtirente, and BC Investments made their investments on behalf of others and allegedly suffered no losses themselves creates a conflict of interest. It appears to me that they have the same fiduciary responsibilities to their members as do Labourers' Fund, Operating Engineers Fund, Sjunde AP-Fonden, and Healthcare Manitoba.

[251] Northwest, Bâtirente, and BC Investments were the investors in the securities of Sino-Forest and although there may be equitable or beneficial owners, under the common law, they suffered the losses, just like the other investors in Sino-Forest securities suffered losses. The fact that Northwest, Bâtirente, and BC Investments held the investments in trust for their members does not change the reality that they suffered the losses.

[252] It is alleged that Northwest, Bâtirente, and BC Investments, who were involved in corporate governance matters associated with Sino-Forest, failed to properly evaluate the risks of investing in Sino-Forest. Based on these allegations, it is submitted that they have a conflict of interest. I disagree.

[253] Having regard to the main allegation being that Sino-Forest was engaged in a corporate shell game that deceived everyone, it strikes me that it is almost a spuriously speculative allegation to blame another victim as being at fault. However, even if the allegation is true, the other class members have no claim against Northwest, Bâtirente, and BC Investments. If there were a claim, it would be by the members of Northwest, Bâtirente, and BC Investments, who are not members of the class suing Sino-Forest. The actual class members have no claim against Northwest, Bâtirente, and BC Investments but have a common interest in pursuing Sino-Forest and the other defendants.

[254] Further, it is arguable that Koskie Minsky and Siskinds are incorrect in suggesting that in *Comité syndical national de retraite Bâtirente inc. c. Société financière Manuvie*, 2011 QCCS 3446, the Superior Court of Québec disqualified Bâtirente as a representative plaintiff because there might be an issue about Bâtirente's investment decisions.

[255] It appears to me that Justice Soldevida did not appoint Bâtirente as a representative plaintiff for a different reason. The action in Québec was a class action. There were some similarities to the case at bar, insofar as it was an action against a corporation, Manulife, and its officers and directors for misrepresentations and failure to fulfill disclosure obligations under securities law. In that action, the personal knowledge of the investors was a factor in their claims against Manulife, and Justice Soldevida felt that sophisticated investors, like Bâtirente, could not be treated on the same footing as the average investor. It was in that context that she concluded that there was an appearance of a conflict of interest between Bâtirente and the class members.

[256] In the case at bar, however, particularly for the statutory claims where reliance is presumed, there is no reason to differentiate the average investors from the sophisticated ones. I also do not see how the difference between sophisticated and average investors would matter except perhaps at individual issues trials, where reasonable reliance might be an issue, if the matter ever gets that far.

[257] Another alleged conflict concerns the facts that BDO Canada, which is not a defendant, is the auditor of Labourers' Fund, and Koskie Minsky and BDO Canada have worked together on several matters. These circumstances are not conflicts of interest. There is no reason to think that Labourers' Fund and Koskie Minsky are going to pull their punches against BDO or would have any reason to do so.

[258] Finally, turning to the major alleged conflict between the bondholders and the shareholders, speaking generally, the alleged conflicts of interest between the bondholders that invested in Sino-Forest and the shareholders that invested in Sino-Forest arise because the bondholders have a cause of action in debt in addition to their causes of action based in tort or statutory misrepresentation claims, while, in contrast,

the shareholders have only statutory and common law claims based in misrepresentation.

[259] There is, however, within the context of the class action, no conflict of interest. In the class action, only the misrepresentation claims are being advanced, and there is no conflict between the bondholders and the shareholders in advancing these claims. Both the bondholders and the shareholders seek to prove that they were deceived in purchasing or holding on to their Sino-Forest securities. That the Defendants may have defences associated with the terms of the bonds is a problem for the bondholders but it does not place them in a conflict with shareholders not confronted with those special defences.

[260] Assuming that the bondholders and shareholders succeed or are offered a settlement, there might be a disagreement between them about how the judgment or settlement proceeds should be distributed, but that conflict, which at this juncture is speculative, can be addressed now or later by constituting the bondholders as a subclass and by the court's supervisory role in approving settlements under the *Class Proceedings Act, 1992*.

[261] If there are bondholders that wish only to pursue their debt claims or who wish not to pursue any claim against Sino-Force or who wish to have the bond trustee pursue only the debt claims, these bondholders may opt out of the class proceeding assuming it is certified.

[262] If there is a bankruptcy of Sino-Forest, then in the bankruptcy, the position of the shareholders as owners of equity is different than the position of the bondholders as secured creditors, but that is a natural course of a bankruptcy. That there are creditors' priorities, outside of the class action, does not mean that, within the class action, where the bondholders and the shareholders both claim damages, i.e., unsecured claims, there is a conflict of interest.

[263] The alleged conflict in the case at bar is different from the genuine conflict of interest that was identified in *Settington v. Merck Frost Canada Ltd.*, [2006] O.J. No. 379 (S.C.J.), where, for several reasons, the Merchant Law Firm was not granted carriage or permitted to be part of the consortium granted carriage in a pharmaceutical products liability class action against Merck.

[264] In *Settington,* one ground for disqualification was that the Merchant Law firm was counsel in a securities class action for different plaintiffs suing Merck for an unsecured claim. If the securities class action claim was successful, then the prospects of an unsecured recovery in the products liability class action might be imperiled. In the case at bar, however, within the class action, the bondholders are not pursuing a different cause of action from the shareholders; both are unsecured creditors for the purposes of their damages' claims arising from misrepresentation. If, in other proceedings, the bondholders or their trustee successfully pursue recovery in debt, then the threat to the prospects of recovery by the shareholders arises in the normal way that debt instruments have priority over equity instruments, which is a normal risk for shareholders.

[265] Put shortly, although the analysis may not be easy, there are no conflicts of interest between the bondholders and the shareholders within the class action that cannot be handled by establishing a subclass for bondholders at the time of certification or at the time a settlement is contemplated.

(e) The Plaintiff and Defendant Correlation

[266] In *Ragoonanan v. Imperial Tobacco Canada Ltd.*, (2000), 51 O.R. (3d) 603 (S.C.J.), in a proposed products liability class action, Mr. Ragoonanan sued Imperial Tobacco, Rothmans, and JTI-MacDonald, all cigarette manufacturers. He alleged that the manufacturers had negligently designed their cigarettes by failing to make them "fire safe." Mr. Ragoonanan's particular claim was against Imperial Tobacco, which was the manufacturer of the cigarette that allegedly caused harm to him when it was the cause of a fire at Mr. Ragoonanan's home. Mr. Ragoonanan did not have a claim against Rothmans or JTI-MacDonald.

[267] In *Ragoonanan*, Justice Cumming established the principle in Ontario class action law that there cannot be a cause of action against a defendant without a plaintiff who has that cause of action. Rather, there must be for every named defendant, a named plaintiff with a cause of action against that defendant. The *Ragoonanan* principle was expressly endorsed by the Court of Appeal in *Hughes v. Sunbeam Corp. (Canada) Ltd.* (2002), 61 O.R. (3de) 433 (C.A.) at paras. 13-18, leave to appeal to S.C.C. ref'd (2003), 224 D.L.R. (4th) vii.

[268] It should be noted, however, that in *Ragoonanan*, Justice Cumming did not say that there must be for every separate cause of action against a named defendant, a named plaintiff. In other words, he did not say that if some class members had cause of action A against defendant X and other class members had cause of action B against defendant X that it was necessary that there be a named representative plaintiff for both the cause of action A v. X and for the cause of action B v. X. It was arguable that if the representative plaintiff had a claim against X, then he or she could represent others with the same or different claims against X.

[269] Thus, there is room for a debate about the scope of the *Ragoonanan* principle, and, indeed, it has been applied in the narrow way, just suggested. Provided that the representative plaintiff has his or her own cause of action, the representative plaintiff can assert a cause of action against a defendant on behalf of other class members that he or she does not assert personally, provided that the causes of action all share a common issue of law or of fact: *Boulanger v. Johnson & Johnson Corp.*, [2002] O.J. No. 1075 (S.C.J.) at para. 22, leave to appeal granted, [2002] O.J. No. 2135 (S.C.J.), varied (2003), 64 O.R. (3d) 208 (Div. Ct.) at paras. 41, 48, varied [2003] O.J. No. 2218 (C.A.); *Healey v. Lakeridge Health Corp.*, [2006] O.J. No. 4277 (S.C.J.); *Matoni v. C.B.S. Interactive Multimedia Inc.*, [2008] O.J. No. 197 (S.C.J.) at paras. 71-77; *Voutour v. Pfizer Canada Inc.*, [2008] O.J. No. 3070 (S.C.J.); *Dobbie v. Arctic Glacier Income Fund*, 2011 ONSC 25 at para. 37. Thus, a representative plaintiff with damages for personal injury can claim in respect of dependents with derivative claims provided that

the statutes that create the derivative causes of action are properly pleaded: *Voutour v. Pfizer Canada Inc.*, *supra*; *Boulanger v. Johnson & Johnson Corp.*, *supra*.

[270] As noted above, in the case at bar, Koskie Minsky and Siskinds submit that *Labourers v. Sino-Forest* has no problem with the *Ragoonanan* principle and that *Smith v. Sino-Forest* and especially the more elaborate *Northwest v. Sino-Forest* confront *Ragoonanan* problems.

[271] For the purposes of this carriage motion, I do not feel it is necessary to do an analysis about the extent to which any of the rival actions are compliant with *Ragoonanan*.

[272] The *Ragoonanan* problem is often easy to fix. The emergence of Mr. Collins in *Smith v. Sino-Forest* to sue for the primary market shareholders is an example, assuming that Mr. Smith's own claims against the defendants do not satisfy the *Ragoonanan* principle. Therefore, I do not regard the plaintiff and defendant correlation as a determinative factor in determining carriage.

[273] It is also convenient here to add that I do not see the spectre of challenges to the Superior Court's jurisdiction over foreign class members or over the foreign defendants are a determinative factor to picking one action over another. It may be that *Northwest v. Sino-Forest* has the potential to attract more jurisdictional challenges but standing alone that potential is not a reason for disqualifying *Northwest v. Sino-Forest*.

3. Determinative Factors

(a) Attributes of the Proposed Representative Plaintiffs

[274] I turn now to the determinative factors that lead me to the conclusion that carriage should be granted to Koskie Minsky and Siskinds in *Labourers v. Sino-Forest*.

[275] The one determinative factor that stands alone is the characteristics of the candidates for representative plaintiff. In the case at bar, this is a troublesome and maybe a profound determinative factor.

[276] Kim Orr extolled the virtues of having its clients, Northwest, Bâtirente and BC Investments, which collectively manage $92 billion in assets, as candidates to be representative plaintiffs.

[277] Similarly, Koskie Minsky and Siskinds extolled the virtues of having Labourers' Fund, Operating Engineers Fund, and Sjunde AP-Fonden as candidates for representative plaintiff, along with the support of major class member Healthcare Manitoba. Together, these parties to *Labourers v. Sino-Forest* collectively manage $23.2 billion in assets. As noted above, Koskie Minsky and Siskinds submitted that their clients were not tainted by involving themselves in the governance oversight of Sino-Forest, which had been lauded as a positive factor by Kim Orr.

[278] As I have already discussed above in the context of the discussion about conflicts of interest, I do not regard Bâtirente's, and Northwest's interest in corporate governance generally or its particular efforts to oversee Sino-Forest as a negative factor.

[279] However, what may be a negative factor and what is the signature attribute of all of these candidates for representative plaintiff is that it is hard to believe that given their financial heft, they need the *Class Proceedings Act, 1992* for access to justice or to level the litigation playing field or that they need an indemnity to protect them from exposure to an adverse costs award.

[280] Although these candidates for representative plaintiff would seem to have adequate resources to litigate, they seem to be seeking to use a class action as a means to secure an indemnity from class counsel or a third-party funder for any exposure to costs. If they are genuinely serious about pursuing the defendants to obtain compensation for their respective members, they would also seem to be prime candidates to opt out of the class proceeding if they are not selected as a representative plaintiff.

[281] Mr. Rochon neatly argued that the class proceedings regime was designed for litigants like Mr. Smith not litigants like Labourers Trust or Northwest. He referred to the *Private Securities Litigation Reform Act of 1995*, legislation in the United States that was designed to encourage large institutions to participate in securities class actions by awarding them leadership of securities actions under what is known as a "leadership order". He told me that the policy behind this legislation was to discourage what are known as "strike suits;" namely, meritless securities class actions brought by opportunistic entrepreneurial attorneys to obtain very remunerative nuisance value payments from the defendants to settle non-meritorious claims.

[282] I was told that the American legislators thought that appointing a lead plaintiff on the basis of financial interest would ensure that institutional plaintiffs with expertise in the securities market and real financial interests in the integrity of the market would control the litigation, not lawyers. See: *LaSala v. Bordier et CIE*, 519 F.3d 121 (U.S. Ct App (3rd Cir)) (2008) at p. 128; *Taft v. Ackermans*, (2003), F.Supp.2d, 2003 WL 402789 at 1,2, D.H. Webber, "The Plight of the Individual Investor in Securities Class Actions" (2010) NYU Law and Economics Working Papers, para. 216 at p. 7.

[283] Mr. Rochon pointed out that the litigation environment is different in Canada and Ontario and that the provinces have taken a different approach to controlling strike suits. Control is established generally by requiring that a proposed class action go through a certification process and by requiring a fairness hearing for any settlements, and in the securities field, control is established by requiring leave for claims under Part XXIII.1 of the *Ontario Securities Act.* See *Ainslie v. CV Technologies Inc.* (2008) 93 O.R. (3d) 200 (S.C.J.) at paras. 7, 10-13.

[284] In his factum, Mr. Rochon eloquently argued that individual investors victimized by securities fraud should have a voice in directing class actions. Mr. Smith lost approximately half of his investment fortune; and according to Mr. Rochon, Mr. Smith is an individual investor who is highly motivated, wants an active role, and wants to have a voice in the proceeding.

[285] While I was impressed by Mr. Rochon's argument, it did not take me to the conclusions that the attributes of the institutional candidates for representative plaintiff in *Labourers v. Sino-Forest* and in *Northwest v. Sino-Forest* when compared to the

attributes of Mr. Smith should disqualify the institutional candidates from being representative plaintiffs or be a determinative factor to grant carriage to a more typical representative plaintiff like Mr. Smith or Mr. Collins.

[286] I think that it would be a mistake to have a categorical rule that an institutional plaintiff with the resources to bring individual proceedings or the means to opt-out of class proceedings and go it alone should be disqualified or discouraged from being a representative plaintiff. In the case at bar, the expertise and participation of the institutional investors in the securities marketplace could contribute to the successful prosecution of the lawsuit on behalf of the class members.

[287] Although Mr. Smith and Mr. Collins might lose their voice, they might in the circumstances of this case not be best voice for their fellow class members, who at the end of the day want results not empathy from their representative plaintiff and class counsel.

[288] Access to justice is one of the policy goals of the *Class Proceedings Act, 1992* and although it may be the case that the institutional representative plaintiffs want but do not need the access to justice provided by the Act, they are pursuing access to justice in a way that ultimately benefits Mr. Smith and other class members should their actions be certified as a class proceeding.

[289] On these matters, I agree with what Justice Rady said in *McCann v. CP Ships Ltd.*, [2009] O.J. No. 5182 (S.C.J.) at paras. 104-105:

> 104. I recognize that access to justice concerns may not be engaged when a class is comprised of large institutions with large claims. Authority for this proposition is found in *Abdool v. Anaheim Management Ltd.* (1995), 21 O.R. (3d) 453 (Div. Ct.). Moldaver J. made the following observation at p. 473:
>
> > As a rule, certification should have as its root a number of individual claims which would otherwise be economically unfeasible to pursue. While not necessarily fatal to an order for certification, the absence of this important underpinning will certainly weigh in the balance against certification.
>
> 105. Nevertheless, I am satisfied on the basis of the record before me that the individual claims and those of small corporations would likely be economically unfeasible to pursue. Further, there is no good principled reason that a large corporation should not be able to avail itself of the class proceeding mechanism where the other objectives are met.

[290] Another goal of the *Class Proceedings Act, 1992* is judicial economy, and the avoidance of a multiplicity of actions. However, the Act envisions a multiplicity of actions by permitting class members to opt-out and bring their own action against the defendants. However, there is an exception. The only class member that cannot opt out is the representative plaintiff, and in the circumstances of the case at bar, one advantage of granting carriage to one of the institutional plaintiffs is that they cannot opt out, and this, in and of itself, advances judicial economy.

[291] Another advantage of keeping the institutional plaintiffs in the case at bar in a class action is that the institutional plaintiffs are already to a large extent representative plaintiffs. They are already, practically speaking, suing on behalf of their own members, who number in the hundreds of thousands. Their members suffered losses by the

investments made on their behalf by BC Investments, Bâtirente, Northwest, Labourers' Fund, Operating Engineers Fund, Sjunde AP-Fonden, and Healthcare Manitoba. These pseudo-class members are probably better served by the court case managing the class action, assuming it is certified and by the judicial oversight of the approval process for any settlements.

[292] These thoughts lead me to the conclusion that in the circumstances of the case at bar, a determinative factor that favours *Labourers v. Sino-Forest* and *Northwest v. Sino-Forest* is the attributes of their candidates for representative plaintiff. In this regard, *Labourers v. Sino-Forest* has the further advantage that it also has Mr. Grant and Mr. Wong, who are individual investors and who can give voice to the interests of similarly situated class members.

(b) Definition of Class Membership and Definition of Class Period

[293] The first group of interrelated determinative factors is: definition of class membership and definition of class period. These factors concern who, among the investors in Sino-Forest shares and bonds, is to be given a ticket to a class action litigation train that is designed to take them to the court of justice.

[294] *Smith v. Sino-Forest* offers no tickets to bondholders because it is submitted that (a) the bondholders will fight with the shareholders about sharing the spoils of the litigation, especially because the bondholders have priority over the shareholders and secured and protected claims in a bankruptcy; (b) the bondholders will fight among themselves about a variety of matters including whether it would be preferable to leave it to their bond trustee to sue on their collective behalf to collect the debt rather than prosecute a class action for an unsecured claim for damages for misrepresentation; and (c) a misrepresentation action by the bondholders against some or all of the defendants may be precluded by the terms of the bonds.

[295] In my opinion, the bondholders should be included as class members, if necessary, with their own subclass, and, thus, *Smith v. Sino-Forest* does not fare well under this group of interrelated factors. As I explained above, I do not regard the membership of both shareholders and bondholders in the class as raising insurmountable conflicts of interest. The bondholders have essentially the same misrepresentation claims as do the shareholders, and it makes sense, particularly as a matter of judicial economy, to have their claims litigated in the same proceeding as the shareholders' claims.

[296] Pragmatically, if the bondholders are denied a ticket to one of the class actions now at the Osgoode Hall station because of a conflict of interest, then they could bring another class action in which they would be the only class members. That class action by the bondholders would raise the same issues of fact and law about the affairs of Sino-Forest. Thus, denying the bondholders a ticket on one of the two class actions that has made room for them would just encourage a multiplicity of litigation. It is preferable to keep the bondholders on board sharing the train with any conflicts being managed by the appointment of separate class counsel for the bondholders, who can form a subclass at certification or later assuming that certification is granted.

[297] As already noted above, for those bondholders who do not want to get on the litigation train, they can opt-out of the class action assuming it is certified. That the defendants may have defences to the misrepresentation claims of the bondholders is just a problem that the bondholders will have to confront, and it is not a reason to deny them a ticket to try to obtain access to justice.

[298] In *Caputo v. Imperial Tobacco Ltd.*, [2004] O.J. No. 299 (S.C.J.), Justice Winkler, as he then was, noted at para. 39 that there is a difference between restricting the joinder of causes of action in order to make an action more amenable to certification and restricting the number of class members in an action for which certification is being sought. He stated:

> Although *Rumley v. British Columbia*, [2001] 3 S.C.R. 184 holds that the plaintiffs can arbitrarily restrict the causes of action asserted in order to make a proceeding more amenable to certification (at 201), the same does not hold true with respect to the proposed class. Here the plaintiffs have not chosen to restrict the causes of action asserted but rather attempt to make the action more amenable to certification by suggesting arbitrary exclusions from the proposed class. This is diametrically opposite to the approach taken by the plaintiffs in *Rumley*, and one which has been expressly disapproved by the Supreme Court in *Hollick v. Toronto (City*), [2001] 3 S.C.R. 158. There, McLachlin C.J. made it clear that the onus falls on the putative representative to show that the "class is defined sufficiently narrowly" but without resort to arbitrary exclusion to achieve that result…..

[299] For shareholders, *Smith v. Sino-Forest* is more accommodating; indeed, it is the most accommodating, in offering tickets to shareholders to board the class action train. Without prejudice to the arguments of the defendants, who may impugn any of the class period or class membership definitions, and assuming that the bondholders are also included, the best of the class periods for shareholders is that found in *Smith v. Sino-Forest*.

[300] To be blunt, I found the rationales for shorter class periods in *Labourers v. Sino-Forest* and *Northwest v. Sino-Forest* somewhat paranoid, as if the plaintiffs were afraid that the defendants will attack their definitions for over-inclusiveness or for making the class proceeding unmanageable. Those attacks may come, but I see no reason for the plaintiffs in *Labourers* and *Sino-Forest* to leave at the station without tickets some shareholders who may have arguable claims.

[301] If Mr. Torchio is correct that almost all of the shareholders would be covered by the shortest class period that is found in *Labourers v. Sino-Forest*, then the defendants may think the fight to shorten the class period may not be worth it. If they are inclined to challenge the class definition on grounds of unmanageability or the class action as not being the preferable procedure, the longer class period definition will likely be peripheral to the main contest.

[302] I do not see the extension of the class period beyond June 2, 2011, when the Muddy Waters Report became public, as a problem. Put shortly, at this juncture, and subject to what the defendants may later have to say, I agree with Rochon Genova's arguments about the appropriate class period end date for the shareholders.

[303] If I am correct in this analysis so far, where it takes me is only to the conclusion that the best class period definition for shareholders is found in *Smith v. Sino-Forest.* It,

however, does not take me to the conclusion that carriage should be granted to *Smith v. Sino-Forest*. Subject to what the defendants may have to say, the class definitions and class period in *Labourers v. Sino-Forest* and in *Northwest v. Sino-Forest* appear to be adequate, reasonable, certifiable, and likely consistent with the common issues that will be forthcoming.

[304] Since for other reasons, I would grant carriage to *Labourers v. Sino-Forest*, the question I ask myself is whether the class definition in *Labourers*, which favourably includes bondholders, but which is not as good a definition as found in *Smith v. Sino-Forest* or in *Northwest v. Sino-Forest* should be a reason not to grant carriage to *Labourers*. My answer to my own question is no, especially since it is still possible to amend the class definition so that it is not under-inclusive.

(c) Theory of the Case, Causes of Action, Joinder of Defendants, and Prospects of Certification

[305] The second group of interrelated determinative factors is: theory of the case, causes of action, joinder of defendants, and prospects of certification. Taken together, it is my opinion, that these factors, which are about what is in the best interests of the putative class members, favour staying *Smith v. Sino-Forest* and *Northwest v. Sino-Forest* and granting carriage to *Labourers v. Sino-Forest.*

[306] In applying the above factors, I begin here with the obvious point that it would not be in the interests of the putative class members, let alone not in their best interests to grant carriage to an action that is unlikely to be certified or that, if certified, is unlikely to succeed. It also seems obvious that it would be in the best interests of class members to grant carriage to the action that is most likely to be certified and ultimately successful at obtaining access to justice for the injured or, in this case, financially harmed class members. And it also seems obvious that all other things being equal, it would be in the best interests of class members and fair to the defendants and most consistent with the policies of the *Class Proceedings Act, 1992* to grant carriage to the action that, to borrow from rule 1.04 or the *Rules of Civil Procedure* secures the just, most expeditious and least expensive determination of the dispute on its merits.

[307] While these points seem obvious, there is, however, a major problem in applying them, because the court should not and cannot go very far in determining the matters that would be most determinative of carriage. A carriage motion is not the time to determine whether an action will satisfy the criteria for certification or whether it will ultimately provide redress to the class members or whether it would be the preferable procedure or the most expeditious and least expensive procedure to resolve the dispute.

[308] Keeping this caution in mind, in my opinion, certain aspects of *Northwest v. Sino-Forest* make the other actions preferable. In this regard, I find the joinder of some defendants to *Northwest v. Sino-Forest* mildly troublesome.

[309] More serious, in *Northwest v. Sino-Forest*, I find the employment and reliance on the tort action of fraudulent misrepresentation less desirable than the causes of action utilized to provide procedural and substantive justice to the class members in *Smith v.*

Sino-Forest and *Labourers v. Sino-Forest*. In my opinion, the fraudulent misrepresentation action adds needless complexity and costs.

[310] While the finger-pointing of the OSC at Ho, Hung, Ip, and Yeung supports their joinder, the joinder of Chen, Lawrence Estate, Maradin, Wong, and Zhao is mildly troublesome. The joinder of defendants should be based on something more substantive than their opportunity to be a wrongdoer, and at this juncture it is not clear why Chen, Lawrence Estate, Maradin, Wong, and Zhao have been joined to *Northwest v. Sino-Forest* and not to the other proposed class actions. Their joinder, however, is only mildly troublesome, because the plaintiffs in *Northwest v. Sino-Forest* may have particulars of wrongdoing and have simply failed to plead them.

[311] Turning to the pleading of fraudulent misrepresentation, when it is far easier to prove a claim in negligent misrepresentation or negligence, the claim for fraudulent misrepresentation seems a needless provocation that will just fuel the defendants' fervour to defend and to not settle the class action. Fraud is a very serious allegation because of the moral and not just legal turpitude of it, and the allegation of fraud also imperils insurance coverage that might be the source of a recovery for class members.

[312] Kim Orr has understated the difficulties the plaintiffs in *Northwest v. Sino-Forest* will confront in impugning the integrity of Sino-Forest, Ardell, Bowland, Chan, Horsley, Hyde, Mak, Martin, Murray, Poon, Wang, West, Chen, Ho, Hung, Ip, Lawrence Estate, Maradin, Wong, Yeung, Zhao, Canaccord, CIBC, Credit Suisse, Credit Suisse (USA), Dundee, Haywood, Maison, Merrill, Merrill-Fenner, Morgan, RBC, Scotia, TD, UBS, E&Y, BDO, Pöyry, Pöyry Forest, JP Management.

[313] Fraud must be proved individually. In order to establish that a corporate defendant committed fraud, it must be proven that a natural person for whose conduct the corporation is responsible acted with a fraudulent intent. See: *Hughes v. Sunbeam Corp. (Canada)*, [2000] O.J. No. 4595 (S.C.J.) at para. 26; *Toronto-Dominion Bank v. Leigh Instruments Ltd. (Trustee of)*, [1998] O.J. No. 2637 (Gen. Div.) at paras. 477-479.

[314] A claim for deceit or fraudulent misrepresentation typically breaks down into five elements: (1) a false statement; (2) the defendant knowing that the statement is false or being indifferent to its truth or falsity; (3) the defendant having an intent to deceive the plaintiff; (4) the false statement being material and the plaintiff being induced to act; and (5) the defendant suffering damages: *Derry* v. *Peek* (1889), 14 App. Cas. 337 (H.L.); *Graham* v. *Saville*, [1945] O.R. 301 (C.A.); *Francis* v. *Dingman* (1983), 2 D.L.R. (4th) 244 (Ont. C.A.). The fraud elements are the second and third in this list.

[315] In the famous case of *Derry* v. *Peek*, the general issue was what counts as a fraudulent misrepresentation. More particularly, the issue was whether a careless or negligent misrepresentation without more could count as a fraudulent misrepresentation. In the case, the defendants were responsible for a false statement in a prospectus. The prospectus, which was for the sale of shares in a tramway company, stated that the company was permitted to use steam power to work a tram line. The statement was false because the directors had omitted the qualification that the use of steam power required the consent of the Board of Trade. As it happened, the consent was not given, the tram line would have to be driven by horses, and the company was wound-up. The Law

Lords reviewed the evidence of the defendants individually and concluded that although the defendants had all been careless in their use of language, they had honestly believed what they had said in the prospectus.

[316] In the lead judgment, Lord Herschell reviewed the case law, and at p. 374, he stated in the most famous passage from the case:

> I think the authorities establish the following propositions. First, in order to sustain an action for deceit, there must be proof of fraud, and nothing short of that will suffice. Secondly, fraud is proved when it is shewn that a false representation has been made (1) knowingly, or (2) without belief in its truth, or (3) recklessly, careless, whether it be true or false. Although I have treated the second and third as distinct cases, I think the third is but an instance of the second, for one who makes a statement under such circumstances can have no real belief in the truth of what he states. To prevent a false statement being fraudulent, there must, I think be an honest belief in its truth. And this probably covers the whole ground, for one who knowingly alleges that which is false has obviously no such honest belief. Thirdly, if fraud is proved, the motive of the person guilty is immaterial. It matters not that there was no intention to cheat or injure the person to whom the statement was made.

[317] Lord Herschell's third situation is the one that was at the heart of *Derry* v. *Peek*, and the Law Lords struggled to articulate that relationship between belief and carelessness in speaking. Before the above passage, Lord Herschell stated at p. 361:

> To make a statement careless whether it be true or false, and therefore without any real belief in its truth, appears to me to be an essentially different thing from making, through want of care, a false statement, which is nevertheless honestly believed to be true. And it is surely conceivable that a man may believe that what he states is the fact, though he has been so wanting in care that the Court may think that there were no sufficient grounds to warrant his belief.

[318] Lord Herschell is saying that carelessness in making a statement does not necessarily entail that a person does not believe what he or she is saying. However, later in his judgment, he emphasizes that carelessness is relevant and could be sufficient to show that a person did not believe what he or she was saying. Thus, carelessness may prove fraud, but it is not itself fraud. Lord Herschell's famous quotation, where he states that fraud is proven when it is shown that a false statement was made recklessly, careless whether it be true or false, states only awkwardly the role of carelessness and must be read in the context of the whole judgment.

[319] In *Angus* v. *Clifford*, [1891] 2 Ch. 449 (C.A.) at p. 471, Bowen, L.J. discussed the role of carelessness or recklessness in establishing fraud; he stated:

> Not caring, in that context [i.e., in the context of an allegation of fraud], did not mean taking care, it meant indifference to the truth, the moral obliquity which consists of wilful disregard of the importance of truth, and unless you keep it clear that that is the true meaning of the term, you are constantly in danger of confusing the evidence from which the inference of dishonesty in the mind may be drawn - evidence which consists in a great many cases of gross want of caution - with the inference of fraud, or of dishonesty itself, which has to be drawn after you have weighed all the evidence.

[320] Bowen, L.J.'s statement alludes to the second element of what makes a statement fraudulent. Deceit or fraudulent misrepresentation requires that the defendant

have “a wicked mind:” *Le Lievre* v. *Gould*, [1893] 1 Q.B. 491 at p. 498. Fraud involves intentional dishonesty, the intent being to deceive. If the plaintiff fails to prove this mental element, then, as was the case in *Derry* v. *Peek*, the claim is dismissed. To succeed in an action for deceit or for fraudulent misrepresentation, the plaintiff must show not only that the defendant spoke falsely and contrary to belief but that the defendant had the intent to deceive, which is to say he or she had the aim of inducing the plaintiff to act mistakenly: *BG Checo International Ltd. v. British Columbia Hydro and Power Authority* (1993), 99 D.L.R. (4th) 577 (S.C.C.).

[321] The defendant’s reason for deceiving the plaintiff, however, need not be evil. In the passage above from *Derry* v. *Peek*, Lord Herschell notes that the person’s motive for saying something that he or she does not believe is irrelevant. A person may have a benign reason for defrauding another person, but the fraud remains because of the discordance between words and belief combined with the intent to mislead the plaintiff: *Smith* v. *Chadwick* (1854), 9 App. Cas. 187 at p. 201; *Bradford Building Society* v. *Borders*, [1941] 2 All E.R. 205 at p. 211; *Beckman* v. *Wallace* (1913), 29 O.L.R. 96 (C.A.) at p. 101.

[322] In promoting its fraudulent misrepresentation claim, Kim Orr relied on *Gregory v. Jolley* (2001), 54 O.R. (3d) 481 (C.A.), which was a case where a trial judge erred by not applying the third branch of the test articulated in *Derry v. Peek*. Justice Sharpe discussed the trial judge’s failure to consider whether the appellant had made out a case of fraud based on recklessness and stated at para. 20:

> With respect to the law, the trial judge's reasons show that he failed to consider whether the appellant had made out a case of fraud on the basis of recklessness. While he referred to a case that in turn referred to the test from *Derry v. Peek*, the reasons for judgment demonstrate to my satisfaction that the trial judge simply did not take into account the possibility that fraud could be made out if the respondent made misrepresentations of material fact without regard to their truth. The trial judge's reasons speak only of an intention to defraud or of statements calculated to mislead or misrepresent. He makes no reference to recklessness or to statements made without an honest belief in their truth. As *Derry v. Peek* holds, that state of mind is sufficient proof of the mental element required for civil fraud, whatever the motive of the party making the representation. In another leading case on civil fraud, *Edgington v. Fitzmaurice*, (1885), 29 Ch. D.459 at 481-82 (C.A.), Bowen L.J. stated: "[I]t is immaterial whether they made the statement knowing it to be untrue, or recklessly, without caring whether it was true or not, because to make a statement recklessly for the purpose of influencing another person is dishonest." The failure to give adequate consideration to the contention that the respondent had been reckless with the truth in regard to the income figures he gave in order to obtain disability insurance constitutes an error of law justifying the intervention of this court.

[323] From this passage, Kim Orr extracts the notion that there is a viable fraudulent misrepresentation against forty defendants all of whom individually can be shown to be reckless as opposed to careless. That seems unlikely, but more to the point, recklessness is only half the battle. The overall motive may not matter, but the defendant still must have had the intent to deceive, which in *Gregory v. Jolley* was the intent to obtain disability insurance to which he was not qualified to receive.

[324] Recklessness alone is not enough to constitute fraudulent misrepresentation, as Justice Cumming notes at para. 25 of his judgment in *Hughes v. Sunbeam Corp. (Canada)*, [2000] O.J. No. 4595 (S.C.J.), where he states:

> The representation must have been made with knowledge of its falsehood or recklessness without belief in its truth. The representation must have been made by the representor with the intention that it should be acted upon by the representee and the representee must in fact have acted upon it.

[325] I conclude that the fraudulent misrepresentation action is a substantial weakness in *Northwest v. Sino-Forest.* In fairness, I should add that I think that the unjust enrichment causes of action and oppression remedy claims in *Labourers v. Sino-Forest* add little.

[326] The unjust enrichment claims in *Labourers* seem superfluous. If Sino-Forest, Chan, Horsley, Mak, Martin, Murray, Poon, Banc of America, Canaccord, CIBC, Credit Suisse, Credit Suisse USA, Dundee, Maison, Merrill, RBC, Scotia and TD, are found to be liable for misrepresentation or negligence, then the damages they will have to pay will far exceed the disgorgement of any unjust enrichment. If they are found not to have committed any wrong, then there will be no basis for an unjust enrichment claim for recapture of the gains they made on share transactions or from their remuneration for services rendered. In other words, the claims for unjust enrichment are unnecessary for victory and they will not snatch victory if the other claims are defeated. Much the same can be said about the oppression remedy claim. That said, these claims in *Labourers v. Sino-Forest* will not strain the forensic resources of the plaintiffs in the same way as taking on a massive fraudulent misrepresentation cause of action would do in *Northwest v. Sino-Forest.*

[327] For the purposes of this carriage motion, I have little to say about the "Integrity Representation" approach to the misrepresentation claims that are at the heart of the claims against the defendants in *Northwest v. Sino-Forest* or of the "GAAP" misrepresentation employed in *Labourers v. Sino-Forest,* or the focus on the authorized intermediaries in *Smith v. Sino-Forest.* Short of deciding the motion for certification, there is no way of deciding which approach is more likely to lead to certification or which approach the defendants will attack as deficient. For present purposes, I am simply satisfied that the class members are best served by the approach in *Labourers v. Sino-Forest.*

[328] The cohesive, yet adequately comprehensive, approach used in *Smith v. Sino-Forest* appears to me close to *Labourers v. Sino-Forest,* but in my opinion, *Smith v. Sino-Forest* wants for the inclusion of the bondholders, and, as noted above, there are other factors which favour *Labourers v. Sino-Forest* over *Smith v. Sino-Forest.* That said, it was a close call for me to choose *Labourers v. Sino-Forest* and not *Smith v. Sino-Forest*.

H. CONCLUSION

[329] For the above Reasons, I grant carriage to Koskie Minsky and Siskinds with leave to the plaintiffs in *Labourers v. Sino-Forest* to deliver a Fresh as Amended Statement of Claim.

[330] In granting leave, I grant leave generally and the plaintiffs are not limited to the amendments sought as a part of this carriage motion. It will be for the plaintiffs to decide whether some amendments are in order to respond to the lessons learned from this carriage motion, and it is not too late to have more representative plaintiffs.

[331] I repeat that a carriage motion is without prejudice to the defendants' rights to challenge the pleadings and whether any particular cause of action is legally tenable.

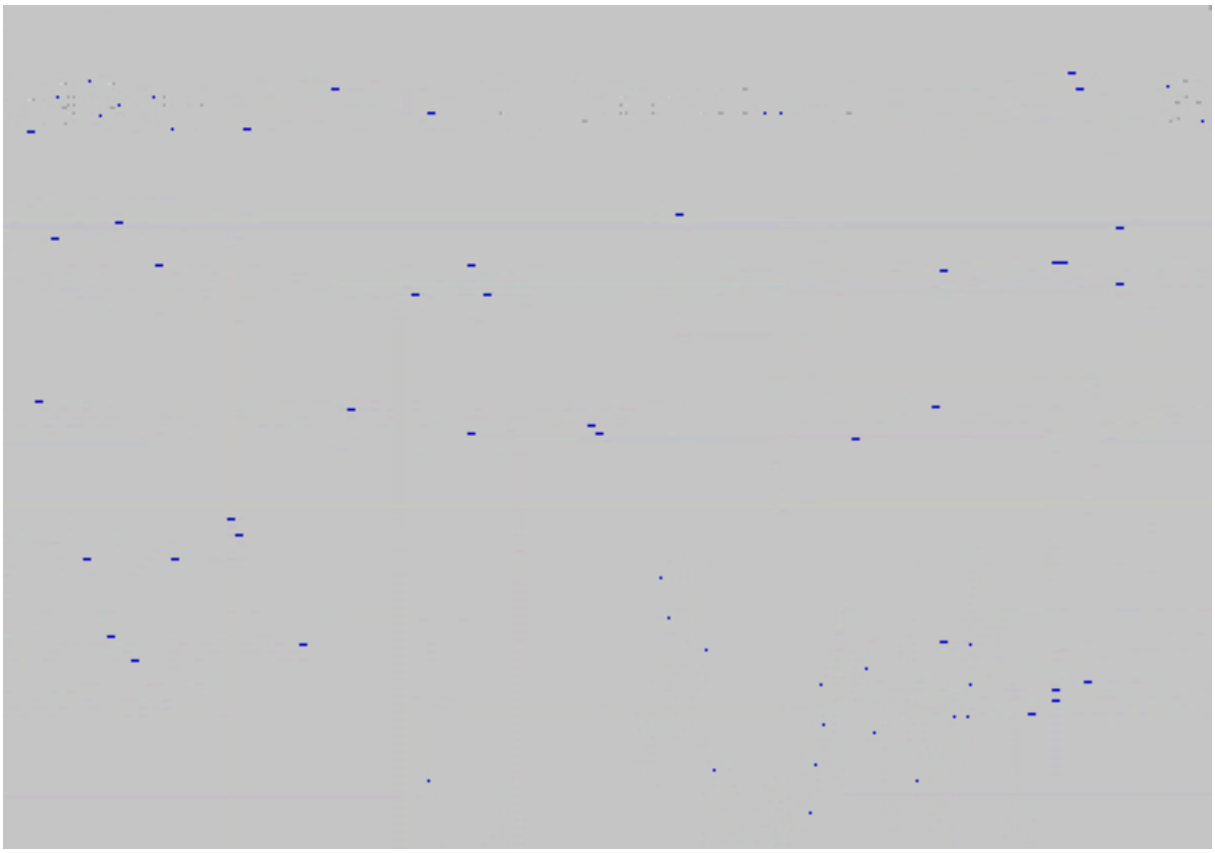
[332] I make no order as to costs, which is in the usual course in carriage motions.

_____

Perell, J.

Released: January 6, 2012

SCHEDULE “A”



CITATION: Smith v Sino-Forest Corporation, 2012 ONSC24
COURT FILE NO.: 11-CV-428238CP
COURT FILE NO.: 11-CV-431153CP
COURT FILE NO.: 11-CV-435826CP
DATE: January 6, 2012

ONTARIO
SUPERIOR COURT OF JUSTICE

BETWEEN:

Douglas Smith and Zhongjun Goa

Plaintiff

- and -

Sino-Forest Corporation et al.

Defendants

AND BETWEEN:

The Trustees of the Labourers' Pension Fund of Central and Eastern Canada and the Trustees of the International Union of Operating Engineers Local 793 Pension Plan for Operating Engineers in Ontario

Plaintiff

- and -

Sino-Forest Corporation et al.

Defendants

AND BETWEEN:

Northwest & Ethical Investments L.P., Comité Syndical National de Retraite Bâtirente Inc.

Plaintiff

- and -

Sino-Forest Corporation et al.

Defendants

REASONS FOR DECISION

Perell, J.

Released: January 6, 2012.

CITATION: Sino-Forest Corporation (Re), 2012 ONSC 4377
COURT FILE NO.: CV-12-9667-00CL
DATE: 20120727

SUPERIOR COURT OF JUSTICE – ONTARIO

(COMMERCIAL LIST)

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

BEFORE: **MORAWETZ J.**

COUNSEL: **Robert W. Staley and Jonathan Bell, for the Applicant**

Jennifer Stam, for the Monitor

Kenneth Dekker, for BDO Limited

Peter Griffin and Peter Osborne, for Ernst & Young LLP

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

James Grout, for the Ontario Securities Commission

Emily Cole and Joseph Marin, for Allen Chan

Simon Bieber, for David Horsley

David Bish, John Fabello and Adam Slavens, for the Underwriters Named in the Class Action

Max Starnino and Kirk Baert, for the Ontario Plaintiffs

Larry Lowenstein, for the Board of Directors

HEARD: **June 26, 2012**

ENDORSEMENT

Overview

[1] Sino-Forest Corporation ("SFC" or the "Applicant") seeks an order directing 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* ("CCAA") including, without limitation: (i) the claims by or on behalf of current or former shareholders asserted in the proceedings listed in Schedule "A" (collectively, the "Shareholder Claims"); and (ii) any indemnification claims against SFC related to or arising from the Shareholder Claims, including, without limitation, those by or on behalf of any of the other defendants to the proceedings listed in Schedule "A" (the "Related Indemnity Claims").

[2] SFC takes the position that the Shareholder Claims are "equity claims" as defined in the CCAA as they are claims in respect of a monetary loss resulting from the ownership, purchase or sale of an equity interest in SFC and, therefore, come within the definition. SFC also takes the position that the Related Indemnity Claims are "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 within the definition.

[3] On March 30, 2012, the court granted the Initial Order providing for the CCAA stay against SFC and certain of its subsidiaries. FTI Consulting Canada Inc. was appointed as Monitor.

[4] On the same day, the Sales Process Order was granted, approving Sales Process procedures and authorizing and directing SFC, the Monitor and Houlihan Lokey to carry out the Sales Process.

[5] On May 14, 2012, the court issued a Claims Procedure Order, which established June 20, 2012 as the Claims Bar Date.

[6] The stay of proceedings has since been extended to September 28, 2012.

[7] Since the outset of the proceedings, SFC has taken the position that it is important for these proceedings to be completed as soon as possible in order to, among other things, (i) enable the business operated in the Peoples Republic of China ("PRC") to be separated from SFC and put under new ownership; (ii) enable the restructured business to participate in the Q4 sales 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.

[8] SFC has negotiated a Support Agreement with the Ad Hoc Committee of Noteholders and intends to file a plan of compromise or arrangement (the "Plan") under the CCAA by no later than August 27, 2012, based on the deadline set out in the Support Agreement and what they submit is the commercial reality that SFC must complete its restructuring as soon as possible.

[9] Noteholders holding in excess of $1.296 billion, or approximately 72% of the approximately $1.8 billion of SFC's noteholders' debt, have executed written support agreements to support the SFC CCAA Plan as of March 30, 2012.

Shareholder Claims Asserted Against SFC

(i) Ontario

[10] 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 Proceedings") 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").

[11] Section 1(m) of the Ontario Statement of Claim defines "class" and "class members" as:

> All 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 securities include those 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 acquisition and who acquired Sino's Securities outside of Canada, except the Excluded Persons.

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

[13] The Ontario Class Proceedings seek damages in the amount of approximately $9.2 billion against SFC and the other defendants.

[14] The thrust of the complaint in the Ontario Class Proceedings 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".

(ii) Quebec

[15] By action filed in Quebec 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. The Quebec Class Proceedings also do not specify the quantum of damages sought, but rather reference "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 securities of Sino at inflated prices during the Class Period".

[16] The complaints in the Quebec Class Proceedings centre 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 other 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.

(iii) Saskatchewan

[17] By Statement of Claim dated December 1, 2011 (the "Saskatchewan Statement of Claim"), Mr. Allan Haigh commenced an action (the "Saskatchewan Class Proceedings") against SFC, Allen Chan and David Horsley.

[18] The Saskatchewan Statement of Claim does not specify the quantum of damages sought, but instead states in more general terms that the plaintiff seeks "aggravated and compensatory damages against the defendants in an amount to be determined at trial".

[19] 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 that the effect of Sino's disclosure documents upon the price of its Sino's [sic] securities.

(iv) New York

[20] By Verified Class Action Complaint dated January 27, 2012, (the "New York Complaint"), Mr. David Leapard and IMF Finance SA commenced a class proceeding against SFC, Mr. Allen Chan, Mr. David Horsley, Mr. Kai Kit Poon, a subset of the Underwriters, E&Y, and Ernst & Young Global Limited (the "New York Class Proceedings").

[21] SFC contends that the New York Class Proceedings focus on the effect of the alleged wrongful acts upon the trading price of SFC's securities.

[22] 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, as summarized in the table below. The positions of those parties are detailed later in these reasons.

	Ontario	Quebec	Saskatchewan	New York
E&Y LLP	X	X	-	X
E&Y Global	-	-	-	X
BDO	X	-	-	-

Poyry	X	X	-	-
Underwriters	11	-	-	2

Legal Framework

[23] Even before the 2009 amendments to the CCAA dealing with equity claims, courts recognized that there is a fundamental difference between shareholder equity claims as they relate to an insolvent entity versus creditor claims. Essentially, shareholders cannot reasonably expect to maintain a financial interest in an insolvent company where creditor claims are not being paid in full. Simply put, shareholders have no economic interest in an insolvent enterprise: *Blue Range Resource Corp. (Re)*, (2004) 4 W.W.R. 738 (Alta. Q.B.) [*Blue Range Resources*]; *Stelco Inc. (Re)*, (2006) CanLII 1773 (Ont. S.C.J.) [*Stelco*]; *Royal Bank of Canada v. Central Capital Corp.* (1996), 27 O.R. (3d) 494 (C.A.).

[24] The basis for the differentiation flows from the fundamentally different nature of debt and equity investments. Shareholders have unlimited upside potential when purchasing shares. Creditors have no corresponding upside potential: *Nelson Financial Group Limited (Re)*, 2010 ONSC 6229 [*Nelson Financial*].

[25] As a result, courts subordinated equity claims and denied such claims a vote in plans of arrangement: *Blue Range Resource*, *supra*; *Stelco*, *supra*; *EarthFirst Canada Inc. (Re)* (2009), 56 C.B.R. (5th) 102 (Alta. Q.B.) [*EarthFirst Canada*]; and *Nelson Financial*, *supra*.

[26] In 2009, significant amendments were made to the CCAA. Specific amendments were made with the intention of clarifying that equity claims are subordinated to other claims.

[27] The 2009 amendments define an "equity claim" and an "equity interest". Section 2 of the CCAA 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, or
> >
> > (e) contribution or indemnity in respect of a claim referred to in any of paragraphs (a) to (d);
>
> "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,

[28] Section 6(8) of the CCAA prohibits a distribution to equity claimants prior to payment in full of all non-equity claims.

[29] Section 22(1) of the CCAA provides that equity claimants are prohibited from voting on a plan unless the court orders otherwise.

Position of Ernst & Young

[30] E&Y opposes the relief sought, at least as against E&Y, since the E&Y proof of claim evidence demonstrates in its view that E&Y's claim:

(a) is not an equity claim;

(b) does not derive from or depend upon an equity claim (in whole or in part);

(c) represents discreet and independent causes of action as against SFC and its directors and officers arising from E&Y's direct contractual relationship with such parties (or certain of such parties) and/or the tortious conduct of SFC and/or its directors and officers for which they are in law responsible to E&Y; and

(d) can succeed independently of whether or not the claims of the plaintiffs in the class actions succeed.

[31] In its factum, counsel to E&Y acknowledges that during the periods relevant to the Class Action Proceedings, E&Y was retained as SFC's auditor and acted as such from 2007 until it resigned on April 5, 2012.

[32] On June 2, 2011, Muddy Waters LLC ("Muddy Waters") issued a report which purported to reveal fraud at SFC. In the wake of that report, SFC's share price plummeted and Muddy Waters profited from its short position.

[33] E&Y was served with a multitude of class action claims in numerous jurisdictions.

[34] The plaintiffs in the Ontario Class Proceedings claim damages in the aggregate, as against all defendants, of $9.2 billion on behalf of resident and non-resident shareholders and noteholders. The causes of action alleged are both statutory, under the *Securities Act (Ontario)* and at common law, in negligence and negligent misrepresentation.

[35] In its factum, counsel to E&Y acknowledges that the central claim in the class actions is that SFC made a series of misrepresentations in respect of its timber assets. The claims against E&Y and the other third party defendants are that they failed to detect these misrepresentations and note in particular that E&Y's audit did not comply with Canadian generally accepted accounting standards. Similar claims are advanced in Quebec and the U.S.

[36] Counsel to E&Y notes that on May 14, 2012 the court granted a Claims Procedure Order which, among other things, requires proofs of claim to be filed no later than June 20, 2012. E&Y takes issue with the fact that this motion was then brought notwithstanding that proofs of claim and D&O proofs of claim had not yet been filed.

[37] E&Y has filed with the Monitor, in accordance with the Claims Procedure Order, a proof of claim against SFC and a proof of claim against the directors and officers of SFC.

[38] E&Y takes the position that it has contractual claims of indemnification against SFC and its subsidiaries and has statutory and common law claims of contribution and/or indemnity against SFC and its subsidiaries for all relevant years. E&Y contends that it has stand-alone claims for breach of contract and negligent and/or fraudulent misrepresentation against the company and its directors and officers.

[39] Counsel submits that E&Y's claims against Sino-Forest and the SFC subsidiaries are:

(a) creditor claims;

(b) derived from E&Y retainers by and/or on behalf of Sino-Forest and the SFC subsidiaries and E&Y's relationship with such parties, all of which are wholly independent and conceptually different from the claims advanced by the class action plaintiffs;

(c) claims that include the cost of defending and responding to various proceedings, both pre- and post-filing; and

(d) not equity claims in the sense contemplated by the CCAA. E&Y's submission is that equity holders of Sino-Forest have not advanced, and could not advance, any claims against SFC's subsidiaries.

[40] Counsel further contends that E&Y's claim is distinct from any and all potential and actual claims by the plaintiffs in the class actions against Sino-Forest and that E&Y's claim for contribution and/or indemnity is not based on the claims against Sino-Forest advanced in the class actions but rather only in part on those claims, as any success of the plaintiffs in the class actions against E&Y would not necessarily lead to success against Sino-Forest, and vice versa. Counsel contends that E&Y has a distinct claim against Sino-Forest independent of that of the plaintiffs in the class actions. The success of E&Y's claims against Sino-Forest and the SFC subsidiaries, and the success of the claims advanced by the class action plaintiffs, are not co-dependent. Consequently, counsel contends that E&Y's claim is that of an unsecured creditor.

[41] From a policy standpoint, counsel to E&Y contends that the nature of the relationship between a shareholder, who may be in a position to assert an equity claim (in addition to other claims) is fundamentally different from the relationship existing between a corporation and its auditors.

Position of BDO Limited

[42] BDO was auditor of Sino-Forest Corporation between 2005 and 2007, when it was replaced by E&Y.

[43] BDO has a filed a proof of claim against Sino-Forest pursuant to the Claims Procedure Order.

[44] BDO's claim against Sino-Forest is primarily for breach of contract.

[45] BDO takes the position that its indemnity claims, similar to those advanced by E&Y and the Underwriters, are not equity claims within the meaning of s. 2 of the CCAA.

[46] BDO adopts the submissions of E&Y which, for the purposes of this endorsement, are not repeated.

Position of the Underwriters

[47] The Underwriters take the position that the court should not decide the equity claims motion at this time because it is premature or, alternatively, if the court decides the equity claims motion, the equity claims order should not be granted because the Related Indemnity Claims are not "equity claims" as defined in s. 2 of the CCAA.

[48] The Underwriters are among the defendants named in some of the class actions. In connection with the offerings, certain Underwriters entered into agreements with Sino-Forest and certain of its subsidiaries providing that Sino-Forest and, with respect to certain offerings, the Sino-Forest subsidiary companies, agree to indemnify and hold harmless the Underwriters in connection with an array of matters that could arise from the offerings.

[49] The Underwriters raise the following issues:

(i) Should this court decide the equity claims motion at this time?

(ii) If this court decides the equity claims motion at this time, should the equity claims order be granted?

[50] On the first issue, counsel to the Underwriters takes the position that the issue is not yet ripe for determination.

[51] Counsel submits that, by seeking the equity claims order at this time, Sino-Forest is attempting to pre-empt the Claims Procedure Order, which already provides a process for the determination of claims. Until such time as the claims procedure in respect of the Related Indemnity Claims is completed, and those claims are determined pursuant to that process, counsel contends the subject of the equity claims motion raises a merely hypothetical question as the court is being asked to determine the proper interpretation of s. 2 of the CCAA before it has the benefit of an actual claim in dispute before it.

[52] Counsel further contends that by asking the court to render judgment on the proper interpretation of s. 2 of the CCAA in the hypothetical, Sino-Forest has put the court in a position where its judgment will not be made in the context of particular facts or with a full and complete evidentiary record.

[53] Even if the court determines that it can decide this motion at this time, the Underwriters submit that the relief requested should not be granted.

Position of the Applicant

[54] The Applicant submits that the amendments to the CCAA relating to equity claims closely parallel existing U.S. law on the subject and that Canadian courts have looked to U.S. courts for guidance on the issue of equity claims as the subordination of equity claims has long been codified there: see e.g. *Blue Range Resources, supra*, and *Nelson Financial, supra.*

[55] The Applicant takes the position that based on the plain language of the CCAA, the Shareholder Claims are "equity claims" as defined in s. 2 as they are claims in respect of a "monetary loss resulting from the ownership, purchase or sale of an equity interest".

[56] The Applicant also submits the following:

(a) the Ontario, Quebec, Saskatchewan and New York Class Actions (collectively, the "Class Actions") all advance claims on behalf of shareholders.

(b) the Class Actions also allege wrongful conduct that affected the trading price of the shares, in that the alleged misrepresentation "artificially inflated" the share price; and

(c) the Class Actions seek damages relating to the trading price of SFC shares and, as such, allege a "monetary loss" that resulted from the ownership, purchase or sale of shares, as defined in s. 2 of the CCAA.

[57] Counsel further submits that, as the Shareholder Claims are "equity claims", they are expressly subordinated to creditor claims and are prohibited from voting on the plan of arrangement.

[58] Counsel to the Applicant also submits that the definition of "equity claims" in s. 2 of the CCAA expressly includes indemnity claims that relate to other equity claims. As such, the Related Indemnity Claims are equity claims within the meaning of s. 2.

[59] Counsel further submits that 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. Further, and to the contrary, counsel submits that the legal characterization of a contribution or indemnity claim depends solely on the characterization of the primary claim upon which contribution or indemnity is sought.

[60] Counsel points out that in *Return on Innovation Capital v. Gandi Innovations Limited*, 2011 ONSC 5018, leave to appeal denied, 2012 ONCA 10 [*Return on Innovation*] this court characterized the contractual indemnification claims of directors and officers in respect of an equity claim as "equity claims".

[61] Counsel also submits that guidance on the treatment of underwriter and auditor indemnification claims can be obtained from the U.S. experience. In the U.S., courts have held that the indemnification claims of underwriters for liability or defence costs constitute equity claims that are subordinated to the claims of general creditors. Counsel submits that 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.

[62] In this case, counsel contends, the Related Indemnity Claims are clearly claims for "contribution and indemnity" based on the Shareholder Claims.

Position of the Ad Hoc Noteholders

[63] Counsel to the Ad Hoc Noteholders submits that the Shareholder Claims are "equity claims" as they are claims in respect of an equity interest and are claims for "a monetary loss resulting from the ownership, purchase or sale of an equity interest" per subsection (d) of the definition of "equity claims" in the CCAA.

[64] Counsel further submits that the Related Indemnity Claims are also "equity claims" as they fall within the "clear and unambiguous" language used in the definition of "equity claim" in the CCAA. Subsection (e) of the definition refers expressly and without qualification to claims for "contribution or indemnity" in respect of claims such as the Shareholder Claims.

[65] Counsel further submits that had the legislature intended to qualify the reference to "contribution or indemnity" in order to exempt the claims of certain parties, it could have done so, but it did not.

[66] Counsel also submits that, if the plain language of subsection (e) is not upheld, shareholders of SFC could potentially create claims to receive indirectly what they could not receive directly (*i.e.*, payment in respect of equity claims through the Related Indemnity Claims) – a result that could not have been intended by the legislature as it would be inconsistent with the purposes of the CCAA.

[67] Counsel to the Ad Hoc Noteholders also submits that, before the CCAA amendments in 2009 (the "CCAA Amendments"), courts subordinated claims on the basis of:

(a) the general expectations of creditors and shareholders with respect to priority and assumption of risks; and

(b) the equitable principles and considerations set out in certain U.S. cases: see e.g. *Blue Range Resources, supra.*

[68] Counsel further submits that, before the CCAA Amendments took effect, courts had expanded the types of claims characterized as equity claims; first to claims for damages of defrauded shareholders and then to contractual indemnity claims of shareholders: see *Blue Range Resources, supra* and *EarthFirst Canada, supra.*

[69] Counsel for the Ad Hoc Noteholders also submits that indemnity claims of underwriters have been treated as equity claims in the United States, pursuant to section 510(b) of the U.S. Bankruptcy Code. This submission is detailed at paragraphs 20-25 of their factum which reads as follows:

20. The desire to more closely align the Canadian approach to equity claims with the U.S. approach was among the considerations that gave rise to the codification of the treatment of equity claims. Canadian courts have also looked to the U.S. law for guidance on the issue of equity claims where codification of the subordination of equity claims has been long-standing.

Janis Sarra at p. 209, Ad Hoc Committee's Book of Authorities, Tab 10.

Report of the Standing Senate Committee on Banking, Trade and Commerce, "Debtors and Creditors Sharing the Burden: A Review of the *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement act*" (2003) at 158, [...]

Blue Range [*Resources*] at paras. 41-57 [...]

21. Pursuant to § 510(b) of the *U.S. Bankruptcy Code*, all creditors must be paid in full before shareholders are entitled to receive any distribution. § 510(b) of the *U.S. Bankruptcy Code* and the relevant portion of § 502, which is referenced in § 510(b), provide as follows:

§ 510. Subordination

(b) For the purpose of distribution under this title, a claim arising from rescission of a purchase or sale of a security of the debtor or of an affiliate of the debtor, for damages arising from the purchase or sale of such a security, or for reimbursement or contribution allowed under 502 on account of such a claim, shall be subordinated to all claims or interests that are senior to or equal the claim or interest represented by such security, except that if such security is common stock, such claim has the same priority as common stock.

§ 502. Allowance of claims or interests

(e) (1) Notwithstanding subsections (a), (b) and (c) of this section and paragraph (2) of this subsection, the court shall disallow any claim for reimbursement or contribution of an entity that is liable with the debtor on or has secured the claim of a creditor, to the extent that

...

(B) such claim for reimbursement or contribution is contingent as of the time of allowance or disallowance of such claim for reimbursement or contribution; or

...

(2) A claim for reimbursement or contribution of such an entity that becomes fixed after the commencement of the case shall be determined,

> and shall be allowed under subsection (a), (b), or (c) of this section, or disallowed under subsection (d) of this section, the same as if such claim had become fixed before the date of the filing of the petition.

22. U.S. appellate courts have interpreted the statutory language in § 510(b) broadly 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.* (2002), 281 F. 3d 133 (3rd Cir. U.S. Court of Appeals) [...]
>
> *American Broadcasting Systems Inc. v. Nugent*, U.S. Court of Appeals for the Ninth Circuit, Case Number 98-17133 (24 January 2001) [...]

23. Further, U.S. courts have held that indemnification claims of underwriters against the corporation for liability or defence costs when shareholders or former shareholders have sued underwriters constitute equity claims in the insolvency of the corporation that are subordinated to the claims of general creditors based on: (a) the plain language of § 510(b), which references claims for "reimbursement or contribution" and (b) risk allocation as between general creditors and those parties that play a role in the purchase and sale of securities that give rise to the shareholder claims (i.e., directors, officers and underwriters).

> *In re Mid-American Waste Sys.*, 228 B.R. 816, 1999 Bankr. LEXIS 27 (Bankr. D. Del. 1999) [*Mid-American*] [...]
>
> *In re Jacom Computer Servs.*, 280 B.R. 570, 2002 Bankr. LEXIS 758 (Bankr. S.D.N.Y. 2002) [...]

24. In *Mid-American*, the Court stated the following with respect to the "plain language" of § 510(b), its origins and the inclusion of "reimbursement or contribution" claims in that section:

> *... I find that the plain language of § 510(b), its legislative history, and applicable case law clearly show that § 510(b) intends to subordinate the indemnification claims of officers, directors, and underwriters for both liability and expenses incurred in connection with the pursuit of claims for rescission or damages by purchasers or sellers of the debtor's securities.* The meaning of amended § 510(b), specifically the language "for reimbursement or contribution . . . on account of [a claim arising from rescission or damages arising from the purchase or sale of a security]," can be discerned by a plain reading of its language.
>
> ... it is readily apparent that the rationale for section 510(b) is not limited to preventing shareholder claimants from improving their position vis-a-

> vis general creditors; *Congress also made the decision to subordinate based on risk allocation. Consequently, when Congress amended § 510(b) to add reimbursement and contribution claims, it was not radically departing from an equityholder claimant treatment provision, as NatWest suggests; it simply added to the subordination treatment new classes of persons and entities involved with the securities transactions giving rise to the rescission and damage claims*. The 1984 amendment to § 510(b) is a logical extension of one of the rationales for the original section — *because Congress intended the holders of securities law claims to be subordinated, why not also subordinate claims of other parties (e.g., officers and directors and underwriters) who play a role in the purchase and sale transactions which give rise to the securities law claims?* As I view it, in 1984 Congress made a legislative judgment that claims emanating from tainted securities law transactions should not have the same priority as the claims of general creditors of the estate. [emphasis added]
>
> [...]
>
> 25. 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*, 148 B.R. 982, 1992 Bankr. LEXIS 2023 (Bankr. S.D.N.Y. 1992) [...]

[70] Counsel submits that there is no principled basis for treating indemnification claims of auditors differently than those of underwriters.

Analysis

Is it Premature to Determine the Issue?

[71] The class action litigation was commenced prior to the CCAA Proceedings. It is clear that the claims of shareholders as set out in the class action claims against SFC are "equity claims" within the meaning of the CCAA.

[72] In my view, this issue is not premature for determination, as is submitted by the Underwriters.

[73] The Class Action Proceedings preceded the CCAA Proceedings. It has been clear since the outset of the CCAA Proceedings that this issue – namely, whether the claims of E&Y, BDO and the Underwriters as against SFC, would be considered "equity claims" – would have to be determined.

[74] It has also been clear from the outset of the CCAA Proceedings, that a Sales Process would be undertaken and the expected proceeds arising from the Sales Process would generate proceeds insufficient to satisfy the claims of creditors.

[75] The Claims Procedure is in place but, it seems to me that the issue that has been placed before the court on this motion can be determined independently of the Claims Procedure. I do not accept that any party can be said to be prejudiced if this threshold issue is determined at this time. The threshold issue does not depend upon a determination of quantification of any claim. Rather, its effect will be to establish whether the claims of E&Y, BDO and the Underwriters will be subordinated pursuant to the provisions of the CCAA. This is independent from a determination as to the validity of any claim and the quantification thereof.

Should the Equity Claims Order be Granted?

[76] I am in agreement with the submission of counsel for the Ad Hoc Noteholders to the effect that the characterization of claims for indemnity turns on the characterization of the underlying primary claims.

[77] In my view, the claims advanced in the Shareholder Claims are clearly equity claims. The Shareholder Claims underlie the Related Indemnity Claims.

[78] In my view, the CCAA Amendments have codified the treatment of claims addressed in pre-amendment cases and have further broadened the scope of equity claims.

[79] The plain language in the definition of "equity claim" does not focus on the identity of the claimant. Rather, it focuses on the nature of the claim. In this case, it seems clear that the Shareholder Claims led to the Related Indemnity Claims. Put another way, the inescapable conclusion is that the Related Indemnity Claims are being used to recover an equity investment.

[80] The plain language of the CCAA dictates the outcome, namely, that the Shareholder Claims and the Related Indemnity Claims constitute "equity claims" within the meaning of the CCAA. This conclusion is consistent with the trend towards an expansive interpretation of the definition of "equity claims" to achieve the purpose of the CCAA.

[81] In *Return on Innovation*, Newbould J. characterized the contractual indemnification claims of directors and officers as "equity claims". The Court of Appeal denied leave to appeal. The analysis in *Return on Innovation* leads to the conclusion that the Related Indemnity Claims are also equity claims under the CCAA.

[82] It would be totally inconsistent to arrive at a conclusion that would enable either the auditors or the Underwriters, through a claim for indemnification, to be treated as creditors when the underlying actions of the shareholders cannot achieve the same status. To hold otherwise would indeed provide an indirect remedy where a direct remedy is not available.

[83] Further, on the issue of whether the claims of E&Y, BDO and the Underwriters fall within the definition of equity claims, there are, in my view, two aspects of these claims and it is necessary to keep them conceptually separate.

[84] The first and most significant aspect of the claims of E&Y, BDO and the Underwriters constitutes an "equity claim" within the meaning of the CCAA. Simply put, but for the Class Action Proceedings, it is inconceivable that claims of this magnitude would have been launched by E&Y, BDO and the Underwriters as against SFC. The class action plaintiffs have launched their actions against SFC, the auditors and the Underwriters. In turn, E&Y, BDO and the Underwriters have launched actions against SFC and its subsidiaries. The claims of the shareholders are clearly "equity claims" and a plain reading of s. 2(1)(e) of the CCAA leads to the same conclusion with respect to the claims of E&Y, BDO and the Underwriters. To hold otherwise, would, as stated above, lead to a result that is inconsistent with the principles of the CCAA. It would potentially put the shareholders in a position to achieve creditor status through their claim against E&Y, BDO and the Underwriters even though a direct claim against SFC would rank as an "equity claim".

[85] I also recognize that the legal construction of the claims of the auditors and the Underwriters as against SFC is different than the claims of the shareholders against SFC. However, that distinction is not, in my view, reflected in the language of the CCAA which makes no distinction based on the status of the party but rather focuses on the substance of the claim.

[86] Critical to my analysis of this issue is the statutory language and the fact that the CCAA Amendments came into force after the cases relied upon by the Underwriters and the auditors.

[87] It has been argued that the amendments did nothing more than codify pre-existing common law. In many respects, I accept this submission. However, I am unable to accept this submission when considering s. 2(1) of the CCAA, which provides clear and specific language directing that "equity claim" means a claim that is in respect of an equity interest, including a claim for, among other things, "(e) contribution or indemnity in respect of a claim referred to in any of paragraphs (a) to (d)".

[88] Given that a shareholder claim falls within s. 2(1)(d), the plain words of subsections (d) and (e) lead to the conclusions that I have set out above.

[89] I fail to see how the very clear words of subsection (e) can be seen to be a codification of existing law. To arrive at the conclusion put forth by E&Y, BDO and the Underwriters would require me to ignore the specific words that Parliament has recently enacted.

[90] I cannot agree with the position put forth by the Underwriters or by the auditors on this point. The plain wording of the statute has persuaded me that it does not matter whether an 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.

[91] However, that is not to say that the full amount of the claim by the auditors and Underwriters can be characterized, at this time, as an "equity claim".

[92] The second aspect to the claims of the auditors and underwriters can be illustrated by the following hypothetical: if the claim of the shareholders does not succeed against the class action defendants, E&Y, BDO and the Underwriters will not be liable to the class action plaintiffs. However, these parties may be in a position to demonstrate that they do have a claim against

SFC for the costs of defending those actions, which claim does not arise as a result of "contribution or indemnity in respect of an equity claim".

[93] It could very well be that each of E&Y, BDO and the Underwriters have expended significant amounts in defending the claims brought by the class action plaintiffs which, in turn, could give rise to contractual claims as against SFC. If there is no successful equity claim brought by the class action plaintiffs, it is arguable that any claim of E&Y, BDO and the Underwriters may legitimately be characterized as a claim for contribution or indemnity but not necessarily in respect of an equity claim. If so, there is no principled basis for subordinating this portion of the claim. At this point in time, the quantification of such a claim cannot be determined. This must be determined in accordance with the Claims Procedure.

[94] However, it must be recognized that, by far the most significant part of the claim, is an "equity claim".

[95] In arriving at this determination, I have taken into account the arguments set forth by E&Y, BDO and the Underwriters. My conclusions recognize the separate aspects of the Related Indemnity Claims as submitted by counsel to the Underwriters at paragraph 40 of their factum which reads:

> ...it must be recognized that there are, in fact, at least two different kinds of Related Indemnity Claims:
>
> (a) indemnity claims against SFC in respect of Shareholder Claims against the auditors and the Underwriters; and
>
> (b) indemnity claims against SFC in respect of the defence costs of the auditors and the Underwriters in connection with defending themselves against Shareholder Claims.

Disposition

[96] In the result, an order shall issue that the claims against SFC resulting from the ownership, purchase or sale of equity interests in SFC, including, without limitation, the claims by or on behalf of current or former shareholders asserted in the proceedings listed in Schedule "A" are "equity claims" as defined in s. 2 of the CCAA, being claims in respect of monetary losses resulting from the ownership, purchase or sale of an equity interest. It is noted that counsel for the class action plaintiffs did not contest this issue.

[97] In addition, an order shall also issue that any indemnification claim against SFC related to or arising from the Shareholders Claims, including, without limitation, by or on behalf of any of the other defendants to the proceedings listed in Schedule "A" are "equity claims" under the CCAA, being claims for contribution or indemnity in respect of a claim that is an equity claim. However, I feel it is premature to determine whether this order extends to the aspect of the Related Indemnity Claims that corresponds to the defence costs of the Underwriters and the auditors in connection with defending themselves against the Shareholder Claims.

[98] A direction shall also issue that these orders are made without prejudice to SFC's rights 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.

MORAWETZ J.

Date: July 27, 2012

SCHEDULE "A" – 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)

CITATION: The Treaty Group Inc. v. Drake International Inc., 2007 ONCA 450
DATE: 20070625
DOCKET: C44744

COURT OF APPEAL FOR ONTARIO

WEILER, ROSENBERG and SIMMONS JJ.A.

BETWEEN:

THE TREATY GROUP INC. carrying on business as. LEATHER TREATY

(Plaintiff/Respondent,
Appellant by way of cross-appeal)

And

DRAKE INTERNATIONAL INC.

(Defendant/Appellant,
Respondent by way of cross-appeal)

Kimberly T. Morris, for the appellant (respondent by way of cross-appeal)

Susan J. Stamm, for the respondent (appellant by way of cross-appeal)

Heard: April 13, 2007

On appeal from the judgment of Justice Todd Ducharme of the Superior Court of Justice dated December 5, 2005.

WEILER J.A.:

BACKGROUND:

[1] Drake International Inc. ("Drake"), an employment placement agency, appeals the award of damages made against it to Leather Treaty, a manufacturer of leather bracelets, in the amount of $130,975.90.

[2] Drake placed Simpson, an administrative assistant whose tasks were to include bookkeeping, in the employ of the respondent, Leather Treaty, without checking her references. Simpson worked as a trusted employee for Leather Treaty for over two years. After she resigned, Leather Treaty discovered that Simpson had been defrauding it. Leather Treaty went to the police, who laid fraud charges against Simpson. In January 2001, Simpson was convicted. Leather Treaty also sued Simpson and her husband for fraud and obtained a civil judgment against them in February 2001. Simpson was found liable for $261,951.81 and her husband was found liable for one half of that amount.

[3] After obtaining judgment against Simpson and her husband, Leather Treaty sued Drake. The basis of the law suit, which alleged both breach of contract and tort, was that Drake failed to conduct reference checks on Simpson and did not check her background. Over Drake's objections, the trial judge held that the judgment against Simpson and her husband did not bar Leather Treaty from seeking damages for the same loss from Drake because the causes of action were different. Drake was not being sued for fraud but for different torts, negligent misrepresentation contained in its fee schedule about the calibre of its service, negligence in failing to conduct reference checks, and for breach of contract.

[4] Although the trial judge found Drake liable for Leather Treaty's loss, he held that Leather Treaty contributed to its own losses in that its failure to supervise Simpson facilitated the fraud. The trial judge reduced the damages by 50 per cent. While contributory negligence does not ordinarily reduce damages for breach of contract, the trial judge was of the opinion that the result should be the same whether Leather Treaty recovered in contract or tort. Consequently, he also apportioned the damages for breach of contract.

[5] With respect to the quantum of damages, the trial judge held that Drake was not liable for costs, such as the hiring of a forensic accountant, or for lost profits due to the time required to pursue civil remedies against Simpson.

[6] In the result, the trial judge awarded Leather Treaty damages of $131,662 or one half of the amount of which it was defrauded.

[7] Following the release of the trial judge's judgment, counsel had a disagreement over its meaning and effect. Drake raised the issue of double recovery by Leather Treaty and sought clarification of the judgment from the trial judge. The positions of the parties are set out below:

a) Leather Treaty's position was that double recovery could be avoided by an undertaking by Leather Treaty not to enforce the portion of the judgment collected from Drake as against the Simpsons. This could be done by advising the Sheriff of satisfaction of that amount from other sources and directing the Sheriff not to enforce to that extent. This would enable Leather Treaty to continue to enforce the remainder of its principal and significant amounts of post-judgment interest as entitled under the Simpson judgment.

b) Drake's position was that the amounts already recovered by Leather Treaty ought to be subtracted from the judgment as against Drake. Its counsel wrote as follows: "The loss suffered by Leather Treaty was $261,951.81. Your Honour's finding was that Leather Treaty was 50 per cent responsible for this loss – $130,975.90. Permitting Leather Treaty to deduct the amount of the judgment awarded against Drake from the sums due and owing in the Simpson judgment would result in double recovery given the finding of contributory fault. Drake further submits that the sums collected to date by Leather Treaty from the Simpsons must first be applied to the damages portion of that judgment and not on account of aggravated damages or prejudgment interest."

[8] The trial judge responded as follows:

> Leather Treaty's position with respect to the undertaking is the correct one. The monies collected from the Simpsons are not to be deducted from the amount owed by Drake – this does not result in double recovery.

[9] The judgment incorporates the undertaking given as follows:

2. THIS COURT ORDERS AND ADJUDGES THAT in accordance with Leather Treaty's undertaking, the monies already collected and to be collected by Leather Treaty from Beverly and Robert Simpson in connection with court proceedings in Court File Number 98-CV-15760CM, are not to be deducted from the amount set out in paragraph 1 above.

ISSUES

[10] Drake appeals and raises 3 issues:

1. Did the trial judge err in finding that Leather Treaty could claim against Drake notwithstanding the judgment against Simpson?

2. Did the trial judge err in his finding on causation?

3. Did the trial judge err in his apportionment of damages to Drake?

[11] Leather Treaty cross-appeals the trial judge's finding that it was responsible for 50 per cent of its damages and submits that its contributory negligence should be capped at 25 per cent.

DECISION

[12] The trial judge gave very comprehensive reasons which are reported at (2005), 36 C.C.L.T. (3d) 265, 15 B.L.R. (4th) 83. He dealt with all of the issues raised on this appeal and the related jurisprudence in a very thorough manner. Inasmuch as I agree with his decision and the reasons he gave, I propose to deal with the issues raised on this appeal in a summary fashion.

1. Whether Leather Treaty was entitled to sue Drake notwithstanding its judgment against Simpson

[13] The trial judge found Drake and Simpson severally rather than jointly liable on the basis that Drake and the Simpsons were not acting in concert or in furtherance of a common purpose. In concluding that, subject to the rule barring double recovery, where a plaintiff elects to pursue a claim against one of severally liable defendants, there is no legal principle that holds that a plaintiff is precluded from pursuing a second action, the trial judge correctly relied on *Olsen v. Poirier et al.* (1978), 21 O.R. (2d) 642 at 650 (H.C.), aff'd (1980) 28 O.R. (2d) 744 (C.A.) and distinguished *Cuttell v. Bentz* (1985), 65 B.C.L.R. 273 (C.A.). It is not the *damage award* that amounts to satisfaction and bars a second action but the *recovery* by the plaintiff in the first action.

[14] Other jurisprudence relied on by Drake, such as *Westar Aluminum & Glass Ltd. v. Brenner* (1993), 17 C.P.C. (3d) 228 (Ont. Ct. Gen. Div.), relates only to the issue of suing alternatively liable parties on one contract or cause of action. Here, there were separate contracts between Leather Treaty and Drake and between Leather Treaty and the Simpsons.

[15] The trial judge correctly held that on the facts of this case there was no bar to Leather Treaty commencing an action, unless it had actually received the full amount of the loss, which it had not.

[16] I would also note that Drake suffered no prejudice by virtue of the fact that separate proceedings were taken. Drake is still entitled to claim over against the Simpsons for any amounts that it pays. The trial judge dealt with the duplication of court time and effort that resulted from Leather Treaty's decision not to sue all the parties at the same time by declining to award costs to Leather Treaty in separate reasons reported at (2006), 268 D.L.R. (4th) 756.

[17] In oral argument before us, Drake also sought to rely on a decision involving cause of action estoppel. However, cause of action estoppel was not pleaded, nor does the appellant meet the requirements for cause of action estoppel. The same causes of action are not raised, nor is there privity between the parties.

[18] Drake submits that because the result of the two actions is to give judgments to Leather Treaty for a total amount that is greater than 100 per cent of the damages, and this could not have happened had there been one action, Drake should not bear any liability or there will be the prospect of double recovery.

An analogous argument was made in *Tucker (Guardian ad Litem of) v. Asleson* (1993), 102 D.L.R. (4th) 518 (B.C.C.A.), in which the plaintiff sued the tortfeasor and the Crown, who were described as several concurrent tortfeasors. The Plaintiff then settled with the tortfeasor for one-third of the damages. The Crown took the position that by its settlement the plaintiff could only claim two-thirds of the damages against the Crown because the plaintiff had been paid in full for one-third of the loss. Southin J.A. rejected this argument. At p. 576 she held that each of several concurrent tortfeasors was liable for the whole of the loss, and that that right was independent of whether the injured person sued both tortfeasors in one action or a separate action. The tortfeasor who had settled was entitled to maintain an action for contribution from the other tortfeasor. Liability had not been apportioned in the first action because it was not necessary. In the action as between tortfeasors apportionment was necessary if the tortfeasor who had settled was to recover for amounts paid in excess of its liability.

[19] My conclusion in this regard is also consistent with the Ontario Law Reform Commission's conclusion in its *Report on Contribution Among Wrongdoers and Contributory Negligence* (Toronto: Ontario Ministry of the Attorney General, 1988) at 137-138:

> P's right to recover in full from D1 should never be prejudiced by the fact that there is another wrongdoer (D2) liable to P, even if P's contributory negligence vis-a-vis that person has reduced the amount that P can claim from D2. Nor should D2 be required to contribute a greater amount than that for which she was liable to P: any payments made by D1 to P that exceed this sum confer no benefit upon D2. Subject to this limitation, it is recommended that P's loss should be distributed between D1 and D2 without regard to the fact that D2 is liable to P for a lesser sum than D1.

[20] Drake submits that this second action is an abuse of process and that it is unfair for it to now be subject to paying the entire 50 per cent of the judgment for which it was

found liable because Simpson is insolvent. The short answer to this submission is that insolvency is not relevant to the allocation of fault. See *Renaissance Leisure Group Inc., c.o.b. Muskoka Sands Inn et al. v. Frazer* (2004), 242 D.L.R. (4th) 229 at para. 52 (Ont. C.A.). The action is not an abuse of process.

[21] Although it cites no authority in support of its submission, Drake claims that it is "unfair" for it to have to pay the full 50 per cent of the damages for which it was found liable. It submits that the amounts that Simpson has paid should be deducted from the total amount of damages awarded and that it should then have to pay 50 per cent of the remaining amount. This argument again confuses liability with recovery and I would not give effect to it. Drake is liable to Leather Treaty for the full 50 per cent of the damages and can claim over against Simpson for contribution and indemnity.

[22] The general rule respecting the date for the assessment of damages is also contrary to Drake's position. Almost invariably, the plaintiff is entitled to have his or her damages assessed at the date of the breach, not the date that judgment is obtained. A common example occurs where the value of the property of which the plaintiff has been deprived declines in value between the date of the wrong and the date of judgment. In this circumstance, the plaintiff is nevertheless entitled to damages at the date of the defendant's wrong. The same is generally true when the value of the property increases between the date of the wrong and the date of judgment. See S.M. Waddams, *The Law of Damages*, looseleaf (Aurora: Canada Law Book, 1991) at 1-28 – 1-30.

[23] In the case of breach of contract, the theory is that damages "crystallize" at the date of the breach. Waddams discusses two policy reasons for this approach. The first is that if the damage assessment is postponed to the date of judgment, one party will then have an incentive to delay the conduct of the action. The second is that the party committing the wrong should not, as a general rule, obtain the benefit of changes in value. This policy choice recognizes that in some cases the plaintiff may be overcompensated in the sense that the plaintiff may be made more than whole for the loss.

[24] In this case, the trial judge avoided the unfairness of overcompensation by making the order that he did. The trial judge correctly addressed the issue of double recovery by way of the undertaking that was given.

2. Did the trial judge err in his finding on causation?

[25] Drake submits that the trial judge made a palpable and overriding error when he found that Leather Treaty would not have hired Simpson if it had received the background information about her. Drake's position is that there was no evidence on this point before the trial judge and the evidence was that "fit" was the most important hiring criterion. Drake argues that Leather Treaty would have hired Simpson regardless of the

information Drake provided and, as a result, there is no causal connection between the loss and Drake's failure to perform reference checks.

[26] Leather Treaty did not only care about "fit". The evidence clearly indicates it wanted a competent employee. The reference in question that was not provided was extremely negative. The trial judge's inference that Leather Treaty would not have hired Simpson if it had been given this reference was a proper one. The trial judge committed no palpable and overriding error in finding that Drake's failure to check references before placing Simpson in Leather Treaty's employ caused or contributed to Leather Treaty's loss.

3. Did the trial judge err in his apportionment of Damages to Drake?

[27] The appellant submits that the trial judge's actual apportionment erred in attributing 50 per cent responsibility to Drake because 85 per cent ($225,109.02) of the loss could have been prevented if appropriate controls were in place.

[28] The appellant's argument is tantamount to the "last clear chance doctrine", where liability is apportioned to a much greater degree to the party who had the last opportunity to avoid the loss. This was rejected on two bases in *Snushall v. Fulsang* (2005), 78 O.R. (3d) 142 at para. 30 (C.A.), leave to appeal to S.C.C. refused, [2005] S.C.C.A. No. 519. The first was that this approach looks only to the consequences of the plaintiff's conduct rather than the entirety of both parties' tortious acts. The second is that it fails to address tort law's primary objective of restoring the plaintiff to the position it would have enjoyed but for the negligence of the defendant. While the decision in *Snushall*, *supra*, relates to a motor vehicle accident in which the passenger failed to wear a seatbelt, the principles on which it is based are of general applicability. The more weight that is attached to Leather Treaty's contributory negligence, the more the assessment of Drake's negligence, which includes its moral and legal blameworthiness, is reduced.

[29] Finally, Drake's submission overlooks the very high standard of deference that is owed to a trial judge's apportionment of liability. A jury award assessing the degree of contributory negligence is to be approached in the same way as a jury verdict respecting damages generally. See *Snushall v. Fulsang*, *supra*, at paras. 19-22 (C.A.**).** The same level of deference is accorded when these determinations are made by a trial judge.

[30] Appellate courts will not interfere unless the verdict is so plainly unreasonable and unjust as to satisfy the court that no jury reviewing the evidence as a whole and acting judicially could have arrived at that conclusion: *McCannell v. McLean*, [1937] S.C.R. 341; *Olmstead v. Vancouver-Fraser Park District*, [1975] 2 S.C.R. 831; *Ferenczy v. MCI Medical Clinics* (2005), 198 O.A.C. 254 (C.A.); *Snushall v. Fulsang*, *supra*. Drake has not satisfied me that that onus has been met here.

[31] Accordingly, for the reasons given I would dismiss the appeal.

Cross-Appeal

1. Did the trial judge err in his finding of contributory negligence?

[32] Leather Treaty submits that the trial judge's findings do not take into account the very different character of Drake's fault as compared to Leather Treaty's. Drake knew that it was sending Simpson into a start-up company that did not appear to be properly organized. These facts suggest that Drake's breach was the more serious of the two. Contributory negligence should be capped at 25 per cent because this case is analogous to *Snushall* in that the negligence of Leather Treaty has absolutely no connection to the fact of Drake's negligence.

[33] Again, I would hold that the high standard for revision of the trial judge's finding and apportionment has not been met. *Snushall* was a seatbelt defence case, which is a specialized area of law in which the range set for contributory negligence is now well-established. That is not the situation here. The trial judge here considered a number of decisions that determined contributory fault for negligent financial oversight, with a range of apportionment from 15 per cent to 50 per cent. I see no basis on which to interfere with his apportionment.

[34] I would dismiss the cross-appeal.

DISPOSITION

[35] For the reasons given I would dismiss both the appeal and the cross-appeal.

[36] The parties may make submissions as to costs. Counsel for Leather Treaty shall deliver a bill of costs together with any submissions, in writing, in support of any requested order for costs within seven (7) days of the release of the decision. Counsel for Drake may deliver a response, in writing, within fourteen (14) days of the release of the decision. Counsel for Leather Treaty may deliver a brief reply within seventeen (17) days of the release of the decision. The submissions of the parties should be delivered to the attention of the Senior Legal Officer of the court.

RELEASED: June 25, 2007 ("KMW")

"Karen M. Weiler J.A."
"I agree M. Rosenberg J.A."
"I agree Janet Simmons J.A."

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

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

ONTARIO
SUPERIOR COURT OF JUSTICE

(COMMERCIAL LIST)
Proceeding commenced at Toronto

SUPPLEMENTARY BOOK OF AUTHORITIES OF THE AD HOC COMMITTEE OF PURCHASERS OF THE APPLICANT'S SECURITIES, INCLUDING THE REPRESENTATIVE PLAINTIFFS IN THE ONTARIO CLASS ACTION

(MOTION RETURNABLE AUGUST 28, 2012)

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