Court of Appeal File No. C56125
Superior Court File No. CV-12-9667-00CL

COURT OF APPEAL FOR ONTARIO

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

APPLICATION UNDER THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED

Factum of the Appellant, BDO Limited

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PART I - APPELLANTS AND ORDER APPEALED FROM

1. BDO Limited ("BDO") was the auditor of Sino-Forest Corporation ("SFC") between 2005 and August 2007, when it was replaced by Ernst & Young LLP ("E&Y"). It has advanced a claim against SFC for indemnity pursuant to the engagement agreements under which BDO was retained as auditor for SFC.

2. BDO appeals from an Order, dated July 27, 2012, by the Honourable Mr. Justice Morawetz (the "Equity Claims Order"), in which the claim by BDO along with those by two other sets of independent third party claimants, Ernst & Young LLP and the Underwriters (as defined below) (collectively, the "Third Party Indemnity Claimants") was declared to be an equity claim, as that term is defined under the *Companies Creditors' Arrangement Act*.

3. BDO says that the Equity Claims Order was in error, as BDO has never been an equity holder in SFC and its claim is not in respect of an equity interest in SFC.

PART II - OVERVIEW

4. BDO has been sued in an Ontario Class Action by primary and secondary market purchasers of SFC shares and notes for alleged misrepresentations in the audit reports issued by BDO regarding SFC's 2005 and 2006 annual financial statements (the "BDO Audit Reports").

5. The Ontario Class Action also names SFC, a number of current and former SFC officers and directors, and several third parties, including the other SFC auditor during the relevant

period, Ernst & Young LLP ("E&Y") as well as the underwriters of several SFC securities offerings during the relevant period (the "Underwriters").

6. On March 30, 2012, SFC obtained protection from its creditors under the *Companies' Creditors Arrangement* Act (the "CCAA"). BDO and several other parties, including E&Y and the Underwriters, have filed Proofs of Claim against SFC under the Claims Procedure Order made in SFC's CCAA proceedings, dated May 14, 2012 (the "Claims Procedure Order").

7. Similar to E&Y and the Underwriters, BDO is independent from SFC and its claim against SFC arises from a number of breaches of the common law and contractual duties owed to BDO under Engagement Agreements governing BDO's retainer to audit SFC's 2005 and 2006 financial statements and the subsequent use of the BDO Audit Reports in Prospectuses and Offering Memoranda issued by SFC.

8. The Claims Procedure Order prescribed a detailed process to determine claims against SFC, as well as its directors and officers; a process that includes the issue of whether and to what extent certain claims are considered to be equity claims under the CCAA.

9. However, before any claims could be assessed under the Claims Procedure Order, SFC moved for a separate order declaring that, *inter alia*, claims by BDO and SFC's other third party service providers are "equity claims" under s. 2 of the CCAA.

10. On July 27, 2012, the Honourable Mr. Justice Morawetz granted the Order sought by SFC on its motion (the "Equity Claims Order") and ordered that, for the most part, any

indemnification claims submitted against SFC by BDO and other third party service providers were equity claims and therefore subordinated to the claims of creditors of SFC.

11. BDO says that it was simply wrong for the Equity Claims Order to treat BDO as an equity claimant when it is clear that BDO is not, and never has been, an equity holder in SFC.

12. At all times, BDO was an independent third party that provided audit services to SFC and its claims against SFC arise in respect of that audit relationship and not in respect of any equity holdings in SFC. It was contrary to the spirit and intent of the relevant CCAA provisions for the Court below to treat BDO as if it were an SFC equity holder.

13. As such, BDO says that the appeal should be granted and the Order below set aside.

PART III - THE FACTS

A. BDO's role as auditor of SFC for 2005 and 2006:

14. BDO is a Hong Kong-based accounting firm formerly known as BDO McCabe Lo Limited that, among other things, audits annual financial statements of publicly traded companies.

15. BDO audited the annual financial statements for the Applicant, SFC Corporation for the years ended December 31, 2005 and December 31, 2006. BDO was replaced by Ernst & Young LLP ("E&Y") as SFC's auditor in August 2007.

16. In accordance with the Claims Procedure Order, BDO has submitted Proofs of Claim against both SFC and its officers and directors; in many cases, the same officers and directors

who are alleged by the OSC, among other things, to have engaged in fraudulent conduct in relation to the very financial statements at issue.

17. In its Proof of Claim against Sino, BDO does not advance its claim in the capacity of an equity holder of SFC. Rather, BDO advances its claims against SFC in its capacity as SFC's former auditor for 2005 and 2006.

18. BDO claims in relation to the breach by SFC of fundamental obligations in relation to the quality and accuracy of SFC's financial reporting and disclosure; obligations that were owed directly to BDO under the terms of BDO's audit engagement agreements with SFC (collectively, the "BDO Engagement Agreements").

BDO Engagement Agreements; BDO's Motion Record, TAB 1A, pp. 167-200

19. In particular, the BDO Engagement Agreements governing the audits of the SFC annual financial statements for the 2005 and 2006 years provided that:

(a) BDO relied upon SFC and its management to bear the primary responsibility for preparing its annual financial statements in accordance with Generally Accepted Accounting Principles ("GAAP"); and

(b) SFC's management bore primary responsibility to implement appropriate internal controls to detect fraud and error in relation to its financial reporting.

BDO Engagement Agreements; BDO's Motion Record, TAB 1A, pp. 170-171 and 178-179

20. The BDO Audit Report for 2006 was subsequently incorporated by reference in a June 2007 Prospectus issued by Sino (the "June 2007 Prospectus") regarding the offering of SFC's common shares to the public.

21. The use by SFC of the 2006 BDO Audit Report in the June 2007 Prospectus was governed by an Engagement Agreement dated May 23, 2007, under which SFC agreed to indemnify BDO in respect of any claims by the Underwriters or any third party as a result of the further steps taken by BDO in relation to the issuance of the June 2007 Prospectus.

> BDO Engagement Agreement, dated May 23, 2007; BDO's Motion Record, TAB 1A, pp. 183 – 184.

22. BDO claims for breach of the Engagement Agreement in respect of the June 2007 Prospectus, as well as that relating to the December 2009 Prospectus – which prospectus did not actually incorporate by reference any audit reports by BDO.

23. BDO also claims indemnity based upon a breach of the Engagement Agreements governing to the use of its audit reports in the three SFC Offering Memoranda, dated July 2008, June 2009 and December 2009, that were not at issue on the motion below – as they related to the issuance of debt securities and not equity securities.

B. BDO's independence from SFC:

24. As SFC's auditor, BDO was required to occupy a position that is the polar opposite of an equity holder. BDO was required to be completely independent from SFC – both in appearance and in fact. BDO could hold no financial stake in the fortunes of SFC, as this would fundamentally compromise its independence.

25. In particular, it is well-settled that an auditor's role is to opine on the procedures used by a corporation in its financial reporting, so as to allow current security holders to oversee management of the company. An auditor's role is not to assist investors or lenders in making personal investment decisions.

David Johnston and Kathleen Doyle Rockwell, *Canadian Securities Regulation,* 4th Edition, at pp. 181 – 183; BDO Book of Authorities, Tab 1

Hercules Managements Ltd. v. Ernst & Young, [1997] 2 S.C.R. 165 at paras. 49 – 51; BDO Book of Authorities, Tab 2

26. SFC's former auditors (BDO and E&Y) never assumed any of the risk and reward that would have been associated with equity ownership in SFC.

C. The Ontario Class Action:

27. BDO has been named as a defendant in an Ontario class action, *The Trustees of the Labourers' Pension Fund of Central and Eastern Canada et al. v. Sino-Forest Corporation et al.* (CV-11-431153-00CP) (the "Ontario Class Action"), which seeks to certify a class action on behalf of all persons who purchased SFC securities – both SFC shares and SFC Notes - in Canada during the Class Period (which is defined as March 19, 2007 to June 2, 2011), as well as all Canadian residents who purchased Sino's securities outside of Canada.

28. Subject to certification and leave being granted under the relevant provisions of the *Securities Act*, the largest portion of the claim in the Ontario Class Action seeks to advance a claim for $6.5 Billion on behalf of all purchasers of SFC securities on the secondary market during the Class Period (the "Secondary Market Claim"). The Secondary Market Claim is brought on behalf of secondary market purchasers of both SFC Shares and SFC Notes. A

29. A significant portion of the Secondary Market Claim is not relevant to this Appeal, as it has been brought on behalf of purchasers of **debt** securities and not equity holders.

30. Subject to certification, BDO has also been sued on behalf of primary market purchasers of SFC securities – again including purchasers of both shares and debt securities. Those claims are as follows:

(a) On behalf of all of the Class Members who purchased Sino common shares in the distribution to which a June 2007 Prospectus issued by Sino (the "June 2007 Prospectus") related, a claim for general damages in the sum of **$175,835,000**;

(b) On behalf of all of the Class Members who purchased Sino common shares in the distribution to which a December 2009 Prospectus issued by Sino (the "December 2009 Prospectus") related, a claim for general damages in the sum of **$319,200,000**;

(c) On behalf of all the Class Members who purchased Sino's 5% Convertible Senior Notes due 2013 pursuant to a July 2008 Offering Memorandum issued by Sino (the "July 2008 Offering Memorandum"), a claim for general damages in the sum of **US$345 million**;

(d) On behalf of all the Class Members who purchased Sino's 10.25% Guaranteed Senior Notes due 2014 pursuant to the June 2009 Offering Memorandum issued by Sino (the "June 2009 Offering Memorandum"), a claim for general damages in the sum of **US$400 million**; and

(e) On behalf of all the Class Members who purchased Sino's 4.25% Convertible Senior Notes due 2016 pursuant to the December 2009 Offering

Memorandum issued by Sino (the "December 2009 Offering Memorandum"), a claim for general damages in the sum of **US$460 million**.

31. It is alleged in the Ontario Class Action that the 2005 Audit Report and the 2006 Audit Report each contain the same statement by BDO; a statement that is alleged to have misrepresented that, in the opinion of BDO, Sino's 2005 and 2006 annual financial statements "...present fairly, in all material respects, the financial position of Sino as at December 31, 2005 and December 31, 2006 and the results of its operations and cash flows for the years then ended in accordance with Canadian generally accepted accounting principles."

Fresh as Amended Statement of Claim, para. 198; BDO Responding Motion Record, Tab 1A, pp. 47-48

D. BDO's claim against Sino:

32. As indicated above, the BDO Audit Reports were prepared pursuant to Engagement Agreements, under which SFC and its management agreed to bear primary responsibility to ensure the accuracy of SFC's financial statements and to ensure that their preparation accorded with GAAP.

33. BDO has a claim against SFC and its management in relation to the breach of the obligations owed by SFC under the BDO Engagement Agreements. That claim is not dependent upon the shareholder claims against SFC succeeding but, rather, seeks compensation relating to the breach of the basic obligations of SFC under the BDO Engagement Agreements that are outlined above.

E. The common law treatment of equity claims and the enactment of the provisions at issue:

34. On this appeal it is important to put into context the 2009 amendments to the CCAA (and other insolvency legislation) that created the definitions of "equity claim" and "equity interest" that are at the centre of this appeal.

35. At common law, it has been a longstanding rule that holders of equity in an insolvent corporation rank behind its ordinary creditors.

36. A significant policy rationale behind treating equity holders differently from creditors is that holders of equity have unlimited upside potential when purchasing shares. Shareholders throw their lot in with the corporation and stand to see their investment rise with the fortunes of the corporation. Accordingly it is fair that equity holders also assume the risk of loss, should the corporation become insolvent.

> *Nelson Financial Group (Re)*, 2010 ONSC 6229 at para. 25; BDO Book of Authorities, TAB 3

37. In contrast, creditors have no corresponding upside potential – their expectation is to be repaid what is owed to them with whatever interest has been negotiated.

> *Nelson Financial Group (Re)*, 2010 ONSC 6229 at para. 25; BDO Book of Authorities, TAB 3

38. Over the years, equity holders have attempted to get around the common law rule that they rank last by characterising their claims relating to something other than their shareholdings in the insolvent corporation.

39. For example, in both *National Bank of Canada v. Merit Energy Ltd.* and *Earthfirst Canada Inc.(Re)*, owners of flow-through common shares tried to jump the queue and be treated as creditors by characterizing their claims as being made under contractual indemnities. In each of the two subject corporations these shareholders had each paid a premium to receive an indemnity from each corporation for certain tax liabilities that could flow through to the shareholders.

40. In both *Merit* and *Earthfirst*, these indemnity rights were found to be "ancillary to the underlying right" of each of the claimants as a shareholder. As such, it was found that their claims should still be subordinated as equity claims

> *National Bank of Canada v. Merit Energy Ltd.*, [2001] A.J. No. 918 (Q.B.) at paras. 48 – 55; ; BDO Book of Authorities, TAB 4
>
> *Earthfirst Canada Inc.(Re)*, 2009 ABQB 316 (Q.B.) at para. 5; BDO Book of Authorities, TAB 5

41. This contrasts with the contractual indemnity claims advanced by independent third party underwriters in *Merit*, which were found not to be equity claims and they ranked with the claims by other unsecured creditors.

> *National Bank of Canada v. Merit Energy Ltd.*, [2001] A.J. No. 918 (Q.B.) at paras. 62 – 68; ; BDO Book of Authorities, TAB 4

42. In 2009, amendments were made to the CCAA to add express statutory definitions of "equity claim" and "equity interest" and to expressly subordinate equity claims to those made by creditors (the "Amendments"). In particular, the following definitions were added to s.2 of the CCAA:

> "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 convertible debt

Similar amendments to the *Bankruptcy and Insolvency Act* were made at the same time.

> *Companies Creditors Arrangement Act,* RSC 1985, c.C-36, as amended, ss. 2, 6(8) and 22.1

43. During the Parliamentary hearings leading to the Amendments, Parliament expressly indicated that it was concerned about the lack of consistency in the treatment of claims brought against an insolvent corporation by purchasers and sellers of its equity securities.

> Standing Senate Committee on Banking Trade and Commerce, *Debtors and Creditors Sharing the Burden*, 2003 [Standing Senate Committee Report] at pp. 158-159, BDO Book of Authorities, Tab 6

44. In the Senate Report drafted following these Parliamentary hearings, equity claims are described as claims not based on the supply of goods, services or credit to a corporation, but rather based on some wrongful or allegedly wrongful act committed by an issuer of an instrument reflecting on the value of the equity in the capital of a corporation.

> Standing Senate Committee on Banking Trade and Commerce, *Debtors and Creditors Sharing the Burden, 2003* [Standing Senate Committee Report] at pp. 158-159, BDO Book of Authorities, Tab 6

45. There is no express mention in any of the materials preceding the Amendments of so extensively expanding the definition of "equity claims" that third party indemnity claims by service providers such as auditors or underwriters will be subordinated.

F. The decision below:

46. In granting the relief sought on the Equity Claims Motion, the Honourable Justice Morawetz acknowledged that the traditional differentiation between creditor and equity claims stems from the fundamentally different nature of debt and equity investments.

47. In particular, Justice Morawetz observed that this difference stems from the fact that shareholders have unlimited upside potential when purchasing shares, while creditors have no corresponding upside potential.

> Endorsement of the Honourable Mr. Justice Morawetz, dated July 27, 2012 ("Morawetz Endorsement"), paras. 23 - 27; Motion Record of BDO Limited, Tab 3, p. 15

48. While Justice Morawetz accepted that the Amendments intention behind the Amendments was to provide clarity to the rules regarding equity claims and to codify pre-existing common law rules, he nevertheless found that the plain language used in the definition of "equity claim" does not focus on the identity of the claimant but, rather the nature of the claim.

> Morawetz Endorsement, paras. 23 – 27 and 87 - 88; Motion Record of BDO Limited, Tab 3, pp. 15 and 25

49. Justice Morawetz found that the plain language covered claims by the Third Party Indemnity Claimants, including BDO. He further observed that these indemnity claims were,

in effect, being used to recover an equity investment by former shareholders of SFC and that, as such, they should be characterized as equity claims under the CCAA.

Morawetz Endorsement, paras. 87 - 90; Motion Record of BDO Limited, Tab 3, p. 25

50. However, Justice Morawetz did observe that there may be circumstances where the plaintiffs' claims in the Class Actions do not succeed against the Third Party Indemnity Claimants and these claimants may still have indemnity claims against SFC that do not arise from the claims by the plaintiff shareholders. As such, Justice Morawetz left open the possibility that claims for legal costs of defending the various class actions might not be equity claims, under the CCAA.

PART IV - ISSUES AND THE LAW

51. In order to maintain some consistency among the three groups of appellants in this appeal, BDO has adopted in this factum the order and listing of the issues as stated in paragraph 9 (a) through (e) of the Notice of Appeal filed by the Underwriters – subject to minor changes in the wording.

A. The motions judge erred in declaring that claims of BDO and other arm's length indemnity claimants who have never been SFC shareholders are equity claims:

52. The decision below, if upheld, marks a major shift in the law of insolvency in Canada.

53. For the first time, BDO and other independent, arm's length third parties who have never held shares in an insolvent company are being treated and ranked as if they were shareholders.

54. Further, these third parties are being treated like shareholders not because of their relationship to the insolvent company but in spite of that relationship. Their existence as independent third party service providers has been ignored simply because a component of these third parties' claims stems from claims made by shareholders in the Ontario Class Action and other similar actions.

55. This runs contrary to the general scheme for ranking and assessing claims that is prescribed under Canadian federal insolvency legislation, including the CCAA - despite there being no indication that the Amendments at issue were ever intended to so drastically change the law on third party indemnity claims.

56. In reviewing the relevant provisions of the CCAA, or any statue for that matter, it is important to consider the following statutory interpretation principles:

> (a) The words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act and the intention of Parliament.
>
> (b) Every Act "shall be deemed to be remedial" and ... every Act shall "receive such fair, large and liberal construction and interpretation as will best ensure the attainment of the object of the Act according to its true intent, meaning, and spirit."

Rizzo & Rizzo Shoes Ltd, Re, [1998] 1 S.C.R. 27 at paras. 6 and 21, BDO Book of Authorities, Tab 7

57. It is a longstanding general rule underlying Canadian bankruptcy and insolvency legislation, including the CCAA, that all unsecured debt claims against a bankrupt or insolvent entity rank *pari passu.*

58. Further, under Canadian bankruptcy and insolvency legislation the relationship of the claimant to the insolvent corporation is relevant – *indeed, crucial* - to how that claimant is treated and ranked.

59. The policy behind treating shareholders differently from third party creditors is simple and fundamental. Shareholders assume the risk of losing their investment due to insolvency because it necessarily accompanies the benefits associated with the unlimited potential upside

that comes from ownership in the company. Creditors assume no such risk because they enjoy no such potential benefit.

> *Nelson Financial Group (Re)*, 2010 ONSC 6229 at para. 25; BDO Book of Authorities, TAB 3

60. In order to analyze whether it is truly the intention of the CCAA that the claims by BDO and the other third party indemnity claimants should be treated as shareholder claims, the Amendments at issue must be examined in the context of the entire statutory scheme in which they exist.

61. Section 2 of the CCAA incorporates the framework in the *Bankruptcy and Insolvency Act* (the "BIA") for the determination of what is a claim provable in CCAA proceedings, as follows:

> 2.(1) In this Act, "claim" means any indebtedness, liability or obligation of any kind that would be a claim provable within the meaning of section 2 the *Bankruptcy and Insolvency Act*.
>
> CCAA, section 2(1)

62. Section 121(1) of the BIA provides as follows:

> 121 (1) Claims provable - All debts and liabilities, present or future, to which the bankrupt is subject on the day on which the bankrupt becomes bankrupt or to which the bankrupt may become subject before the bankrupt's discharge by reason of any obligation incurred before the day on which the bankrupt becomes bankrupt shall be deemed to be claims provable in proceedings under this Act.
>
> BIA, section 121(1)

63. The Amendments to the CCAA introduced two new definitions: "equity claims" and "equity interests." Equity claims are defined in Section 2(1) of the CCAA as follows:

> 2.(1) – "equity claim" means a claim that is in respect of an equity interest, including a claim for, among others,
>
> (a) a dividend or similar payment,
>
> (b) a return of capital,
>
> (c) a redemption or retraction obligation,
>
> (d) a monetary loss resulting from the ownership, purchase or sale of an equity interest or from the rescission, or, in Quebec, the annulment, of a purchase or sale of an equity interest, or
>
> (e) contribution or indemnity in respect of a claim referred to in any of paragraphs (a) to (d).
>
> CCAA, section 2(1)

64. By definition, an equity claim must be a claim "in respect of an equity interest." Equity interest is defined in Section 2(1) of the CCAA as follows:

> 2.(1) – "equity interest" means
>
> (a) in the case of a corporation other than an income trust, a share in the corporation - or a warrant or option or another right to acquire a share in the corporation - other than one that is derived from a convertible debt, and
>
> (b) in the case of an income trust, a unit in the income trust - or a warrant or option or another right to acquire a unit in the income trust - other than one that is derived from a convertible debt.
>
> CCAA, section 2(1)

65. The Amendments then make clear that equity claims are subordinate to general unsecured claims. Section 6(8) of the CCAA provides that:

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

66. In expanding the definition of "equity claim" to encompass claims by third parties that have never held equity in the subject corporation, the decision below has interpreted the Amendments in isolation without looking at them in the context of the entire CCAA and its objectives.

67. The decision below has also failed completely to consider the relationship of the third party indemnity claimants to the insolvent company when characterising their claims – despite the nature of that relationship being crucial to the manner in which claims are normally ranked under the CCAA and the BIA.

68. These were, with respect, mistakes.

69. BDO and the other Third Party Indemnity Claimants are, in substance, independent third party creditors of SFC. To interpret the Amendments as making these independent service providers to SFC as making these parties equity claimants runs contrary to the statutory scheme under the CCAA and the logical meaning of the Amendments within that statutory scheme.

70. The relationship between an auditor and the company it audits is the polar opposite of the relationship between a shareholder and the company in which the shares are held.

71. A third party auditor does not, and cannot, have a direct stake in the value of the company it audits. As such, the rationale behind subordinating the claims of those that choose to participate in the increases in the value of the corporation and assume the risk of decreases

in its value by buying shares, simply does not apply to an auditor that advances an indemnity claim against the corporation.

72. The bottom line is that BDO has never been a shareholder of SFC or otherwise held equity in SFC. BDO's only relationship with SFC has been as a third party auditor and seeks indemnity from SFC pursuant to the obligations arising from that legal relationship – not from any equity interest.

B. The motions judge erred in failing to properly construe subsections (a) to (e) of the CCAA definition of "equity claim."

73. The words "contribution or indemnity in respect of a claim" used in subsection (e) of the definition of "equity claim" are clearly meant to apply to claims arising from an indemnity granted in favour of shareholders of a company and not to claims arising from a contractual indemnity granted to an independent third party.

74. The new definition of "equity claim," including the non-exhaustive list of examples of claims that would amount to equity claims listed in parts (a) through (e) of that definition, hinges entirely upon the claim being in respect of an "equity interest" in the insolvent corporation. An equity interest means that the claimant holds equity (i.e. shares) in the corporation.

75. When looking at claims for contribution or indemnity against an insolvent corporation under part (e) of the definition of "equity claim," the only interpretation that fits within the objects of the CCAA is that it applies only to claims that a shareholder or former shareholder has against the insolvent company.

76. Perfect examples of the types of situations to which part (e) of the "equity claim" definition would properly have applied can be found in the pre-Amendment cases of *National Bank of Canada v. Merit* and *Earthfirst Canada Inc.(Re).*

> *National Bank of Canada v. Merit Energy Ltd.*, [2001] A.J. No. 918 (Q.B.) at paras. 48 – 55; BDO Book of Authorities, TAB 4
>
> *Earthfirst Canada Inc.(Re)*, 2009 ABQB 316 (Q.B.) at para. 5; BDO Book of Authorities, TAB 5

77. In both of these cases, the identity of the claimants as shareholders was key to the determination that they were equity claimants. The courts correctly characterized the claimants' indemnity rights as being part of the bundle of rights they enjoyed by virtue of being shareholders and therefore found that the claimants were, in substance, equity claimants.

78. It is consistent with the objectives of the CCAA that indemnity claims by actual current and former shareholders under contractual indemnities they purchased along with their shareholdings should be subordinated under the Amendments – as these claims are essentially shareholder claims that are dressed up as contractual indemnity claims. That is the proper interpretation of the Amendments.

79. Conversely, it runs contrary to the objectives of the CCAA and the normal and ordinary meaning of "equity" to define as equity claimants completely independent third party service providers that have never held equity in the insolvent corporation.

80. It is especially inappropriate to define auditors as equity claimants – given that auditors are prohibited from ever holding equity in the insolvent corporation.

C. The motions judge erred in holding that the Amendments substantially altered the law so as to subordinate as equity claims the claims of contractual, arm's length indemnity claimants such as auditors

81. As indicated above, there is no indication in the Amendments or in the materials produced by Parliament leading to the Amendments of an intention to so drastically alter the definition of equity claim as to capture claims by independent third party auditors, such as BDO.

Standing Senate Committee Report at p. 159, BDO Book of Authorities, Tab 6

82. There is no indication in the Parliamentary materials of an intention that claims by auditors and other service providers that have never held equity in the insolvent corporation and *could not* ever hold equity in the insolvent corporation are to suddenly be considered as equity claims.

83. The most that can be said is that Parliament did turn its mind to making Canadian insolvency statutes consistent with the rule regarding the treatment of equity holders in the U.S. – a rule that has, in some cases, broadened the types of claims that are subordinated beyond those by equity holders.

Standing Senate Committee Report at p. 159, BDO Book of Authorities, Tab 66

84. However, even in the U.S. there is no precedent for treating indemnity claims by auditors as equity claims. At most, there are a couple of U.S. case law precedents for indemnity claims by underwriters to be subordinated where those claims have a nexus or causal relationship to the purchase or sale of securities.

In re Jacom Computer Services Inc., , 280 B.R. 816 (Bankr. D.Del. 1999); BDO Book of Authorities, Tab 8

85. There is no precedent in the U.S. of Canada for indemnity claims by auditors to be subordinated as equity claims, nor should there be.

86. Auditors are independent and are required to be independent. Auditors do not and *cannot* throw their lot in with company they are auditing. Auditors do not *and cannot* seek to benefit from increases in the share value of the company they audit and they do not *and cannot* agree to participate in the company's downside.

87. To treat auditors' claims in the same manner as those by equity holders would be antithetical to their independent role in auditing public companies.

88. Further, there is no nexus or causal relationship between the audit of a company's financial statements and the purchase or sale of shares. It is well-settled that an auditor's role is opine on the procedures used by a corporation in its financial reporting, so current security holders can oversee management of the company. **An auditor's role is not to assist investors or lenders in making personal investment decisions.**

> David Johnston and Kathleen Doyle Rockwell, *Canadian Securities Regulation,* 4th Edition, at pp. 181 – 183

89. The limited case law commentary on the Amendments that existed prior to the decision below correctly observed that the Amendments were intended to codify the pre-existing common law principles on equity claimants.

> *Re Nelson Financial Group*, 2010 ONSC 6229 (SCJ) at para. 27

90. BDO agrees with that observation and submits that it is consistent with the rationale given for the Amendments by Standing Senate Committee Report which was to impose

"fairness and predictability" to the "hodgepodge system" that was previously in place in Canada depending upon where a particular corporation was organized. There is no indication that the Amendments intended to be a complete overhaul and re-defining of what it means to be an equity claimant – which is how the decision below interpreted the Amendments.

Standing Senate Committee Report at p. 159, BDO Book of Authorities, Tab 6

D. The motions judge erred in finding that the characterization of the Third Party Indemnity Claims as equity claims turns on the nature of the underlying claim for which indemnity is sought rather than the nature and origin of the indemnity rights of BDO and the other Third Party Indemnity Claimants:

91. In finding that the indemnity claims by BDO and the other Third Party Indemnity Claimants were indemnity claims under the CCAA, s.2, the decision below erroneously focused on the origin of the loss or damages for which indemnity has been sought rather than the nature of the relationship between the Third Party Indemnity Claimants and SFC and the rights under which these parties seek indemnity from SFC.

92. Traditionally under common law, the question has been about the substance of the claim made against the insolvent, not whether certain portions of the damages recovered under that claim might end up flowing through to persons who are or were equity holders.

National Bank of Canada v. Merit Energy Ltd., [2001] A.J. No. 918 (Q.B.) at paras. 48 and 62 - 65; BDO Book of Authorities, TAB 4

93. In focusing on the identities of the persons suing BDO and the other Third Party Indemnity Claimants, the court below fundamentally misconstrued the nature of the contractual and common law claims advanced against SFC by these parties.

94. The analysis of the court below is akin to characterising a homeowner's breach of warranty claim against a contractor as a personal injury claim merely because the damages caused by construction defects happened to also cause injury to a visitor on the homeowner's premises. There is little doubt that the homeowner's claim is in the nature of a breach of contract claim – regardless of whether a component of the damages for which indemnity is sought relates to a third party's personal injury.

95. Contrary to the decision below, there is nothing in the Amendments that requires a drastic change in focus from the nature of the claimant's claim against the insolvent corporation and requires that it be shifted to the nature of the damages for which the claimant is seeking indemnity.

96. It is more consistent with the nature and objectives of the CCAA to interpret the Amendments to the effect that an equity claim must flow from the claimant's position as an equity holder than it is to base the definition on the fear that a portion of the amount claimed might eventually flow through to an equity holder.

E. The motions judge erred in finding that the Third Party Indemnity Claims are being used to recover an equity investment:

97. The Claims by BDO and the other Third Party Claimants are not in respect of an equity interest held by these claimants and are therefore not equity claims. As such, they must be distinguished from the claims of shareholders themselves.

98. Similar to the claims advanced by the Underwriters in the *National Bank v. Merit Energy* case, BDO's indemnity claim against SFC is based on its status as a service provider

to SFC and upon breaches of the obligations owed by SFC and its management to BDO under that relationship. These breaches and the claims arising therefrom are separate and distinct from those that can be advanced by SFC shareholders and they do not depend upon the claims brought by SFC shareholders succeeding.

> *National Bank of Canada v. Merit Energy Ltd.*, [2001] A.J. No. 918 (Q.B.) at paras. 48 and 62 - 65; BDO Book of Authorities, TAB 4

99. The fact that money recovered under these separate and distinct claim might eventually be used to pay claims by shareholders is beside the point. The claim by BDO is not in relation to BDO's equity holdings in SFC and it should therefore not be characterised as an equity claim under a statute.

PART V - RELIEF SOUGHT

100. THE APPELLANT ASKS that the Order below be set aside and an Order be granted as follows:

(a) Dismissing the Equity Claims Motion brought by SFC;

(b) Declaring that any indemnification claims against Sino asserted by BDO and other appellants in the companion appeals with this appeal, are not "equity claims" as defined in the CCAA;

(c) Ordering that BDO's claims are to be dealt with as unsecured creditor claims in accordance with the Claims Procedure Order, as defined herein; and

(d) Awarding to BDO its costs of the appeal and the motion appealed from.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 26th day of October, 2012.

Peter R. Greene

Kenneth A. Dekker

Michelle E. Booth

AFFLECK GREENE McMURTRY LLP

Lawyers for the Appellant, BDO Limited

Court of Appeal File No. C56125
Court File No. CV-12-9667-00CL

COURT OF APPEAL FOR ONTARIO

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

APPLICATION UNDER THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED

CERTIFICATE

Counsel for BDO Limited (Appellant) hereby certifies that:

a) An Order under subrule 61.09(2) of the *Rules of Civil Procedure* is not required, and

b) 2.5 hours will be required for oral argument for the Appellants (including Ernst & Young and the Underwriters).

DATED AT TORONTO this 26th day of October, 2012

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SCHEDULE "A"
LIST OF AUTHORITIES

1. David Johnston and Kathleen Doyle Rockwell, *Canadian Securities Regulation,* 4th Edition

2. *Hercules Managements Ltd. v. Ernst & Young*, [1997] 2 S.C.R. 165

3. *Nelson Financial Group (Re)*, 2010 ONSC 6229

4. *National Bank of Canada v. Merit Energy Ltd.*, [2001] A.J. No. 918

5. *Earthfirst Canada Inc.(Re)*, 2009 ABQB 316 (Q.B.)

6. Standing Senate Committee on Banking Trade and Commerce, *Debtors and Creditors Sharing the Burden*, 2003 [Standing Senate Committee Report]

7. *Rizzo & Rizzo Shoes Ltd, Re,* [1998] 1 S.C.R. 27

8. *In re Jacom Computer Services Inc.,* , 280 B.R. 816 (Bankr. D.Del. 1999)

SCHEDULE "B"
RELEVANT STATUTES

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

s.2: In this Act,....

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

(*a*) a dividend or similar payment,
(*b*) a return of capital,
(*c*) a redemption or retraction obligation,
(*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, and

(*b*) in the case of an income trust, a unit in the income trust — or a warrant or option or another right to acquire a unit in the income trust — other than one that is derived from a convertible debt;

. . . . .

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

. . . . .

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

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

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APPLICATION UNDER THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED

Court of Appeal File No. C56125
Superior Court File No. CV-12-9667-00CL

COURT OF APPEAL FOR ONTARIO

Proceeding commenced at Toronto

Factum of the Appellant, BDO Limited

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