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

FACTUM OF THE UNDERWRITERS NAMED IN CLASS ACTIONS
(motion for an Equity Claims Order, returnable on June 26, 2012)

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PART I - OVERVIEW

1. This Factum is filed by the Underwriters (as defined below) in connection with the motion (the "Equity Claims Motion") of Sino-Forest Corporation ("Sino-Forest") for an order (the "Equity Claims Order"), *inter alia*, determining that any indemnification claims against Sino-Forest (the "Related Indemnity Claims") related to or arising from the ownership, purchase or sale of an equity interest in Sino-Forest (the "Shareholder Claims") are "equity claims" as defined in section 2 of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended (the "CCAA").

2. It is the position of the Underwriters that this Court should not decide the Equity Claims Motion at this time because it is premature, or, alternatively, in the event that this Court decides the Equity Claims Motion at this time, the Equity Claims Order should not be granted because the Related Indemnity Claims are not "equity claims" as defined in section 2 of the CCAA.

3. In the event that this Court hears the Equity Claims Motion at this time, and irrespective of the outcome, no determinations can be made regarding: (a) indemnity claims in respect of the claims of bondholders arising from bond issuances; and (b) indemnity claims against subsidiaries of Sino-Forest that are not applicants in Sino-Forest's CCAA case. As confirmed by Sino-Forest's counsel, those issues form no part of the Equity Claims Motion.

4. The Underwriters reserve the right to supplement this Factum.

PART II – THE FACTS

5. Sino-Forest and certain of its current and former officers, directors and employees, along with Sino-Forest's current and former auditors, technical consultants and various underwriters involved in prior equity and debt offerings (the "Offerings") have been named as defendants in one or more class action lawsuits in Ontario, Quebec, Saskatchewan and New York (the "Class Actions").

> Affidavit of Elizabeth Fimio, sworn June 8, 2012 [Fimio Affidavit] at para. 2, Sino-Forest Motion Record, Tab 2

6. The Underwriters (namely, Credit Suisse Securities (Canada) Inc., TD Securities Inc., Dundee Securities Corporation (now known as DWM Securities Inc.), RBC Dominion Securities Inc., Scotia Capital Inc., CIBC World Markets Inc., Merrill Lynch Canada Inc., Canaccord Financial Ltd. (now known as Canaccord Genuity Corp.), Maison Placements Canada Inc., Credit Suisse Securities (USA) LLC and Merrill Lynch, Pierce, Fenner & Smith Incorporated, successor by merger to Banc of America Securities LLC) are among the defendants named in some of the Class Actions.

> Fimio Affidavit at para. 2 and Exhibits "A", "B", "C" and "D", Sino-Forest Motion Record, Tabs 2, 2(A), 2(B), 2(C) and 2(D)

7. In connection with the Offerings, certain Underwriters have entered into agreements with Sino-Forest and certain of its subsidiaries (the "Sino-Forest Subsidiary Companies") providing that Sino-Forest and, with respect to certain Offerings, the Sino-Forest Subsidiary Companies, have agreed to indemnify and hold harmless the Underwriters in connection with an array of matters that could arise from the Offerings, as more fully described in the Affidavit of Rebecca L. Wise, sworn April 23, 2012.

> Affidavit of Rebecca L. Wise, sworn April 23, 2012 at para. 8 and Exhibits "A", "C" and "F", Responding Motion Record of the Underwriters filed in connection with the motion of Sino-Forest returnable on May 8, 2012, Tabs 1, 1(A), 1(C) and 1(F)

8. On June 26, 2012, Sino-Forest will be seeking the Equity Claims Order. It is expected that at the same time, the Monitor will also be seeking an order in respect of a mediation of the claims between the parties in the Class Actions, the Applicant and its other stakeholders.

PART III – LAW & ARGUMENT

The Issues

9. The following issues are before this Court and addressed below:

(1) Should this Court decide the Equity Claims Motion at this time?

(2) In the event that this Court decides the Equity Claims Motion at this time, should the Equity Claims Order be granted?

Issue I: The Equity Claims Motion Should not be Decided at this Time

10. While it is apparent that the subject matter of the Equity Claims Motion is important to Sino-Forest's CCAA case, it is also apparent that the timing of the Equity Claims Motion raises important questions for this Court to consider, including whether or not now is the time to decide the Equity Claims Motion and what sort of evidentiary record this Court wants before it when it ultimately does decide the subject matter of the Equity Claims Motion.

Prematurity

11. An issue should not be determined by the court where it is not justiciable because it is not yet ripe for determination. In such cases, the litigation is premature. The doctrine of ripeness is an aspect of a general policy or practice that a court may decline to decide a case which raises merely a hypothetical or abstract question.

> L. Abrams and K.P. McGuiness, *Canadian Civil Procedure Law*, 2nd ed. (Toronto: LexisNexis, 2010) at §3.36 at p. 219, Brief of Authorities of the Underwriters, Tab 1

12. On May 14, 2012, Sino-Forest sought and obtained a Claims Procedure Order which established a claims procedure for the identification and determination of certain claims in the

Sino-Forest CCAA case, including, *inter alia*, establishing a claims bar date on June 20, 2012 and setting out a process, to be conducted after June 20th and indeed after the date of the hearing of this motion, for the revision or disallowance of claims and the dispute of such revisions and disallowances by claimants (the "Claims Procedure").

13. By seeking the Equity Claims Order at this time, Sino-Forest is attempting to pre-empt the Claims Procedure, which already provides a process for the determination of claims.

14. Until such time as the Claims Procedure in respect of Related Indemnity Claims is completed, and Related Indemnity Claims are finally determined pursuant to that process, the subject matter of the Equity Claims Motion raises merely a hypothetical or abstract question because this Court is being asked to determine the proper interpretation of section 2 of the CCAA before the Court has the benefit of an actual claim in dispute before it. The evidentiary record before this Court at this time is necessarily constrained by the abstract nature of this question of interpretation, and does not include a complete factual record consisting of, *inter alia*, relevant proofs of claim and notices of revision or disallowance, as contemplated by the Claims Procedure.

15. In effect, Sino-Forest is asking this Court to pre-empt the very Claims Procedure that Sino-Forest (along with the Monitor in this CCAA case), is running, concurrently with it seeking to have this Court determine the Equity Claims Motion. The proper time to hear such a motion is when the subject matter is not merely hypothetical and abstract, but when and if there is a crystallized dispute (i.e., in the context of a dispute in the Claims Procedure with respect to a particular claim).

16. In addition, by asking this Court to render judgment on the proper interpretation of section 2 of the CCAA in the abstract, Sino-Forest is putting this 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. Rather this Court's judgment will be exercised and its time expended in the abstract. The ramifications for future cases of doing so are foreseeably negative, and would raise questions of whether or not such judgment is of broad or narrow application.

17. By deciding the Equity Claims Motion at this time, this Court would be departing from its traditional role of, *inter alia*, hearing live disputes between parties or, for example, providing directions pursuant to its orders. The Equity Claims Motion is not a motion for directions –it is something very different. By seeking the Equity Claims Order at this time, Sino-Forest may be abdicating its responsibility under the Claims Procedure Order by deciding not to determine the relevant claims itself prior to resorting to this Court in the case of dispute. If Sino-Forest's objective was to have this Court determine the proper interpretation of section 2 of the CCAA, the proper avenue for it to accomplish such objective was the inclusion of explicit language calling for such a mechanism in the Claims Procedure Order. Sino-Forest did not take this approach to the detriment of the Claims Procedure and interested parties therein.

18. The Claims Procedure contains mechanisms for the determination of claims and there is recourse to this Court, if necessary, in the case of disputes. Therefore, it is not necessary to determine the Equity Claims Motion at this time; the issue raised in that motion can be addressed at a later and more appropriate time. The Claims Procedure has not yet provided for the determination of the relevant claims, and in the context of the Claims Procedure, the subject matter of the Equity Claims Motion could be decided in a properly adversarial manner, with the benefit of an actual claim and a full evidentiary record.

19. As the Claims Procedure is ongoing, the subject matter of the Equity Claims Motion is not yet ripe for consideration.

Avoiding Multiplicity of Proceedings

20. One of the fundamental problems with bringing the motion prematurely is that the Equity Claims Motion is contrary to the mandatory direction in section 138 of the *Courts of Justice Act*, R.S.O. 1990, c. C-43, as amended, that multiplicity of proceedings shall be avoided as far as possible. It is not necessary to use judicial resources at this time to determine an issue, which may very well return to this Court in a truly adversarial context in respect of a particular claim, as discussed above. That will duplicate proceedings before this Court. The better and more efficient course is to have the issue raised in the Equity Claims Motion determined in the ordinary course through the Claims Procedure already approved by this Court.

Undermining the Mediation

21. Finally, the Equity Claims Motion is also ill-timed in the face of a pending mediation. The Monitor in this CCAA case has been exploring the feasibility of such a mediation. It is expected that the Monitor will seek a mediation order on June 26, 2012. In the event that such a mediation is ordered, it is essential that it be given the maximum prospects of success. Deciding the Equity Claims Motion at this time would have the effect of entrenching positions based on a premature determination made by this Court on an incomplete record on what could amount to the eve of the commencement of a mediation. The result could be destabilizing to the relative positions of the parties and diminish the prospects of success at a mediation, which is not in the interest of the stakeholders.

Issue II: Alternatively, the Equity Claims Order Should not be Granted

22. It is respectfully submitted that, in the event that this Court decides that the Equity Claims Motion should be decided at this time, the Equity Claims Order should not be granted.

23. The law and argument below in respect of this issue is presented without the benefit of a complete factual record consisting of, *inter alia*, relevant proofs of claim and notices of revision or disallowance, as there is no crystallized dispute (i.e., in the context of a dispute in the Claims Procedure with respect to a particular claim) at this time. When and if this issue is decided in the context of such a dispute, the law and argument presented could differ from the law and argument that follows.

Statutory Framework for Defining Equity Claims

24. The general rule under Canadian bankruptcy and insolvency legislation is that all unsecured debt claims against a bankrupt or insolvent entity rank *pari passu*. Amendments (the "Amendments") to Canadian bankruptcy and insolvency legislation that came into effect in September 2009, added new provisions to both the *Bankruptcy and Insolvency Act*, R.S.C., 1985, c. B-3 ("BIA") and the CCAA concerning the treatment of equity claims against a bankrupt or insolvent entity to clarify what, in fact, constitutes an equity as opposed to a debt claim.

25. A determination of whether the Related Indemnity Claims are unsecured debt claims or equity claims requires an analysis of the statutory provisions relating to claims provable and equity claims. Section 2 of the CCAA incorporates the BIA framework 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), Schedule "B"

26. 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), Schedule "B"

27. The Amendments introduced two new definitions: that of "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), Schedule "B"

28. By definition, an equity claim must be a claim "in respect of an equity interest". Equity interest is, in turn, 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), Schedule "B"

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

> 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), Schedule "B"

30. In reviewing these provisions of the CCAA, it is helpful 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, Brief of Authorities of the Underwriters, Tab 2

31. To a large extent, Parliament's intent, especially with respect to the Amendments, is reflected in the Standing Senate Committee on Banking Trade and Commerce's *Debtors and Creditors Sharing the Burden* (the "Senate Report"). With reference to the Senate Report, equity claims are generally understood to be those claims that are not based on the supply of goods, services or credit to a corporation, but rather are based on some wrongful or allegedly wrongful act committed by an issuer of an instrument reflecting 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, Brief of Authorities of the Underwriters, Tab 3

32. In the examples of equity claims provided in the Senate Report, indemnity claims of independent third-parties dealing at arm's length, such as underwriters, are notably absent. The Senate Report, citing the Joint Task Force on Business Insolvency Law Reform, states that "all [equity] claims against a debtor in an insolvency proceeding ... including claims for payment of dividends, redemption or retraction or repurchase or shares, and damages (including securities fraud claims) are to be treated as equity claims subordinate to all other secured and unsecured claims against the debtor ... ."

> *Standing Senate Committee Report* at pp. 158-159, Brief of Authorities of the Underwriters, Tab 3

33. Also notably absent from the Senate Report's recommendation, is any reference to the indemnity claims of independent third-parties dealing at arm's length. The Senate Report recommended that:

> [t]he Bankruptcy and Insolvency Act be amended to provide that the claim of a seller or purchaser of equity securities, seeking damages or rescission in connection with the transaction, be subordinated to the claims of ordinary creditors. Moreover, these claims should not participate in the proceeds of a restructuring or bankruptcy until other creditors of the debtor have been paid in full.
>
> *Standing Senate Committee Report* at pp. 158-159, Brief of Authorities of the Underwriters, Tab 3

34. In light of the Senate Report's recommendations, the inclusion of indemnity claims in subparagraph (e) of the CCAA definition of equity claim ought to be interpreted narrowly so as to restrict this provision to instances of indemnities in favour of shareholders only and not indemnities granted to independent third-parties dealing at arm's length. Subparagraph (e) ought to be interpreted to include such shareholder indemnity claims as those in respect of indemnities provided by companies to shareholders that in effect guarantee the performance of their shares, shareholders framing their actual tort claims as indemnities, shares with indemnity components or other hybrid securities and other similar indemnity claims. If interpreted less narrowly, subparagraph (e) could include indemnity claims of company insiders, such as directors and officers. However, the inclusion of indemnities granted to independent third-parties dealing at arm's length requires too broad an interpretation that is not supported by the Senate Report or the public policy considerations discussed in greater detail below.

The Historical Treatment of Equity Claims

35. It has been held by Canadian courts in subsequent decisions that, generally speaking, the Amendments merely codify existing case law on point and do not represent a departure from the law in this regard. Therefore, the pre-Amendments case law discussed below remains relevant.

> *Re Nelson Financial Group Ltd.* (2010), 71 C.B.R. (5th) 153 (Ont. S.C.J.) at para. 27, Brief of Authorities of the Underwriters, Tab 4

36. Historically, common law practice, as explained by the Ontario Court of Justice in *Re Central Capital Corp.*, was such that on the insolvency of a company, the claims of creditors rank ahead of the claims of shareholders for the return of their capital and are only entitled to share in the assets of an insolvent corporation until after all the ordinary creditors have been paid in full. This is premised on the notion that shareholders are higher risk takers, having willingly chosen to tie their investment to the fortunes of the corporation, as opposed to creditors who choose a lower level of exposure to risk.

> *Re Central Capital Corp.* (1995), 29 C.B.R. (3d) 33 (Ont. C.J. (Gen. Div. – Commercial List)) at para. 36, Brief of Authorities of the Underwriters, Tab 5

37. Elements considered in subordination cases were summarized by the Alberta Court of Queen's Bench in *Re Blue Range Resources Corp.* as:

(a) the claims of shareholders rank behind the claims of creditors in bankruptcy;

(b) creditors do business on the assumption that they will rank ahead of shareholders in the event of their debtor's insolvency;

(c) shareholders are not entitled to rescind their shares on the basis of misrepresentation after the company has become insolvent;

(d) United States jurisprudence supports the priority of creditors in "stockholder fraud" cases; and

(e) to allow the shareholders to rank *pari passu* with the unsecured creditors could open the floodgates to aggrieved shareholders launching misrepresentation claims.

> *Re Blue Range Resources Corp.* (2000), 15 C.B.R. (4th) 169 (Alta. Q.B.) at paras 35-45, Brief of Authorities of the Underwriters, Tab 6

Application of Equity Claims Definition to Related Indemnity Claims

38. In addition to confirming this long-standing principle of bankruptcy and insolvency law that shareholders cannot recover on their equity claims until all creditors of a corporate entity have been paid in full, the Amendments also addressed the application of this rule to certain categories of claims over which confusion had arisen as a result of difficulties in determining debt claims from equity claims. Such determination is conducted against the backdrop of the public policy considerations discussed in the Senate Report and in the case law above. The Senate Report observed that:

> [i]n view of recent corporate scandals in North America, the Committee believes that the issue of equity claim must be addressed in insolvency legislation. In our view, the law must recognize the facts in insolvency proceedings: since holders of equity have necessarily accepted - through their acceptance of equity rather than debt - that their claims will have a lower priority

> than claims for debt, they must step aside in a bankruptcy proceeding. Consequently, their claims should be afforded lower ranking than secured and unsecured creditors, and the law, in the interests of fairness and predictability - should reflect both this lower priority for holders of equity and the notion that they will not participate in a restructuring or recover anything until all other creditors have been paid in full.
>
> *Standing Senate Committee Report* at pp. 158-159, Brief of Authorities of the Underwriters, Tab 3

39. The consequences of such a determination have a direct impact on the claim holders' priority, as equity claims will be subordinated to the claims of unsecured creditors, while debt claims will share *pro rata* with the claims of unsecured creditors. The Amendments were intended, in part, to make this characterization exercise easier and more consistent.

40. In the present case, the consequence of characterizing the Related Indemnity Claims as equity claims is to subordinate the Related Indemnity Claims to unsecured claims against Sino-Forest. In order to characterize them correctly, it must be recognized that there are, in fact, at least two different kinds of Related Indemnity Claims:

(a) indemnity claims against Sino-Forest in respect of shareholder claims against the Underwriters ("Shareholder Indemnity Claims"); and

(b) indemnity claims against Sino-Forest in respect of the defence costs of the Underwriters in connection with defending themselves against shareholder claims ("Shareholder Defence Indemnity Claims"),

each requiring separate analysis.

Shareholder Indemnity Claims

41. The Shareholder Indemnity Claims are not in respect of an equity interest (and therefore are not equity claims). The Shareholder Indemnity Claims must be distinguished from the claims of shareholders, themselves. Shareholder Indemnity Claims are claims of Underwriters against Sino-Forest in respect of claims brought by shareholders against the Underwriters, as opposed to direct shareholder claims against Sino-Forest.

42. In addition, the inclusion of indemnity claims in subparagraph (e) of the CCAA definition of equity claim ought to be interpreted narrowly so as to restrict this provision to instances of indemnities in favour of shareholders only and not indemnities granted to independent third-parties dealing at arm's length, such as the Underwriters. The Underwriters' indemnity claims are based on their status as contractual counterparties to Sino-Forest that supplied services to Sino-Forest. The Underwriters bargained for, *inter alia*, certain protections in the relevant agreements with Sino-Forest, including the indemnity provisions contained therein.

43. Cases decided by Canadian courts in which shareholders' direct indemnity claims were rejected as being claims in equity rather than debt ought to be distinguished from the present case insofar as they deal with shareholders' direct indemnity claims, as opposed to indemnity claims by independent third-parties dealing at arm's length, such as the Underwriters.

> *National Bank of Canada v. Merit Energy Ltd.* (2001), 28 C.B.R. (4th) 228 (Alta. Q.B.) [*Merit*] at para 64, Brief of Authorities of the Underwriters, Tab 7
>
> *Re EarthFirst Canada Inc.* (2009), 56 C.B.R. (5th) 102 (Alta. Q.B.) at para. 5, Brief of Authorities of the Underwriters, Tab 8

44. There is divergent case law on the characterization of indemnity claims as equity claims. In *Merit*, the Alberta Court of Queen's Bench considered the contractual indemnity claims of underwriters, and distinguished such claims of the underwriters from shareholder indemnification claims. The Court held:

> 62. The fundamental premise of the Trustee's argument is that the Underwriters' indemnity simply "flows through" or "passes on" the Flow-Through Shareholders' claim to Merit. This ignores the nature of the causes of action being advanced by the Underwriters and the existence of a contractual indemnity freely given by Merit for good and valuable consideration. The Trustee did not suggest that the indemnity was invalid or unenforceable, rather, it argued that this valid and enforceable right should be treated as a "shareholders' claim" and subordinated. With respect, I cannot agree with the Trustee's position.
>
> 63. The Trustee's argument attempts to shift the Court's focus from the Underwriters' claim against Merit to the claim being asserted against the Underwriters, even though it is the former that

> the Trustee wants the Court to subordinate. The Flow-Through Shareholders' cause of action against the Underwriter's is predicated on the Underwriters' alleged failure to discharge a statutory duty and their liability is not contingent in any way on a successful claim by the Underwriters against Merit under the indemnity.
>
> 64. The Underwriters' indemnity claims against Merit are not made as a shareholder or for any return of investment made by the Underwriters. Rather, they are based on contractual, legal and equitable duties owed directly by Merit to the Underwriters. Similarly, the other causes of action advanced by the Underwriters against Merit in the Third Party Notice do not arise from any equity position in the company, but are based on agency, fiduciary and contractual relationships between the Underwriters and Merit, to which the Flow-Through Shareholders are strangers and are unavailable for them to assert.
>
> 65. For example, the Underwriters are entitled to an indemnity for defence costs even if the Flow-Through Shareholders' claims fail completely. The ultimate success or failure of the Flow-Through Shareholders' claims makes no difference to the existence and enforceability of this right against Merit.
>
> *Merit* at paras 62-65, Brief of Authorities of the Underwriters, Tab 7

45. The Court in *Merit* accepted that an underwriter's contractual indemnification claims are distinct from the claims of shareholders for a return of their investment, and the Court acknowledged that the policy rationale behind subordinating shareholder claims does not hold in the case of an underwriter's contractual indemnification claims.

46. Although *Merit* was decided prior to the Amendments, as discussed above, Canadian courts have held that the Amendments are intended to codify rather than change the pre-existing common law on point. Therefore, the Amendments ought to be interpreted in a manner consistent with the holding in *Merit* (i.e., excluding indemnification claims of underwriters from being equity claims based on policy considerations).

47. The decision of the Ontario Superior Court of Justice in *Return on Innovation Capital Ltd. v. Gandi Innovations Ltd.* ("*Gandi*") considered the case of a third-party indemnity in favour

of directors and officers. In *Gandi*, the Gandi companies were insolvent and in CCAA proceedings. A shareholder sued, *inter alia*, the directors and officers for recovery of its equity investment in the debtor corporation. The shareholder's claims were framed as claims for such things as breach of contract, fraud, rescission, negligent misrepresentation, and breach of fiduciary duty. The Court concluded that if the claims of the plaintiff are themselves equity claims, then any resulting claims for indemnity or contribution by the defendants are also equity claims.

> *Return on Innovation Capital Ltd. v. Gandi Innovations Ltd.* (2011), 83 C.B.R. (5th) 123 (Ont. S.C.J.) [*Gandi*]. at para. 61, Brief of Authorities of the Underwriters, Tab 9

48. *Gandi*, however, can be distinguished from *Merit* and the present case due to the fact that the third parties in that case were insiders (i.e., directors and officers) of the Gandi companies, as opposed to independent third parties dealing at arm's length, as is the case with the Underwriters in the present case. Correspondingly, the treatment of each group of indemnified parties should differ to reflect this essential dissimilarity in position.

49. Fundamentally, the postponement of equity claims (both at common law prior to the Amendments and now pursuant to the Amendments) is a policy-driven outcome. Independent third-parties dealing at arm's length, such as underwriters, cannot reasonably be said to have accepted the risks that a shareholder has with respect to its claims. Returning to first principles, the policy reason for treating equity claims as subordinate to the claims of creditors is that equity owners always take the risk of not being paid together with the possible reward of the upside of ownership, and that is their bargain. When an owner seeks to recover its investment as a debt, it is trying to resile from the bargain it struck. Underwriters don't take on the same risk-reward bargain when they supply services to a company. Underwriters strike their own bargain with a company, and a central part of their contractual compensation is the indemnity they receive from a company. Importantly, the amount of the indemnity claims of Underwriters are capped by the value of the securities underwritten by them, and such amount is not a function of the profits lost by trading in the securities, further distancing the Underwriters from the risk-reward profile of shareholders.

50. In addition, creditors of Sino-Forest had notice of the contractual indemnities provided by Sino-Forest to the Underwriters, as the relevant underwriting and related agreements were publicly disclosed by Sino-Forest and filed with securities regulators pursuant to applicable securities legislation. The services supplied to Sino-Forest by the Underwriters had the effect of providing Sino-Forest with additional capital to, *inter alia*, fund its operations and ongoing obligations to creditors and others.

51. The Related Indemnity Claims of the Underwriters are derivative of the Underwriters' status as contractual counterparties to Sino-Forest in respect of the indemnities as opposed to derivative of the Shareholder Claims. The risk-reward profile of the shareholder and underwriter is fundamentally different and a policy-driven analysis of equity claims should account for this dissimilarity in position.

Shareholder Defence Indemnity Claims

52. Shareholder Defence Indemnity Claims are not properly characterized as equity claims. Indemnity claims in respect of defence costs incurred by underwriters in defending themselves against lawsuits brought by shareholders are independent claims that ought not to be held to be equity claims under the CCAA. As part of the bargain struck between underwriters and a company, underwriters may be entitled to indemnities in respect of certain of their defence costs. In the present case, the Underwriters' contractual compensation includes an indemnity in respect of such costs.

53. As discussed above, equity owners always take the risk of not being paid together with the possible reward of the upside of ownership, and thus rank behind creditors of a company in the case of a bankruptcy or insolvency. It would be inconsistent with this policy rationale to treat costs incurred by independent third-parties dealing at arm's length, such as underwriters, to defend themselves from lawsuits brought by shareholders the same way as claims of shareholders, whose claims are subordinated to creditors. There is no corresponding shareholder claim in respect of the defence costs incurred by independent third-parties dealing at arm's length.

54. In this way, defence costs are completely unrelated to the Shareholder Claims, as they will be incurred regardless of the success of the shareholder's claims against Sino-Forest, and, as a result, are in a category of their own. They are not derivative of Shareholder Claims, and are, therefore, not properly equity claims.

PART IV - RELIEF REQUESTED

55. This Factum is filed by the Underwriters in connection with the Equity Claims Motion.

56. It is respectfully submitted that when the principles outlined above are applied in the present case, this Court should not decide the Equity Claims Motion at this time or, alternatively, in the event that this Court decides the Equity Claims Motion at this time, the Equity Claims Order should not be granted, as the Related Indemnity Claims are not "equity claims" as defined in section 2 of the CCAA.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

David Bish per AMS

David Bish

John Fabello per AMS

John Fabello

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SCHEDULE "A"

LIST OF AUTHORITIES

1. L. Abrams and K.P. McGuiness, *Canadian Civil Procedure Law*, 2nd ed. (Toronto: LexisNexis, 2010)

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

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

4. *Re Nelson Financial Group Ltd.* (2010), 71 C.B.R. (5th) 153 (Ont. S.C.J.)

5. *Re Central Capital Corp.* (1995), 29 C.B.R. (3d) 33 (Ont. C.J. (Gen. Div. – Commercial List))

6. *Re Blue Range Resources Corp.* (2000), 15 C.B.R. (4th) 169 (Alta. Q.B.)

7. *National Bank of Canada v. Merit Energy Ltd.* (2001), 28 C.B.R. (4th) 228 (Alta. Q.B.)

8. *Re EarthFirst Canada Inc.* (2009), 56 C.B.R. (5th) 102 (Alta. Q.B.)

9. *Return on Innovation Capital Ltd. v. Gandi Innovations Ltd.* (2011), 83 C.B.R. (5th) 123 (Ont. S.C.J.)

SCHEDULE "B"

LEGISLATION

COURTS OF JUSTICE ACT, R.S.O. 1990, C. C-43

Multiplicity of proceedings

138.As far as possible, multiplicity of legal proceedings shall be avoided.

COMPANIES' CREDITORS ARRANGEMENT ACT, R.S.C. 1985, C. C-36

Definitions

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 of the *Bankruptcy and Insolvency 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;

...

Compromises to be sanctioned by court

6. (1) If a majority in number representing two thirds in value of the creditors, or the class of creditors, as the case may be — other than, unless the court orders otherwise, a class of creditors having equity claims, — present and voting either in person or by proxy at the meeting or meetings of creditors respectively held under sections 4 and 5, or either of those sections, agree to any compromise or arrangement either as proposed or as altered or modified at the meeting or meetings, the compromise or arrangement may be sanctioned by the court and, if so sanctioned, is binding

- (*a*) on all the creditors or the class of creditors, as the case may be, and on any trustee for that class of creditors, whether secured or unsecured, as the case may be, and on the company; and
- (*b*) in the case of a company that has made an authorized assignment or against which a bankruptcy order has been made under the *Bankruptcy and Insolvency Act* or is in the course of being wound up under the *Winding-up and Restructuring Act*, on the trustee in bankruptcy or liquidator and contributories of the company.

Court may order amendment

(2) If a court sanctions a compromise or arrangement, it may order that the debtor's constating instrument be amended in accord- ance with the compromise or arrangement to reflect any change that may lawfully be made under federal or provincial law.

Restriction — certain Crown claims

(3) Unless Her Majesty agrees otherwise, the court may sanction a compromise or arrangement only if the compromise or arrangement provides for the payment in full to Her Majesty in right of Canada or a province, within six months after court sanction of the compromise or arrangement, of all amounts that were outstanding at the time of the application for an order under section 11 or 11.02 and that are of a kind that could be subject to a demand under

- (*a*) subsection 224(1.2) of the *Income Tax Act*;
- (*b*) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, or a premium under Part VII.1 of that Act, and of any related interest, penalties or other amounts; or
- (*c*) any provision of provincial legislation that has a purpose similar to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, and the sum
    - (i) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

- (ii) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection.

Restriction — default of remittance to Crown

(4) If an order contains a provision authorized by section 11.09, no compromise or arrangement is to be sanctioned by the court if, at the time the court hears the application for sanction, Her Majesty in right of Canada or a province satisfies the court that the company is in default on any remittance of an amount referred to in subsection (3) that became due after the time of the application for an order under section 11.02.

Restriction — employees, etc.

(5) The court may sanction a compromise or an arrangement only if

- (*a*) the compromise or arrangement provides for payment to the employees and former employees of the company, immediately after the court's sanction, of
  - (i) amounts at least equal to the amounts that they would have been qualified to receive under paragraph 136(1)(*d*) of the *Bankruptcy and Insolvency Act* if the company had become bankrupt on the day on which proceedings commenced under this Act, and
  - (ii) wages, salaries, commissions or compensation for services rendered after proceedings commence under this Act and before the court sanctions the compromise or arrangement, together with, in the case of travelling salespersons, disbursements properly incurred by them in and about the company's business during the same period; and
- (*b*) the court is satisfied that the company can and will make the payments as required under paragraph (*a*).

Restriction — pension plan

(6) If the company participates in a prescribed pension plan for the benefit of its employees, the court may sanction a compromise or an arrangement in respect of the company only if

- (*a*) the compromise or arrangement provides for payment of the following amounts that are unpaid to the fund established for the purpose of the pension plan:
  - (i) an amount equal to the sum of all amounts that were deducted from the employees' remuneration for payment to the fund,
  - (ii) if the prescribed pension plan is regulated by an Act of Parliament,
    - (A) an amount equal to the normal cost, within the meaning of subsection 2(1) of the *Pension Benefits Standards Regulations, 1985*, that was required to be paid by the employer to the fund, and

- (B) an amount equal to the sum of all amounts that were required to be paid by the employer to the fund under a defined contribution provision, within the meaning of subsection 2(1) of the *Pension Benefits Standards Act, 1985*, and

- (iii) in the case of any other prescribed pension plan,

  - (A) an amount equal to the amount that would be the normal cost, within the meaning of subsection 2(1) of the *Pension Benefits Standards Regulations, 1985*, that the employer would be required to pay to the fund if the prescribed plan were regulated by an Act of Parliament, and

  - (B) an amount equal to the sum of all amounts that would have been required to be paid by the employer to the fund under a defined contribution provision, within the meaning of subsection 2(1) of the *Pension Benefits Standards Act, 1985*, if the prescribed plan were regulated by an Act of Parliament; and

- (*b*) the court is satisfied that the company can and will make the payments as required under paragraph (*a*).

Non-application of subsection (6)

(7) Despite subsection (6), the court may sanction a compromise or arrangement that does not allow for the payment of the amounts referred to in that subsection if it is satisfied that the relevant parties have entered into an agreement, approved by the relevant pension regulator, respecting the payment of those amounts.

Payment — equity claims

(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.

BANKRUPTCY AND INSOLVENCY ACT, R.S.C., 1985, C. B-3

Claims provable

121. (1) 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.

Contingent and unliquidated claims

(2) The determination whether a contingent or unliquidated claim is a provable claim and the valuation of such a claim shall be made in accordance with section 135.

Debts payable at a future time

(3) A creditor may prove a debt not payable at the date of the bankruptcy and may receive dividends equally with the other creditors, deducting only thereout a rebate of interest at the rate of five per cent per annum computed from the declaration of a dividend to the time when the debt would have become payable according to the terms on which it was contracted.

Family support claims

(4) A claim in respect of a debt or liability referred to in paragraph 178(1)(*b*) or (*c*) payable under an order or agreement made before the date of the initial bankruptcy event in respect of the bankrupt and at a time when the spouse, former spouse, former common-law partner or child was living apart from the bankrupt, whether the order or agreement provides for periodic amounts or lump sum amounts, is a claim provable under this Act.

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

FACTUM OF THE UNDERWRITERS NAMED IN CLASS ACTIONS
(motion for an Equity Claims Order, returnable on June 26, 2012)

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