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

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

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

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF SINO-FOREST CORPORATION

Applicant

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

FACTUM OF ERNST & YOUNG LLP

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

June 22, 2012

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TO: **THE SERVICE LIST**

FACTUM OF ERNST & YOUNG LLP

PART I - IN A NUTSHELL

1. The Applicant, Sino-Forest Corporation ("Sino-Forest", the "Company" or the "Applicant"), sought and obtained a claims procedure order from this Honourable Court on May 14, 2012 (the "Claims Procedure Order").

2. The Claims Procedure Order, obtained on an unopposed basis, expressly provided that the determinations sought on the present motion would be made in the context of the claims process. The Company now brings this motion, before proofs of claim have been reviewed or analyzed:

(a) an order that the claims against the Company resulting from the ownership, purchase or sale of an equity interest in the Company, including without limitation the claims by or on behalf of current or former shareholders asserted in the Class Actions (as defined below) are "equity claims" within the meaning of section 2 of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (the "CCAA");

(b) an order that any indemnification claims against the Company related to or arising from the claims described in (a), including without limitation by or on behalf of any of the other defendants in the Class Actions, are also "equity claims" within the CCAA, being claims for contribution or indemnity in respect of equity claims; and

(c) a direction that the order sought is without prejudice to the Company's right (but not the right of any other party) to apply for a similar order with respect to any claims (or indemnification claims) that are in respect of Securities other than shares.

3. Ernst & Young LLP ("E&Y") opposes the relief sought, at least as against E&Y, since the E&Y Proof of Claim (as defined below) evidences 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 discrete and independent causes of action as against the Company 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 the Company 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.

4. The policy rationale for the 2009 amendments to the CCAA that introduced the statutory provisions on which the Company relies in support of this motion do not support such relief as against E&Y, and in fact militate directly against it.

5. For these reasons, E&Y asks this Honourable Court to dismiss this motion with costs at least as against it, with prejudice to the right of any party to seek this or similar relief in respect

of Securities other than shares. E&Y notes that the Company, Monitor and noteholders have confirmed that no relief is sought on this motion in respect of those components of the claims of the Class Action Plaintiffs advanced on behalf of noteholders, or those components of the claims of the Class Action Defendants against the Company in respect of the noteholders. E&Y also notes that the Company, Monitor and noteholders have confirmed that no relief is sought on this motion in respect of claims against the subsidiaries of Sino-Forest.

PART II - THE FACTS

Background

6. During the periods relevant to the class action proceedings, E&Y was retained as Sino-Forest's auditor – from 2007 until it resigned on April 5, 2012.

Reference Affidavit of W. Judson Martin sworn April 23, 2012 ("April 23 Martin Affidavit") , Motion Record of Sino-Forest Corporation returnable May 8, 2012, at para. 13, Tab 2

7. On June 2, 2011, a short-seller, Muddy Waters LLC, issued a report which purported to reveal alleged fraud at the Company and cast various aspersions on the Company's advisors. In the wake of that report, Sino-Forest's share price plummeted and Muddy Waters profited handsomely from its short position.

Reference Affidavit of W. Judson Martin sworn March 30, 2012, at para, 114 ("March 30 Martin Affidavit") attached as Exhibit A to Affidavit of W. Judson Martin sworn April 23, 2012, Motion Record of Sino-Forest Corporation returnable May 8, 2012, Tab 2

8. E&Y was served with a multitude of class action claims in numerous jurisdictions including Ontario and Quebec (the "Class Actions"). In Ontario alone, E&Y was served with

four competing proposed class actions. Following a carriage motion, an uneasy peace was brokered between two law firms and a number of proposed representative plaintiffs were absorbed into what is now the Ontario Class Action.

Reference April 23 Martin Affidavit, Motion Record of Sino-Forest Corporation returnable May 8, 2012, Tab 2, at paras. 7-8

Smith v. Sino-Forest Corporation, 2012 ONSC 24 attached as Exhibit D to the Affidavit of Daniel Bach sworn April 11, 2012, Motion Record of the Proposed Representative Plaintiffs, Tab 2

9. The plaintiffs in the Ontario Class Action claim damages in the aggregate, and 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)*, R.S.O. 1990, c.S-5 and at common law, in negligence and negligent misrepresentation. The central claim is that Sino-Forest 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 in particular that E&Y's audit did not comply with Canadian generally accepted auditing standards. Similar claims are advanced in the Quebec and U.S. actions, (together with the Ontario Class Action, the "Class Actions").

Reference Motion Record of the Company, Tabs 2A-D.

10. On March 30, 2012, this Court granted the Initial Order, which stayed the proceedings (the "Stay"). On April 13, 2012, this Court extended the Stay until June 1, 2012, and on May 31, 2012 extended the stay to September 28, 2012. On May 8, 2012 the Court ordered that the Stay extends to the third party defendants to the Ontario Class Action, including E&Y.

Reference April 23 Martin Affidavit, Motion Record of Sino-Forest Corporation returnable May 8, 2012, Tab 2, at para. 5

11. On May 14, 2012, this Honourable Court granted the Claims Procedure Order. The motion, brought by the Company, proceeded on an unopposed basis following extensive discussions amongst the stakeholders including the Company, E&Y, the Class Action plaintiffs and the other Class Action defendants, among others, which permitted that to occur.

12. Pursuant to the Claims Procedure Order:

(a) Proofs of Claim were directed to be filed with the Monitor by any party advancing a claim;

(b) Proofs of Claim were required to be filed no later than June 20, 2012. Claimants could mark as "confidential" any documents or portions thereof;

(c) the Monitor, in consultation with the Applicant and the directors and officers named in the Proof of Claim as applicable, shall review all Proofs of Claim and D&O Proofs of Claim;

(d) the Monitor may attempt to resolve any claims and may by notice in writing revise or disallow in whole or in part the amount and/or status of any Proof of Claim or D&O Proof of Claim;

(e) where a purported Proof of Claim or D&O Proof of Claim is revised or disallowed, the Monitor shall deliver to the Claimant a notice of revision or disallowance attaching a form of Dispute Notice (as defined in the Claims Procedure Order);

(f) in respect of any Proof of Claim or D&O Proof of Claim that exceeds $1 million, the Monitor and the Applicant shall not accept, admit, settle, resolve, value (for any purpose), revise or reject such Proof of Claim or D&O Proof of Claim without order of the Court; and

(g) a Claimant who intends to dispute a notice of revision or disallowance shall file a dispute notice with the Monitor, and failing a resolution or settlement of such disputed claim, the Monitor shall seek direction from the Court on the correct process for the resolution of the dispute. Without limitation, this "includes any dispute arising as to whether a claim is or is not an 'equity claim' as defined in the CCAA" (para. 44).

13. This motion was then brought notwithstanding that:

(a) Proofs of Claim and D&O Proofs of Claim had not yet been filed; and

(b) the Claimants, or at least E&Y, have requested but have not yet received from the Monitor Proofs of Claim of other Claimants in order that E&Y can determine how to respond to this motion and whether the Claims Procedure Order (including but not limited to paragraph 45 which provides that any claims and related D&O claims and/or D&O indemnity claims shall be determined at the same time and in the same proceeding) has been complied with.

14. E&Y filed with the Monitor, in accordance with the Claims Procedure Order, a Proof of Claim against Sino-Forest and a Proof of Claim against the directors or officers of Sino-Forest.

E&Y's Proof of Claim against Sino-Forest Corporation

15. E&Y has contractual claims of indemnification against Sino-Forest and its subsidiaries for all relevant years, in respect of its annual audits as well as related to prospectuses and debt offerings. E&Y has statutory and common law claims of contribution and/or indemnity against Sino-Forest and its subsidiaries for all relevant years. It appears that similar claims for contribution and indemnity have been or will be made by the defendant underwriters and the Company's former auditors, BDO. As evidenced in the E&Y Proof of Claim, E&Y also has stand-alone claims for breach of contract and negligent and/or fraudulent misrepresentation against the Company and its directors and officers.

Reference

April 23 Martin Affidavit at paras. 13-15, Exhibits H and I, Motion Record of Sino-Forest Corporation returnable May 8, 2012, Tabs 2, 2-H, 2-I

Exhibits A-J to the Proof of Claim, Affidavit of Christina Shiels sworn June 21, 2012 ["June 21 Shiels Affidavit"], Tab A, E&Y Motion Record, Tabs 1A-J

Exhibits A-B to the June 21 Shiels Affidavit, *supra*, Tab A, E&Y Motion Record, Tab 1A returnable June 26, 2012, Tabs 1A-B

16. In the E&Y Proof of Claim, E&Y claims as against Sino-Forest and the SFC subsidiaries and the directors and officers for variously:

(a) Damages for:

(i) Breach of contract;

(ii) Negligent misrepresentation;

(iii) Fraudulent misrepresentation;

(iv) Inducing breach of contract;

(v) Injury to reputation; and

(vi) Vicarious liability.

(b) Contractual indemnity, pursuant to E&Y's engagement letters; and

(c) Contribution and indemnity under the *Negligence Act*, R.S.O 1990, c. N-1 and other applicable legislation outside Ontario (the *"Negligence Act"*).

17. The relationship between E&Y on the one hand, and Sino-Forest, the SFC subsidiaries and their respective directors and officers on the other, was at all material times at arm's length. E&Y contracted with Sino-Forest to provide it with auditing services upon terms established by a series of engagement letters (the "Engagement Letters") for 2007 through and including 2010, attached as Schedule C1 to the Proof of Claim against the Company.

Reference June 21 Shiels Affidavit, *supra*, Tab A, E&Y Motion Record, Tab 1A, Exhibit A-C1

18. Management of Sino-Forest and the SFC subsidiaries was and is responsible for the preparation and fair presentation of Sino-Forest's consolidated financial statements, which Sino-Forest prepared and issued, and contracted with E&Y on behalf of Sino-Forest and the SFC subsidiaries to audit. Management was responsible for the preparation of those consolidated financial statements in accordance with Canadian generally accepted accounting principles ("GAAP"), and for such internal controls as management determined were necessary to enable the preparation of consolidated financial statements that were free from material misstatement, whether due to fraud or error.

Reference June 21 Shiels Affidavit, *supra*, Tab A, E&Y Motion Record, Tab 1A

19. The Board of Directors of Sino-Forest approved the consolidated financial statements. The consolidated financial statements were accompanied in all cases by representations from management.

20. E&Y's responsibility was to express an opinion on those consolidated financial statements based on its audits conducted in accordance with Canadian generally accepted auditing standards ("GAAS").

21. E&Y had a direct professional relationship with Sino-Forest and with each of the SFC subsidiaries.

22. E&Y as auditor of Sino-Forest did not have any relationship with the equity or debt holders of Sino-Forest in their capacity as security holders of Sino-Forest other than to be appointed as auditor. E&Y was not a shareholder, other equity holder or a holder of funded debt of Sino-Forest or any SFC subsidiary.

Reference June 21 Shiels Affidavit, *supra*, Tab A, E&Y Motion Record, Tab 1A

23. At all relevant times, E&Y provided services to Sino-Forest and the SFC subsidiaries upon pre-established contractual terms with the expectation of receiving fees for the professional services rendered, dependent in no way on the Company's financial performance.

24. E&Y's claims against Sino-Forest and the SFC subsidiaries are:

(a) Creditor claims;

(b) Derived from E&Y's 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 costs of defending and responding to various proceedings, both pre- and post-filing; and

(d) Not equity claims in the sense contemplated by the *CCAA*. Equity holders of Sino-Forest have not advanced, and could not advance, any claims against the SFC subsidiaries. Restructuring legislation (and jurisprudence) in the jurisdictions of incorporation of the relevant subsidiaries does not provide for subordination of these claims to the claims of other unsecured creditors.

25. E&Y's claim is that of an unsecured creditor.

26. E&Y's claim is distinct from any and all potential and actual claims by the plaintiffs in the Class Actions against Sino-Forest. E&Y's claim for contribution and indemnity is not based upon the claims against Sino-Forest advanced in the Class Actions, but rather in part upon the claims made in the Class Actions 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. 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. Either could succeed if the other were to fail.

27. 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.

28. The policy rationale for subordinating equity claims to the claims of creditors of the corporation, given the well-established corporate law recognizing the bargain that shareholders have struck and the inherent fact that their fortunes rise or fall with those of the company, does not apply to auditors. Shareholders accept both risk and reward, and benefit directly from any increase in the value of the equity in a company. An auditor is in a fundamentally different position, namely that of a professional service provider who entered into a contract with the debtor company based upon the expectation of receiving a pre-established payment, independently of the company's financial performance.

PART III - ISSUES AND THE LAW

A. THE PROVISIONS OF THE CCAA

29. The specific provisions of the CCAA dealing with "equity claims" were introduced in 2007 by Bill C-12 and proclaimed in force in September, 2009 as part of a broad reform of Canadian insolvency legislation.

Reference Bill C-12, *An Act to Amend the Bankruptcy and Insolvency Act, the Companies' Creditors Arrangement Act, the Wage Earner Protection Act* and chapter 47 of the Statutes of Canada, s. 105 (the "Act"), Schedule B

30. The CCAA now defines an equity claim as a claim that is "in respect of an equity interest". Section 2(1) states:

"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;

Reference Section 2 of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, C-36, Schedule B

31. Absent an equity relationship at the root of a claim, that claim should not be qualified as an equity claim.

32. There is no guidance in the jurisprudence as to the interpretation of these new statutory provisions. Accordingly, it is necessary to consider the provisions against the present facts, to assess and then apply the legislative purposes underlying the new CCAA provisions to equity claims and to review the relevant case law from the period prior to the enactment of the amendments of 2009.

33. Such a review, when reviewed in factual context, reveals that:

(a) in order to be classified as an equity claim, a claim for indemnity must be in respect of an equity claim brought against the Applicant. E&Y's indemnity claim

is not derived from shareholder claims against Sino-Forest, but rather separate causes of action against E&Y.

(b) E&Y's separate claims against the Company (and the directors and officers) for breach of contract and/or fraudulent or negligent misrepresentation, among others, are not claims for indemnity and are not equity claim; and

(c) the policy reasons behind the classification of shareholder claims and indemnity claims in respect thereof as equity claims does not, and should not, apply to auditors.

B. CLASSIFICATION OF E&Y'S CLAIM AS AN EQUITY CLAIM IS CONTRARY TO THE PLAIN LANGUAGE OF THE CCAA

(a) Section 2(e) of the CCAA refers, *inter alia*, to "indemnity or contribution claims" in respect of claims against the debtor company

34. The plain language of "equity claim" in section 2 of the CCAA is clear and unambiguous and must be the starting point of any analysis as to the scope of such definition:

> [34] … The language of section 2 is clear and unambiguous and equity claims include a "claim that is in respect of an equity interest" and a claim for a dividend or similar payment and a claim for rescission. (emphasis added)
>
> **Reference** *Nelson Financial Group Ltd.*, 2010 ONSC 6229, at para. 34, E&Y Brief of Authorities, Tab 1

35. The term "equity claim" is defined at s. 2(e) of the CCAA with reference to the term "claim", which is itself defined by reference to the term "claim provable within the meaning of the *Bankruptcy and Insolvency Act*" (the "BIA"):

> s. 2. 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,
>
> (…)
>
> (e) contribution or indemnity in respect of a claim referred to in any of paragraphs (a) to (d);

Reference *Companies' Creditors Arrangement Act*, R.S.C. 1985, C-36, Schedule B

36. It is well established by section 121 of the BIA that a provable claim in bankruptcy can only be asserted against the bankrupt, not against a third party:

> 121. (1) All debts and liabilities, present or future, to which the bankrupt is subject on the day on which the bankrupt becomes bankrupt (…) shall be deemed to be claims provable in proceedings under this Act.

Reference *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, Schedule B

37. Accordingly, the term "claim" at s. 2(1)(e) of the CCAA, which identifies those indemnity or contribution claims that may be characterized as "equity claims", refers to claims against the debtor company.

38. Accordingly, in order for s. 2(1)(e) to operate to subordinate an indemnity claim the indemnity must compensate a loss arising from a claim against the Company.

39. This interpretation accords with case law preceding the 2009 amendments, which established that claims by shareholders against the company pursuant to indemnity agreements should be subordinated in the same manner as equity claims are subordinated under the CCAA following the 2009 amendments.

Reference *National Bank of Canada v. Merit Energy Ltd.*, 2001 ABQB 583 (CanLII) at paras. 39, 51-55, E&Y Brief of Authorities, Tab 2

In Re Earthfirst Canada Inc., 2009 ABQB 316 (CanLII) at para. 5, E&Y Brief of Authorities, Tab 3

(b) E&Y's claim is not "in respect of" a claim against Sino-Forest

40. The actual and contingent losses in respect of which E&Y is asserting a claim against Sino-Forest, namely E&Y's potential liability under the Class Actions, do not arise from a "claim" against Sino-Forest. They arise instead from a different and distinct claim brought by the Class Action Plaintiffs against E&Y.

41. The claims brought by the Class Action plaintiffs against E&Y are distinct from the Class Actions plaintiffs' claims against Sino-Forest, as they arise from distinct allegations of wrongdoing.

42. As against Sino-Forest, the Class Action plaintiff's claim is that Sino-Forest and certain of its directors and officers made a series of misrepresentations, based in fraud and/or negligence resulting from an overstatement of its timber assets and holding *inter alia*.

Reference Motion to Authorize the Bringing of a Class Action and to Obtain the Status of Representative filed before the Superior Court of Québec styled Guining Liu v. Sino-Forest Corporation et al., bearing the Court No. 200-06-000132-111, paras. 20 and 21

43. In contrast, the Class Actions plaintiffs' claim against E&Y is premised upon E&Y's alleged failure to comply with professional standards in performing the audits of the financial Company's consolidated statements.

Reference Motion to Authorize the Bringing of a Class Action and to Obtain the Status of Representative filed before the Superior Court of Québec styled *Guining Liu v. Sino-*

Forest Corporation et al., bearing the Court No. 200-06-000132-111, para. 22 and 23

44. Accordingly, E&Y's indemnity claim against Sino-Forest is not based upon a "claim" against the Applicant within the meaning of the CCAA or the BIA, and cannot be "in respect of" a "claim" within the meaning of subparagraphs a) to d) of s. 2(1) the definition of "equity claim" in the CCAA. It is based on separate causes of action advanced against E&Y.

(c) In the alternative, E&Y's claim is not in substance an indemnity claim

45. A significant component of E&Y's claim is not an indemnity claim at all, but rather a claim for breach of contract and/or inducing breach of contract, arising from Sino-Forest's violation of the terms of the Engagement Letters pursuant to which Sino-Forest undertook to provide E&Y with complete and full disclosure of its financial information.

Reference E&Y's Proof of Claim, paragraphs 28 to 35

46. In addition, a significant component of E&Y's claim is based upon fraudulent and/or negligent misrepresentation as against Sino-Forest, as well as up upon Sino-Forest's vicarious liability for the misrepresentations of its directors, officers, employees and agents, and those of its subsidiaries.

Reference June 21 Shiels Affidavit, *supra*, Tab A, E&Y Motion Record, Tab 1A

47. Accordingly, E&Y's claim is not in substance a "claim for contribution or indemnity" within the meaning of s. 2(e) of the CCAA and should not be classified as an equity claim.

(d) Even if characterized as a claim, E&Y's claim is not exclusively in respect of an equity claim

48. Even if this Court sought to classify the component of E&Y's claim as a claim for indemnity, not all of E&Y's claims for indemnity are in respect of shareholder claims and therefore cannot constitute an "equity claim" within the meaning of s. 2(e) of the CCAA. As noted above, no relief is sought on this motion in respect of the claims of the Class Action plaintiffs or defendants relating to Sino-Forest notes.

49. The Class Action Plaintiffs asserting a claim against E&Y and against Sino-Forest comprise a significant group of noteholders and the shareholders of Sino-Forest.

Reference Verified Class Action Complaint filed before the Supreme Court of the State of New York styled *David Leapard and IMF Finance SA et al. v. Sino-Forest Corporation et al*, bearing the number Court Index No. 200-06-000132-111, para. 13

Motion to Authorize the Brining of a Class Action and to Obtain the Status of Representative filed before the *Superior Court of Québec styled Guining Liu v. Sino-Forest Corporation et al.*, bearing the Court No. 200-06-000132-111, para. 57, p. 18

50. The noteholders represent a significant portion of the total value of the Class Action Plaintiffs' claim against E&Y.

Reference Motion Regarding the Status of Shareholder Claims and Related Indemnity Claims under the CCAA, at para. 5

51. Pursuant to its claim in the present CCAA proceedings, E&Y seeks to recover damages arising from its potential liability under the Class Actions, which includes E&Y's potential liability to both noteholders and to shareholders of Sino-Forest.

52. Noteholders, as holders of a debt obligation as against Sino-Forest, do not fall within the scope of the definition of "equity claim". The Company, noteholders and the Monitor have all

confirmed that no relief sought on this motion applies to that component of E&Y's claim relating to noteholders.

C. THE SUBSTANCE OF THE RELATIONSHIP BETWEEN E&Y AND SINO-FOREST

53. To determine whether E&Y's claim is an equity claim or not, consideration must be given to the substance of the relationship between E&Y and Sino-Forest as Courts have done in this context:

> Guidance on the appropriate approach to the issue of characterization was provided by the Ontario Court of Appeal in Re Central Capital Corporation[7]. (...) In considering whether the two shareholders had provable debt claims, Laskin J.A. considered the substance of the relationship between the company and the shareholders. If the governing instrument contained features of both debt and equity, that is, it was hybrid in character, the court must determine the substance of the relationship between the company and the holder of the certificate. The Court examined the parties' intentions.
>
> **Reference** *Nelson Financial Group Ltd., supra,* at para. 29
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> *Central Capital Corp.*, (1996), 132 D.L.R. (4th) 223 (Ont. C.A.) at paras. 116, 119, 120, E&Y Brief of Authorities, Tab 5
>
> *Re Blue Range Resource Corporation,* 2000 ABQB 4 (CanLII) at para. 26, E&Y Brief of Authorities, Tab 4

54. For this analysis, contractual documents governing the relationship between E&Y and Sino-Forest must be examined.

> **Reference** *Nelson Financial Group Ltd., supra,* at para. 29
>
> *Central Capital Corp.*, (1996), 132 D.L.R. (4th) 223 (Ont. C.A.) at para. 116, 119, 120, E&Y Brief of Authorities, Tab 5

55. The relationship between E&Y and Sino-Forest has always been purely contractual. E&Y contracted with Sino-Forest with a view to providing auditing services upon terms established by the Engagement Letters for 2007 through and including 2010.

56. The Engagement Letters stipulate that E&Y was retained as an independent service provider to be paid based upon a fixed or an hourly basis, and in any case entirely independently of Sino-Forest's revenues or financial performance.

57. The Engagement Letters contain the following provision:

> Miscellaneous – E&Y shall provide all Services as an independent contractor and nothing shall be construed to create a partnership, joint venture or other relationship between EY and client (…)
>
> **Reference** Terms and conditions of Engagement Letters dated: June 21, 2007, s. 21; February 5, 2008, s. 19; April 16, 2008, s.21; April 16, 2008, s.21; April 16, 2008, s.21; April 16, 2008, s.21; May 7, 2008, s.21; May 7, 2008, s.21; July 4, 2008, s. 21; August 7, 2008, s.21; August 18, 2008, s.22; January 6, 2009, s.21; January 6, 2009, s.21; May 17, 2009, s.20; October 1, 2009, s.20; November 9, 2009, s.19; November 17, 2009, s.20; November 17, 2009, s.20; November 17, 2009, s.20; and, March 22, 2010, s.20.

58. E&Y's remuneration has never been dependent upon Sino-Forest's profits.

59. E&Y has never been a shareholder of Sino-Forest or of any SFC subsidiary nor did it ever hold any equity of Sino-Forest or any SFC subsidiary.

60. In its role as auditor of Sino-Forest, E&Y contracted to express an opinion on the consolidated financial statements of Sino-Forest and the SFC subsidiaries. E&Y had a direct contractual and professional relationship with each of those entities.

61. Based upon the provisions of the Engagement Letters, E&Y could not have expected that it would ever be treated any differently than the other ordinary creditors of Sino-Forest in the event of a liquidation, winding-up or dissolution of the latter.

62. Undoubtedly, the substance of the relationship between E&Y and Sino-Forest can in no way be considered one of equity.

(a). The Law Prior to the Proclaiming in Force of the new CCAA Provisions

63. It is only since 2000 has Canadian jurisprudence began fill the legislative void with respect to the treatments of claims brought by shareholders against a debtor company.

64. Prior to the 2009 legislative amendments, Canadian courts had held that:

(a) Claims by shareholders seeking to recover the loss of share value or other shareholder interest ought to be subordinated to unsecured claims, regardless of the legal basis of such claims; and

Reference *Re Blue Range Resources, supra,* at para. 57
National Bank of Canada v. Merit, supra, at para. 55

(b) Claims by third parties, including auditors, seeking indemnification from the debtor company for litigation relating to its shares, were not subordinated and ranked equally with unsecured claims.

Reference *National Bank of Canada v. Merit, supra,* at paras. 72 and 80

65. This jurisprudence developed by the courts before the 2009 amendments, as well as the policy reasons justifying such legislative amendments, was based on the very nature of a shareholder's ownership interest and the consequences that flow therefrom.

66. Pursuant to Canadian jurisprudence, claims by shareholders generally fell in two categories: (1) claims in tort for negligent or fraudulent misrepresentation, and (2) claims in contract pursuant to an indemnity agreement.

67. Courts, prior to the 2009 amendments to the CCAA, subordinated both these types of claims.

(i) Claims by Shareholders in Tort

68. In *Re Blue Range Resources*, the first decision on this matter by a Canadian court, Justice Romaine of the Alberta Court of Queen's Bench held that a claim by a shareholder for fraudulent misrepresentation made by the debtor company at the time of the issuance of shares was in substance a claim for a return of the shareholders' capital investment. As such, Romaine J. held that the shareholders' claim ought to be subordinated to unsecured claims.

Reference *Re Blue Range Resources, supra,* at para. 25 and 57

69. In the absence of any Canadian case law on this matter, Romaine J. based her decision on the following five policy reasons:

(a) Recovery by shareholders on a *pari passu* basis with creditors would contravene the fundamental corporate law principle that a claim in damages by a shareholder for a return of the amount paid for the shares should rank below creditors in an insolvency;

(b) The expectation of creditors who conduct business with corporations upon the assumption that they would be given priority over the shareholders should not be disturbed;

(c) The investment of shareholders is inherently a risky one compared to creditors' interest to receive payment. Accordingly, it is equitable to impose the risk of fraud on the shareholders;

(d) United States case law supported the subordination of shareholders' claims based on fraud in an insolvency context; and

(e) Recovery by shareholders on a *pari passu* basis with creditors would open the floodgates to tort claims by shareholders in the context of CCAA proceedings.

70. An application of these policy reasons to this matter dictates that E&Y's claim against the Company should not be qualified as an equity claim and should not be subordinated to creditor claims.

(ii) Claims by Shareholders Pursuant to Indemnity Agreements

71. Claims by shareholders pursuant to indemnity agreements with the debtor company, whereby the latter is obligated to indemnify shareholders, have also been subordinated in the context of CCAA proceedings.

Reference *National Bank of Canada v. Merit Energy Ltd., supra*, at paras. 39 and 51-55
Re Earthfirst Canada Inc., supra, at para. 5

72. In both *Merit Energy* and *Earth First Canada*, the debtor company had agreed that any expenses qualifying as exploration expenses for the purpose of *Income Tax Act* deductions would be for the benefit of their shareholders and undertook to indemnify them in the event the shareholders were unable to benefit from any such expenses.

73. Both the Alberta Court of Queen's Bench and the Ontario Superior Court respectively held that the claims of the shareholders holding flow-through shares of the debtor company (based on an indemnity agreement) were subordinated to the claims of unsecured creditors.

74. The Alberta Court of Queen's Bench and the Ontario Superior Court both stated that the essence of the relationship between the shareholders and the debtor company was one that concerns primarily a stock investment, regardless of whether their indemnity claims could have been individually characterized as a debt.

75. When analyzing the nature of a claim to determine whether such claim should be subordinated to the unsecured creditors, Canadian Courts have considered the substance of the relationship between a claimant and the debtor company.

> Guidance on the appropriate approach to the issue of characterization was provided by the Ontario Court of Appeal in *Re Central Capital Corporation* [7]. (...) In considering whether the two shareholders had provable debt claims, Laskin J.A. considered the substance of the relationship between the company and the shareholders. If the governing instrument contained features of both debt and equity, that is, it was hybrid in character, the court must determine the substance of the relationship between the company and the holder of the certificate. The Court examined the parties' intentions.
>
> **Reference** *Nelson Financial Group Ltd., supra,* at para. 34
>
> *Central Capital Corp., supra* at para. 116, 119 and 120.
>
> *Re: Blue Range Resource Corporation, supra,* at para. 26

76. In carrying out this analysis, courts have examined the contractual documents governing the parties' relations, as well as the parties' intentions.

> **Reference** *Nelson Financial Group Ltd., supra,* at para. 31
>
> *Central Capital Corp., supra,* at paras. 121-131

77. For example, in *Central Capital Corp.*, Justice Laskin of the Ontario Court of Appeal considered the share purchase agreements entered into between the claimants and the debtor company, the claimants' right to receive dividends and the claimants' treatment in the company's

books and records, in order to conclude that the claimants were shareholders of the debtor company and that their claims should be subordinated.

Reference *Central Capital Corp., supra,* at paras. 121-131

78. Similarly, in *Nelson Financial Group*, the Ontario Superior Court found that the relationship between preferred shareholders asserting a claim in tort and the debtor company was one based in equity rather than debt, principally because:

(a) The claimants had the right to receive dividends;

(b) The claimants enjoyed a position slightly better than other shareholders but inferior to creditors upon liquidation, dissolution or winding up; and

(c) The claimants' shares and other entitlements as against the company appeared in the company's books as equity.

Reference *Nelson Financial Group Ltd., supra,* at para. 31

79. In only one case have the courts considered whether or not a claim by a third party based upon an indemnity agreement (as opposed to indemnity claims by flow-through shareholders) was subordinate to unsecured claims.

80. In *National Bank of Canada v. Merit Energy Ltd.*, the Alberta Court of Queen's Bench refused to subordinate the claims of the auditor, underwriters and directors who sought to recover their losses based on an indemnity agreement. According to the Court, the subordination of the claims of such third parties would in no way further the well-sounded policy principles that grounded the decision of Romaine J. in *Re Blue Range Resources*, since:

(a) The shareholders' claim against each of the directors, underwriters and auditors is distinct from the claims of the latter against the debtor company. As such, the shareholders are "strangers" to the claims of those third parties against the debtor company. Accordingly, the obligation of the debtor company to indemnify its directors, underwriters and auditors is not "in respect of" a shareholder's interest;

(b) Underwriters, directors and auditors are creditors of the debtor company who do not assume the risk assumed by shareholders; and

(c) Allowing the claims of underwriters, directors and auditors would not open the floodgates to claims by shareholders in CCAA proceedings, since such parties are not shareholders.

Reference *National Bank of Canada v. Merit Energy Ltd., supra,* at paras. 62-72 and 79-81

81. The Alberta Court also dismissed the argument that the recovery by third parties of indemnity claims on a *pari passu* basis with unsecured claims would allow the shareholders to recover indirectly from those indemnified parties what they could not recover directly from the company.

Reference *National Bank of Canada v. Merit Energy Ltd., supra,* at paras. 69-72

82. The Court stated that such an argument erroneously assumed that the success by the shareholders against the indemnified party was either contingent upon, or necessarily leading to, success by the indemnified parties against the debtor company. Such an assumption was not supported by the facts of that case, nor is it supported by the facts of the present case.

83. In *Return on Innovations v. Gandi Innovations*, which is the only Canadian decision rendered after the coming into force of the 2009 legislative reform that dealt with the notion of equity claims, the Ontario Superior Court approached the issue differently. It is important to observe that the decision was not based on the amended CCAA (which governs the present case) since the initial order in that case had been issued prior to the coming into force of the legislative reform in September 2009. (It also dealt only with the indemnification claims of directors, not third parties such as underwriters).

Reference *Return on Innovations v. Gandi Innovations*, 2011 O.J. 3827 ("*Return on Innovations*") at para. 55, E&Y Brief of Authorities, Tab 6

84. Accordingly, the Ontario Court of Appeal confirmed that the decision in *Return on Innovations* should not be read as a direct judicial precedent on the interpretation of the term "equity claims" within the meaning of s. 2 of the amended CCAA.

Reference *Return on Innovations,* 2012 ONCA 10 (C.A.), at para. 12, E&Y Brief of Authorities, Tab 7

85. The Ontario Court of Appeal, though upholding the decision of the Superior Court, expressly refrained from ruling on the characterization of directors' claims generally, and suggested that the holding in *Return on Innovations* may be limited to its specific facts, namely a CCAA proceeding commenced before the 2009 amendments and in which the central question concerned strictly the characterization of directors' claims.

Reference *Return on Innovations (C.A.), supra,* at paras. 11 and 12, Tab 7

86. In that regard, the Ontario Court of Appeal stated as follows:

> [11] "Equity" claims are subsequent in priority to non-equity claims by virtue of s. 6(8) of the CCAA. What constitutes an "equity claim" is

> defined in s. 2(1) and would appear to encompass the indemnity claims asserted by the Claimants here.
>
> (...)
>
> [12] This issue in the proposed appeal is not of significance to the practice since all insolvency proceedings commenced after the new provisions of the CCAA came into effect in September 2009 will be governed by those provisions, not by the prior jurisprudence. The interpretation of sections 6(8) and 2(1) does not come into play in this appeal. To the extent that existing case law continues to govern whatever pre-September 2009 insolvency proceedings are still in the system, those cases will fall to be decided on their own facts.
>
> **Reference** *Return on Innovations (C.A.), supra,* at paras. 11 and 12. Tab 7

87. Should this Court hold that *Return on Innovations* is applicable on these facts, respectfully, the Ontario Superior Court erroneously concluded that the indemnity claims of directors against the debtor company should be subordinated to the ordinary creditors.

88. The Court arrived at this conclusion based upon an erroneous premise, i.e. that the jurisprudence prior to 2009 (that indemnity claims were to be subordinated to unsecured creditors) was codified within the definition of the term "equity claim" at s. 2(1)(e) of the CCAA and.

> [55] This definition of equity claims came into force on September 18, 2009. Although this provision does not apply to the Gandi Group's CCAA proceedings which commenced shortly prior to the legislative amendments, courts have noted that the amendments codified existing case law relating to the treatment of equity claims in insolvency proceedings. (...)

89. The Superior Court's decision in *Return on Innovations* is not a reliable precedent for the interpretation of the term "equity claim" at s. 2 of the CCAA, as was stated by the Ontario Court of Appeal. Moreover, the premise underlying it is, respectfully, mistaken. For these reasons, this decision ought to be distinguished upon the facts from the present case.

90. As set out below, E&Y's claim is based upon a cause of action rooted in a breach of contract and in tort, and therefore does not constitute an "indemnity or contribution" claim within the meaning of s. 2(e) of the CCAA.

Reference June 21 Shiels Affidavit, *supra*, Tab A, E&Y Motion Record, Tab 1A

91. The claims of directors are distinct and distinguishable from those against auditors in that by definition, directors are insiders of the issuing company, unlike auditors who are independent third parties.

92. Directors are also in a superior position to assume the risk of misrepresentation since they are in a position to prevent it.

93. The directors and officers of the Company explicitly assumed the risk of misrepresentation, having undertaken to provide E&Y with complete and accurate financial information and to maintain internal controls to prevent fraud and misstatements in that regard, as provided for in the Engagement Letters.

94. A significant number of the Engagement Letters includes the following provisions:

> The preparation and fair representation of the consolidated financial statements and unaudited interim financial information in accordance with Canadian generally accepted accounting principles are the responsibility of the management of the Company. Management is also responsible for establishing and maintaining effective internal controls, for properly recording transactions in the accounting records, for safeguarding assets, and for identifying and ensuring that the Company complies with the laws and regulations applicable to its activities.
>
> The design and implementation of internal controls to prevent and detect fraud are the responsibility of the Company's management, as is an assessment of the risk that the consolidated financial statements may be materially misstated as a result of a fraud. Management of the Company is responsible for apprising us of all known instances of fraud or suspected fraud, illegal or possibly illegal acts and allegations involving

> financial improprieties received by management or the Audit Committee (regardless of the source or form and including, without limitation, allegations by "whistle-blowers," employees, former employees, analysts, regulators or others), and for providing us full access to information and facts relating to these instances and allegations, and any internal investigations of them, on a timely basis. Allegations of financial improprieties include allegations of manipulation of financial results by management or employees, misappropriation of assets by management or employees, intentional circumvention of internal controls, inappropriate influence on related party transactions by related parties, intentionally misleading EY, or other allegations of illegal acts or fraud that could have a non-trivial effect on the financial statements or otherwise affect the financial reporting of the Company. If the Company limits the information otherwise available to us under this paragraph (based on the Company's claims of solicitor/client privilege or otherwise), the Company will immediately inform us of the fact that certain information is being withheld from us. (…)
>
> Management of the Company is responsible for providing us with and making available complete financial records and related data and copies of all minutes of meetings of shareholders, directors and committees of directors; information relating to any known or probable instances of non-compliance with legislative or regulatory requirements, including financial reporting requirements; and information regarding all related parties and related party transactions. (…)
>
> **Reference** Engagement letters dated June 21, 2007, s.14-16; April 16, 2008, s.8-10; April 16, 2008, s.8-10; See also Engagement Letters dated March 30, 2004, s.7-9; December 15, 2004, s.7-9; August 7, 2008, s.15-18, October 1, 2009, s.15,16,18; and, December 7, 2010, s.15,17

95. Auditors generally, and more specifically E&Y in this case, do not benefit from the same privileged position as directors to prevent the risk of misrepresentation.

96. E&Y relied upon the information prepared by or at the request of the directors and officers of Sino-Forest and the SFC's subsidiaries to prepare its reports, which veracity and accuracy constituted a contractual obligation to the benefit of E&Y under the Engagement Letters.

97. E&Y's claim cannot be considered on the same footing as the contractual indemnifications that are customarily provided by companies to their directors and officers.

(b) The Policy Reasons at the Root of the Historical Subordination of Equity Claims and the Legislative purpose behind the 2009 Amendments to the CCAA

98. As noted, it is well established in the case law developed before the 2009 amendments to the CCAA that the claims of shar eholders in the context of a restructuring of the issuing company ought to be subordinated to those of ordinary creditors for the following policy reasons:

(a) Recovery by shareholders on a *pari passu* basis with creditors would contravene the fundamental corporate law principle that shareholders should not recover in an insolvency context before the payment in full of unsecured creditors;

(b) The expectation of creditors who conduct business with corporations upon the assumption that they would be given priority over the shareholders should not be disturbed;

(c) The investment of shareholders is inherently a risky one compared to creditors' interest to receive payment. Hence, it is equitable to impose the risk of fraud on the shareholders;

(d) United States case law supports the subordination of shareholders' claims based on fraud in an insolvency context; and

(e) Recovery by shareholders on a *pari passu* basis with creditors would open the floodgates to tort claims by shareholders in the context of CCAA proceedings.

Reference *Re Blue Range Resources, supra*, at paras. 29-50, Tab 4
National Bank of Canada v. Merit Energy Ltd., supra, at para. 26, Tab 2.

99. These policy reasons, and the emphasis on the subordination of shareholders *qua* owners of the company who have engaged in a risky investment are reflected in the clause-by-clause analysis of the provisions of Bill C-12 which introduced the definition of equity claims.

> **Reference** Bill C-12, Clause-by-Clause analysis, s. 105, http://www.ic.gc.ca/eic/site/bsf-osb.nsf/eng/br01978.html, E&Y Brief of Authorities, Tab 8

100. As such, the clause-by-clause analysis of Bill C-12 clarifies that the provisions subordinating equity claims are founded upon the nature of shareholders' rights against the debtor company:

> The definition of "equity claim" is added to provide greater clarity in subsequent provisions that deal with the rights of shareholders.
>
> **Reference** Bill C-12, Clause-by-Clause analysis, s. 105, http://www.ic.gc.ca/eic/site/bsf-osb.nsf/eng/br01978.html, E&Y Brief of Authorities, Tab 8
>
> The amendment is one of several that are made with the intention of clarifying that equity claims are to be subordinate to other claims. Equity claims are ownership interests and, as such, should be subject to the risks of insolvency. [emphasis added]
>
> **Reference** Bill C-12, Clause-by-Clause analysis, s. 105, http://www.ic.gc.ca/eic/site/bsf-osb.nsf/eng/br01978.html, E&Y Brief of Authorities, Tab 8

101. According to each of the Senate Committee on Banking, Trade and Commerce, and the Joint Task Force on Business and Insolvency Law Reform of 2002, the legislative purpose underlying the new CCAA provisions on equity claims were the following:

(a) In the interest of predictability, to enshrine in statutory law the rule that shareholders may not recover, in priority to creditors, amounts in relation to claims in damages against the debtor company; and

(b) In the interest of facilitating and encouraging restructuring proceedings in Canada, to align Canadian statutory law with U.S. law.

Reference 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, Nov. 2003, at pp. 158 and 159, E&Y Brief of Authorities, Tab 9

102. In the United States, the subordination of equity claims is provided at section. 510 (b) of title 11 of the *United States Code* (the "U.S. Bankruptcy Code"), a provision which bears striking similarities to the definition of the term "equity claim" as well as to sections 6(8) and 22.1 of the CCAA:

> (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 section 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.
>
> (emphasis added)

103. As here, in deciding whether a claim for indemnity is covered by section 510(b), courts in the U.S. have also considered whether the pro rata payment of an indemnity claim would indirectly benefit the shareholders:

> An equally important policy consideration behind *Section 510(b)*, emphasized by the Ninth Circuit in *In re Holiday Mart, Inc., 715 F.2d 430, 433 (1983)*, is that it would not be fair to shift the risk of

> unlawfulness in the issuance of securities from the stockholders to the creditors.
>
> **Reference** *In Re De Laurentiis Entertainment Group Inc.* (1991, CD Cal), 124 B.R. 305 at pp. 7-8, E&Y Brief of Authorities, Tab 10

104. E&Y is not aware of any decision in the United States where an auditor's claim was subordinated to the ordinary creditors' claims. None of the U.S. cases cited by the Company in its factum relate to claims by auditors, who are in a fundamentally different position to shareholders and underwriters. The 2009 CCAA amendments were intended to harmonize Canadian law with U.S. law.

105. Moreover, E&Y's claim is not for damages arising from the purchase or sale of shares but is based mainly upon alleged wrongdoings of the Company which resulted in multiple breaches of contract and in tort.

106. The damages that could be pursued against E&Y by the plaintiffs in the Class Action are distinct and independent from the damages that Sino-Forest may have to pay to the Plaintiffs, the latter being strictly a function of the wrongdoings alleged against Sino-Forest in the Class Actions.

107. As such, since the source of liability towards Plaintiffs in the Class Actions is potentially distinct as between Sino-Forest and E&Y, recovery by E&Y against Sino-Forest can in no way benefit the Plaintiffs' claim against Sino-Forest. The claims are distinct for the purpose of the provisions of the CCAA.

(c). The Classification of E&Y's Claim as an Equity Claim does not further the Policy Reasons justifying the Historical Subordination of Equity Claims and the Legislative Purpose behind the 2009 Amendments

108. Since E&Y is not a shareholder of Sino-Forest, none of the above-mentioned policy reasons underlying the subordination of shareholders' claims could be furthered by the characterization of E&Y's claim as an equity claim.

109. As demonstrated above, the substance of E&Y's relationship with Sino-Forest is clearly in the nature of a creditor-debtor relationship.

110. E&Y could not be said to have engaged in an inherently risky investment, where the amount it could expect to receive in return for the services provided to Sino-Forest was similar to equity-type profits. Similarly, E&Y could not be said to have accepted to incur equity-type risks in return for the amount it expected to receive from Sino-Forest.

111. Like other creditors and suppliers of Sino-Forest, E&Y was promised an amount that was based solely on the services provided and could expect to receive such an amount from Sino-Forest independently of Sino-Forest's financial performance.

112. While "equity investors bear the risk relating to the integrity and character of management" and "tie their investment to the fortune of the corporation", the same is not true for E&Y.

> Historically, the claims and rights of shareholders were not treated as provable claims and ranked after creditors of an insolvent corporation in a liquidation. As noted by Laskin J.A. in Re Central Capital Corporation, on the insolvency of a company, the claims of creditors have always ranked ahead of shareholders for the return of capital. This principle is premised on the notion that shareholders are understood to be higher risk participants who have chosen to tie their investment to the fortunes of the corporation. In contrast, creditors choose a lower level of exposure, the assumption being that they will rank ahead of the

> shareholders in insolvency. Put differently, amongst other things, equity investors bear the risk relating to the integrity and character of management.
>
> **Reference** *Nelson Financial Group, supra,* at para. 25, Tab 1.

113. E&Y has engaged in a contractual relationship with Sino-Forest, upon terms clearly providing that Sino-Forest and Sino-Forest's management undertook the responsibility to ensure the accuracy of the unaudited financial information and to prevent and detect material misstatements resulting from fraud.

114. In that regard, the Engagement Letters contained the following provision:

> Client Responsibilities - Client will provide to EY in a timely manner complete and accurate information and access to management personnel, staff, premises, computer systems and applications as is reasonably required by EY to complete the performance of the Services.
>
> **Reference** Terms and conditions of Engagement Letters dated: June 21, 2007, s.3; February 5, 2008, s.3; April 16, 2008, s.3; April 16, 2008, s.3; April 16, 2008, s.3; April 16, 2008, s.3; May 7, 2008, s.3; May 7, 2008, s.3; July 4, 2008, s.3; August 7, 2008, s.3; August 18, 2008, s.3; January 6, 2009, s.3; January 6, 2009, s.3; May 17, 2009, s.3; October 1, 2009, s.3; November 9, 2009, s.3; November 17, 2009, s.3; November 17, 2009, s.3; November 17, 2009, s.3; and, March 22, 2010, s.3

115. Hence, the policy reasons related to the assumption of risk, business expectations, and the corporate law ranking between creditors and shareholders would be in no way furthered by the characterization of E&Y's claim as an equity claim.

116. The subordination of E&Y's claim would certainly not further the legislative purposes behind the 2009 amendment to subordinate shareholder recovery since E&Y's relationship with Sino-Forest is not in the nature of a shareholder-issuer relation but rather in the nature of a debtor-creditor relationship.

117. The qualification of E&Y's claim as an equity claim would not enhance the predictability of shareholders treatment in an insolvent context.

PART IV - ORDER REQUESTED

118. E&Y requests that this Court dismiss the Applicant's motion.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 22nd day of June, 2012.

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SCHEDULE "A"

LIST OF AUTHORITIES

1. *Nelson Financial Group Ltd.*, 2010 ONSC 6229.

2. *National Bank of Canada v. Merit Energy Ltd.*, 2001 ABQB, 583 (CanLII).

3. *Re Earthfirst Canada Inc.*, 2009 ABQB 316 (CanLII).

4. *Blue Range Resource Corporation,* 2000 ABQB 4 (CanLII).

5. *Royal Bank of Canada v. Central Capital Corp.* [1996], (CA) O.J. No. 359

6. *ROI Fund Inc. v. Gandi Innovations Ltd.* [2011] O.J. 3827

7. *ROI Fund Inc. v. Gandi Innovations Ltd.*, 2012 ONCA 10

8. Bill C-12, Clause by Clause Analysis.

9. 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*, Nov. 2003

10. *Re De Laurentiis Entertainment Group Inc.*, 1991, (CD Cal), 124 B.R. 305.

SCHEDULE "B"

Bankruptcy and Insolvency Act

R.S.C., 1985, c. B-3

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.

(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.

(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.

(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.

Companies' Creditors Arrangement Act

R.S.C., 1985, c. C-36

2. (1) 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;

[…]

6. (8) This Act extends and does not limit the provisions of any instrument now or hereafter existing that governs the rights of creditors or any class of them and has full force and effect notwithstanding anything to the contrary contained in that instrument.

[…]

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 AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF SINO-FOREST CORPORATION

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

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

PROCEEDING COMMENCED AT TORONTO

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