USING THE COMPANIES CREDITORS ARRANGEMENT ACT TO SETTLE CLASS ACTIONS: LESSONS OF *SINO-FOREST*

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In class action litigation, a proposed settlement will be assessed by the court on the basis of whether it is fair, reasonable and in the best interests of the class. However, in situations where the defendant is granted protection under the *Companies' Creditors Arrangement Act*, the dynamics may drastically change.[1] As illustrated in the *Sino-Forest* litigation, a settlement within the context of the CCAA may take precedent over the opt-out rights of class members. Further, the class members, if equity claimants, will generally be unable to vote on any plan put forward by the settling parties. Lastly, for some parties, a CCAA settlement may serve as an opportunity to obtain a release it would not have otherwise obtained.

This paper will outline the specific provisions of class proceedings legislation and the CCAA as it pertains to settlements. It will then address how class settlements are impacted by CCAA proceedings by outlining the Ontario court's equity and settlement decisions in *Labourers' Pension Fund of Central and Eastern Canada v Sino-Forest Corporation*. In particular, the authors will canvas when claims will be characterized as "equity claims" for the purposes of the CCAA, the ability to obtain comprehensive third party releases within the context of the CCAA, and the ability to "cram down" a plan on plaintiff shareholders upon approval of the plan by the majority of a debtor company's creditors. In light of these factors, strategic tips are provided which counsel ought to consider prior to entering into CCAA-focused negotiations.

1. THE *CLASS PROCEEDINGS ACT*

The implementation of class action legislation is a recognition of the three important advantages the class action offers as a procedural tool. First, class actions promote judicial economy by avoiding unnecessary duplication in fact-finding and legal analysis. Second, class actions improve access to justice as claims may be prosecuted which would otherwise be too costly for an individual to prosecute on his or her own. Lastly, class actions ensure actual and potential wrongdoers modify their behaviour to account for harm they are causing, or might cause, to the public.[2]

Despite the advantages of class proceedings, class action legislation does provide a mechanism by which class members may "opt out" of the certified class proceedings. Ontario, Quebec, Manitoba, Nova Scotia, Saskatchewan and Alberta follow an opt-out model where persons falling within the definition of a class will automatically become class members unless they take an active step to opt

[1] *Companies' Creditors Arrangement Act*, RSC 1985, c C-36 ("CCAA").

[2] *Hollick v Toronto (City)*, [2001] 3 SCR 158, 2001 SCC 68 at para 15.

out.[3] In British Columbia, Newfoundland and New Brunswick, residents of the province may opt out – however, non-resident members of a class must take an active step to opt in.[4]

In Alberta, a proceeding may be settled, discontinued or abandoned only with the approval of the court.[5] While Alberta's *CPA* and similar legislation in other provinces states that a settlement is not binding unless approved by the court there are no statutory guidelines that the court must follow in determining whether to approve a settlement.[6] As a result, authorities are well-developed in respect of the factors the court will consider prior to granting settlement approval. As recently stated by Justice Perell in *Maksimovic v Sony of Canada Ltd*, to approve a settlement of a class proceeding, the court must find that, in all the circumstances, the settlement is fair, reasonable and in the best interests of the class.[7]

In determining whether a settlement is reasonable and in the best interests of the class, the following factors may be considered:

1. the likelihood of recovery or likelihood of success;
2. the amount and nature of discovery, evidence or investigation;
3. the proposed settlement terms and conditions;
4. the recommendation and experience of counsel;
5. the future expense and likely duration of litigation;
6. the number of objectors and nature of objections;
7. the presence of good faith, arm's length bargaining and the absence of collusion;
8. the information conveying to the court the dynamics of, and the positions taken by, the parties during negotiations; and

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[3] Ontario *Class Proceedings Act, 1992*, SO 1992, c 6, s 9 ("Ontario *CPA*"); Quebec *Code of Civil Procedure*, CQLR c C-25, Article 1007 ("Quebec *CCP*"); Manitoba *Class Proceedings Act*, CCSM c C130, s 16 ("Manitoba *CPA*"); Nova Scotia *Class Proceedings Act*, SNS 2007, c 28, s 19 ("Nova Scotia *CPA*"); Saskatchewan *The Class Actions Act*, SS 2001, c C-12.01, s 18 ("Saskatchewan *CAA*"); Alberta *Class Proceedings Act*, SA 2003, c C-16.5, s 17 ("Alberta *CPA*").

[4] British Columbia *Class Proceedings Act*, RSBC 1996, c 50 s 16 ("B.C. *CPA*"); Newfoundland and Labrador *Class Actions* Act, SNL 2001, c C-18.1, s 17 ("Newfoundland *CAA*"); New Brunswick *Class Proceedings Act*, RSNB 2011, c 125, s 18 ("New Brunswick *CPA*"). See also Ward Branch, *Class Actions in Canada*, loose-leaf (Toronto: Thomson Reuters Canada Limited, 2013) at 10-1.

[5] Alberta *CPA*, *supra* note 3, s 35.

[6] Ward Branch, *Class Actions in Canada*, loose-leaf (Toronto: Thomson Reuters Canada Limited, 2013) at 16-2 ("Branch").

[7] *Maksimovic v Sony of Canada Ltd*, 2013 ONSC 4604, 2013 CarswellOnt 9043.

9. the nature of communications by counsel and the representative plaintiff with class members during the litigation.[8]

These factors provide a guide for analysis rather than a rigid set of criteria that must be applied to every settlement. Depending on the specific facts of a case, it may be that one or more of the factors will have greater significance than others and as such, should be attributed greater weight.[9]

While the standard to be met by parties seeking approval of a settlement does not require perfection, the court will scrutinize the proposed settlement to ensure it does not "sell short the potential rights" of unrepresented parties.[10] Furthermore, the court may hear submissions from objectors and intervenors prior to granting approval. While class proceedings legislation does not expressly provide a process for receiving objections by class members on a proposed settlement, in Ontario and elsewhere there is a well-established practice of combining the settlement approval motion with a fairness hearing, where objections may be received and considered by the court.[11]

Where the court determines that the settlement is reasonable, in the best interests of the class and thus approves the settlement, the settlement will bind every class member who has not opted out of the proceeding.[12]

2. THE COMPANIES CREDITORS ARRANGEMENT ACT

The CCAA provides a legislative framework within which a debtor company may continue to carry on business and retain control over its assets while its creditors, shareholders and the court consider a plan or compromise. The process is overseen by a judge who, within the confines of the CCAA, can maintain the status quo while negotiations, creditor approvals and reorganization take place.[13]

a. The Initial Order

A company which is bankrupt or insolvent and has debts of five million dollars or more may bring an application before the court to obtain an initial order granting the company CCAA protection.[14]

On an initial application in respect of a debtor company, the CCAA provides authority for the court to make a stay order on any terms that it may impose where the applicant satisfies the court that circumstances exist that make the order appropriate.[15] Given the objectives of the CCAA, an initial

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[8] *Ibid* at para 22.

[9] *Parsons v Canadian Red Cross Society*, 1999 CarswellOnt 2932 at para 73; *McCarthy v Canadian Red Cross Society,* 2007 CanLII 21606 (ONSC) at para 9.

[10] *Dabbs v Sun Life Assurance Co of Canada*, (1998) 40 OR (3d) 429, [1998] OJ No 2811 (QL).

[11] *McCarthy v Canadian Red Cross Society,* 2007 CanLII 21606 (ONSC) at para 9.

[12] Alberta *CPA*, s 35; B.C. *CPA*, s 35; Saskatchewan *CAA*, s 38; Manitoba *CPA*, s 35; New Brunswick *CPA*, s 37; Newfoundland *CAA*, s 35; Nova Scotia *CPA*, s 38; Ontario *CPA,* s 29; Quebec *CPP*, s 1027. See also Branch, *supra* note 6 at 10-2.

[13] *Blue Range Resources Corp, Re*, 2000 ABCA 239, 2000 CarswellAlta 2004 at para 6.

[14] CCAA, *supra* note 1, s 2 ("debtor company"), s 3.

[15] *Ibid*, s 11, s 11.02(3)(a).

order will generally be granted by the court unless any compromise or arrangement is "doomed to failure" or it is readily apparent that the debtor simply wishes to avoid its obligations to creditors. While the company may not have a formalized plan on its initial application, there must also be a "germ of a plan."[16]

While the initial order may only be granted for a period no longer than 30 days, the debtor company may apply to the court for an extension of the initial order. In addition to considering whether circumstances exist that would make an extension appropriate, on an application to extend, the debtor company must also satisfy the court that it has acted in good faith and with due diligence.[17]

Under the terms of an initial order, the debtor company may be permitted to do the following:

a. continue to carry on business in a manner consistent with the preservation of the business;

b. continue to retain employees and others who are necessary to continue the ordinary course of business;

c. pay reasonable expenses and capital expenditures necessary for the preservation of the business, such as payments on insurance, maintenance and security services; and

d. pay for goods or services supplied to the company following the initial order.[18]

The terms of the initial order will look to maintain the status quo and provide the debtor company with time to reorganize its affairs for the benefit of the company and its creditors. For this reason, the court will also likely grant a stay of all current and further proceedings, including class proceedings, against the debtor company, its directors, and officers.[19]

Further, the court has the broad inherent jurisdiction to supplement the stay provisions outlined in section 11 of the CCAA and impose a stay with respect to third parties where it is "necessary and appropriate to facilitate a debtor company's restructuring process."[20] Such was the case in *Re 4519922 Canada Inc*. In this case, 4519922 Canada Inc. ("**451**") applied for an Initial Order granting it protection under the CCAA, extending the protection of the Initial Order to the partnership Coopers & Lybrand Chartered Accountants ("**CLCA**") of which it was a partner and to CLCA's insurers, and staying outstanding litigation relating to Castor Holdings Limited.[21]

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[16] *Sharp-Rite Technologies Ltd, Re*, 2000 BCSC 122, 2000 CarswellBC 128 (SC) at para 25; *Inducon Development Corp, Re*, 1991 CarswellOnt 219, OJ No 8 (QL) at para 14.

[17] CCAA, *supra* note 1, s 11.02(3)(a) and (b).

[18] For an example of an initial order and model initial orders, see Janis Sarra, *Rescue! The Companies' Creditors Arrangement Act* (Toronto: Thomson Canada Limited, 2007) Appendices 1-7 ("Sarra, *Rescue!*").

[19] CCAA, *supra* note 1, s 11.02; *Re: Cansugar Inc CCAA Extension*, 2004 NBQB 7.

[20] *Cinram International Inc (Re)*, 2012 ONSC 3767 at para 63; Kelly Bourassa and Milly Chow, "At the Crossroads: What Happens When Class and Insolvency Proceedings Collide?" (2014) Annual Review of Insolvency Law 417 at 433.

[21] *Re 4519922 Canada Inc*, 2015 ONSC 124 ("*Re 4519922*").

While the application was opposed by a contingent creditor of 451, the Court extended the initial stay of proceedings to CLCA, finding that the affairs of the 451 and CLCA were so intertwined that not extending the stay to CLCA would significantly impair the effectiveness of the stay in respect of 451.[22] The Court also extended the stay to the insurers of CLCA who had agreed to contribute a substantial amount towards a global settlement.[23]

b. Lifting the Stay

During the time the initial order is operative or after its extension, a creditor may apply to lift the stay of proceedings. Situations in which a court will lift a stay include where a plan is likely to fail, where the applicant is faced with a limitations issue, or where the applicant would be severely prejudiced by refusal to lift the stay where there is no resulting prejudice to the debtor company or its creditors.[24]

Thus, in *Comstock Canada Ltd, Re*, the court lifted the stay of proceedings in order to allow the creditor company, Honeywell, to terminate its contract with the debtor company regarding the construction of a real estate project. Honeywell argued it was prejudiced by the stay since it would require Honeywell to be involved in two contracts at the same time. The debtor company had acknowledged it was unable to perform its obligations under the contract and it took no issue with Honeywell entering into a new contract with a replacement contractor. Finding that the project was not an asset in the CCAA proceedings, the court granted lifting of the stay.[25]

However, not all litigants will be successful in an application to lift the stay. For example, in *Air Canada, Re*, Justice Farley dismissed the plaintiffs' motions to lift the stay as the litigation, which would be "of major proportions" and "complexity", would adversely impact the debtor company's restructuring efforts.[26]

c. Mediation within the Context of the CCAA

As the purpose of CCAA proceedings is to assist the debtor company in restructuring its affairs for the benefit of the company and its creditors, it comes as no surprise that mediation may be used as a tool to reach a settlement of all, or some, of the outstanding claims relating to the company.

Where the debtor company is involved in class action proceedings prior to the initial order, parties stayed in the CCAA proceedings will often include the class members as represented by the representative plaintiff, the debtor company, and the debtor company's directors, officers, lenders, and experts. Generally, the monitor will canvas whether these parties are interested in mediation and will bring an application for the approval of a proposed mediation order if a sufficient number of major stakeholders express interest.

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[22] *Ibid* at paras 37-38.

[23] *Ibid* at paras 68-72.

[24] *Canadian Airlines Corp, Re*, [2000] AJ No 1692 (QL), CarswellAlta 622 at para 20.

[25] *Comstock Canada Ltd, Re*, 2013 ONSC 6043, 2013 CarswellOnt 13598.

[26] *Air Canada, Re*, 2004 CarswellOnt 481, [2004] OJ No 527 (QL) at para 7.

Features of a mediation order may include:

a. a provision permitting the addition of other parties to the mediation by way of a Notice to Mediate;

b. that the mediation is subject a privileged exercise;

c. the exchange of documents amongst the parties, including mediation briefs and expert reports;

d. the selection of a mediator;

e. a standstill of all claims while the mediation is ongoing; and

f. a request to extend the stay of proceedings until the completion date of the mediation.

As a result of the stay of proceedings, at the time of mediation not all parties may have had the opportunity to assert claims against other parties. Therefore, the mediation order may require all parties to the mediation to exchange Statements of Issues setting out the party's claim, the factual and legal basis of the claim, and the relief sought.

Mediation raises an interesting dynamic of settlement communications within the context of CCAA proceedings. In particular, counsel may be having discussions not only with parties adverse in interest, potentially adverse in interest, and parties who may be aligned in interest, but also counsel for the monitor. Presumably, the monitor is also having settlement discussions with all parties participating in the mediation and, as such, counsel must pay particular attention to imposing strict limits on the monitor in respect of what the monitor can say, if anything, about settlement discussions to other counsel/parties.

If the mediation is successful then it will likely be reflected in a plan proposed by the monitor for court approval. If the court approves the plan, the Order will likely include provisions that:

a. bar any further claims from continuing or commencing against settling parties;

b. require contribution to the CCAA estate from the settling parties;

c. require settling parties to make themselves available for examination/questioning;

d. require settling parties to produce relevant records, as if it were a party.

3. SETTLEMENT WITHIN THE CCAA

a. The Classification of Claims

Prior to participating in a mediation under the CCAA, it is important to gain an understanding of the strength of all stakeholders' claims within the context of the CCAA.[27]

The claims which may be dealt with by a compromise or arrangement under the CCAA are outlined in section 19 of the CCAA. In short, these claims include those which the debtor company is, or may be subject to as a result of "debts or liabilities" which have arisen prior to the date of the CCAA proceedings or the date of the initial bankruptcy event, if applicable.[28]

The CCAA provides for three main types of claims: those made by equity claimants, secured creditors and unsecured creditors. An "equity claim" is defined by the CCAA as:

> … a claim that is in respect of an equity interest, including a claim for, among others,
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> *(a)* a dividend or similar payment,
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> *(b)* a return of capital,
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> *(c)* a redemption or retraction obligation,
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> *(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
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> *(e)* contribution or indemnity in respect of a claim referred to in any paragraphs (*a*) to (*d*).[29]

Section 2 of the CCAA also defines the term "equity interest" as including, 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 …[30]

Further, section 2 defines an "unsecured creditor" as any creditor which is not a secured creditor. In turn, a "secured creditor" is defined by the CCAA as:

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[27] Michael Barrack, "The Interplay Between Class Actions and CCAA Filings" (Presentation delivered at the Osgoode Professional Development's 10th National Symposium on Class Actions, 4 April 2013), online: Thornton Grout Finnigan LLP <http://tgf.ca>.

[28] CCAA, *supra* note 1, s 19.

[29] *Ibid*, s 2 ("equity claim").

[30] *Ibid*, s 2 ("equity interest").

> …a holder of a mortgage, hypothec, pledge, charge, lien or privilege on or against, or any assignment, cession or transfer of, all or any property of a debtor company as security for indebtedness of the debtor company, or a holder of any bond of a debtor company secured by a mortgage, hypothec, pledge, charge, lien or privilege on or against, or any assignment, cession or transfer or, or a trust in respect of, all or any property of the debtor company, whether the holder or beneficiary is resident or domiciled within or outside Canada, and a trustee under any trust deed or other instrument securing any of those bonds shall be deemed to be a secured creditor for all purposes of this Act except for the purpose of voting at a creditor's meeting in respect of any of those bonds.[31]

Under section 4 and 5, where the secured and/or unsecured creditors of the debtor company, or any class of them have reached a compromise or arrangement with the company and/or its directors and officers[32], the court may order a meeting of the creditors and, if it so determines, the shareholders.[33] Where a majority in number representing two-thirds in value of each class of creditor has voted in favour of the compromise or arrangement, section 6 authorizes the court to sanction the compromise or arrangement.[34]

No compromise or arrangement will be sanctioned by the court unless it provides that all non-equity claims will be paid before equity claims.[35] Further, equity claimants are not entitled to vote on any compromise or arrangement unless the court orders otherwise.[36] Situations where the court may permit equity claimants to vote include where the plan contemplates a payment to equity claimants such that the equity claimants maintain an economic interest in the restructuring of the debtor corporation.[37]

Thus, the legislative scheme of the CCAA is to subordinate the claim of equity claimants to secured and unsecured creditors with respect to voting on, and the court-approval of, any proposed compromise or arrangement. Understanding the classification of creditors and the relative weaknesses of being classified as an equity claimant will thus assist counsel in assessing the reasonableness of any settlement proposed during the course of mediation or plan proposed by the monitor.

b. Interplay of Class Actions and the CCAA: Sino-Forest

The interplay between class proceedings and equity claimants is exemplified in a number of decisions arising from litigation in *Labourers' Pension Fund of Central and Eastern Canada v Sino-Forest Corporation* ("**Sino-Forest Decisions**"). Specifically, the Sino-Forest Decisions provide guidance on:

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[31] *Ibid*, s 2 ("secured creditor").

[32] *Ibid*, s 5.1.

[33] *Ibid*, s 4, 5.

[34] *Ibid*, s 6.

[35] *Ibid*, s 6(8).

[36] *Ibid*, s 22.1.

[37] Sarra, *Rescue!*, *supra* note 18 at 240-242. See also *Re Canadian Airlines Corp*, [2000] AJ No 1692 (QL); *Lowen Group Inc (Re)*, (2001) 22 BLR (3d) 134; OJ No 5640 (QL); *Stelco Inc (Re)*, (2000) 14 BLR (4th) 260, OJ No 276 (QL).

a. what constitutes an "equity claim" under the CCAA,

b. the ability of settlements within the CCAA to "cram down" on class action plaintiffs; and

c. confirmation that a CCAA settlement may be used to obtain third party releases.

i. The Equity Claims Decision

Sino-Forest was a forest plantation operator and lumber production company which was a TSE registrant. During the period from March 19, 2007 through June 2, 2011, Sino-Forest made three separate offerings of common shares with three separate prospectuses. Sino-Forest also issued and had various notes outstanding, which were offered to investors, by way of offering memoranda, between March 19, 2007 and June 2, 2011.[38]

Ernst & Young ("**EY**") acted as Sino-Forest's auditor from 2000 to 2004 and 2007 to 2012, and BDO Limited ("**BDO**") acted as Sino-Forest's auditor from 2005 to 2006.

Following a June 2, 2011 report issued by Muddy Waters LLC, proposed class actions were commenced in Ontario, Quebec, Saskatchewan, and New York State against, amongst others, Sino-Forest, certain of its officers, directors and employees, BDO, EY and the underwriters. They alleged that:

a. Sino-Forest misrepresented its assets and financial situation and its compliance with GAAP in its public disclosure;

b. the underwriters, BDO and EY failed to detect these misrepresentations;

c. BDO and EY misrepresented that their audit reports were prepared in accordance with generally accepted auditing standards;

d. these misrepresentations artificially inflated the share price and class members suffered damages when the shares fell after the release of the Muddy Waters report.[39]

On March 30, 2012, Sino-Forest sought and obtained protection under the CCAA. On May 14, 2012 a Claims Procedure Order was granted which established a procedure to file and determine claims against Sino-Forest, by way of Proof of Claim submitted to the Monitor.[40]

Sino-Forest applied for an order directing that the claims against Sino-Forest which resulted from the ownership, purchase or sale of an equity interest in the corporation were "equity claims" as defined by section 2 of the CCAA (the "**Equity Claims Decision**"). These claims included the claims

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[38] *Labourers' Pension Fund of Central and Eastern Canada v Sino-Forest*, 2013 ONSC 1078, 100 CBR (5th) 30 at paras 4-5 ("*Ernst & Young Decision*").

[39] *Sino-Forest Corporation (Re)*, 2012 ONCA 816 at para 13 ("*Equity Claims Appeal Decision*").

[40] *Ibid* at para 18.

brought on behalf of shareholders (the "**Shareholder Claims**") and any indemnification claims against the corporation relating to the Shareholder Claims (the "**Related Indemnity Claims**").[41]

EY had brought contractual claims of indemnification against Sino-Forest and its subsidiaries and statutory and common law claims for contribution and/or indemnity. EY contended that it also had stand-alone claims for breach of contract and negligent and/or fraudulent misrepresentation against Sino-Forest, its directors and officers.[42] Opposing the classification of its claim as an equity claim, EY argued that its claims against Sino-Forest were independent of, and did not depend on the success of, the Shareholder Claims. Consequently, EY held it was an unsecured creditor.[43]

Justice Morawetz held that the Shareholder Claims were clearly equity claims falling squarely within the definition of section 2 of the CCAA. Further, Justice Morawetz asserted that the definition of "equity claim" focussed on the nature of the claim:

> The plain language in the definition of "equity claim" does not focus on the identity of the claimant. Rather, it focuses on the nature of the claim. In this case, it seems clear that the Shareholder Claims led to the Related Indemnity Claims. Put another way, the inescapable conclusion is that the Related Indemnity Claims are being used to recover an equity investment.[44]

Justice Morawetz noted that but for the Shareholder Claims, it was inconceivable that claims the magnitude of the Related Indemnity Claims would have been made against Sino-Forest. Further, if the Related Indemnity Claims were characterized as an unsecured claim, it would permit the shareholders to achieve creditor status through their claim against E&Y and others even though their direct claim against Sino-Forest would rank as an equity claim.[45]

Justice Morawetz qualified his decision in one respect, stating that E&Y's claim for defence costs was not necessarily an equity claim:

> It could very well be that each of E&Y, BDO and the Underwriters have expended significant amounts in defending the claims brought by the class action plaintiffs which, in turn, could give rise to contractual claims as against SFC. If there is no successful equity claim brought by the class action plaintiffs, it is arguable that any claim of E&Y, BDO and the Underwriters may legitimately be characterized as a claim for contribution or indemnity but not necessarily in respect of an equity claim.[46]

On appeal, the Court of Appeal held that a broad reading and interpretation of section 2 of the CCAA resulted in the Related Indemnity Claims falling squarely within the definition of an "equity claim" as

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[41] *Sino-Forest Corporation (Re)*, 2012 ONSC 4377 ("*C*").

[42] *Ibid* at para 38.

[43] *Ibid* at para 40. BDO was the auditor of Sino-Forest from 2005 and 2007 and adopted the submissions of Ernst & Young for the purposes of the Equity Claims Decision.

[44] *Ibid* at para 79.

[45] *Ibid* at para 84.

[46] *Ibid* at para 93.

set out in subsection (e)[47]. In upholding Justice Morwetz's decision, the Court agreed that the definition of "equity claim" focused on the nature of the claim as opposed to the identity of the claimant.[48] The Court noted that section 6(8) of the CCAA, introduced as a result of 2009 amendments to the CCAA, showed an intention of Parliament that the monetary loss suffered by a shareholder (or other equity claimants) ought not to diminish the assets of the corporation available to general creditors. The Court commented:

> In our view, in enacting s. 6(8) of the CCAA, Parliament intended that a monetary loss suffered by a shareholder (or other holder of an equity interest) in respect of his or her equity interest not diminish the assets of the debtor available to general creditors in a restructuring. If a shareholder sues auditors and underwriters in respect of his or her loss, in addition to the debtor, and the auditors or underwriters assert claims of contribution or indemnity against the debtor, the assets of the debtor available to general creditors would be diminished by the amount of the claims for contribution and indemnity.[49]

ii. The Ernst & Young Decision

Subsequent to the Equity Claims Decision, a plan was proposed to Sino Forest's creditors which featured Article 11, reflecting the "framework" for a proposed EY Settlement and third-party releases (the "**Plan**").[50] On December 3, 2012, a large majority of creditors approved the Plan and the Plan was sanctioned on December 10, 2012 with Article 11. As the Plan only provided the framework for the EY Settlement, the Ad Hoc Securities Purchasers' Committee, including the representative plaintiffs in the Ontario class action (the "**Applicant**"), subsequently brought a motion for approval of the settlement and release of claims against EY (the "**Settlement**").

While the Settlement was supported by the Monitor, Sino Forest's major creditors, and the Applicant, the settlement was objected to by a group of Sino-Forest's investors who, as equity claimants, were not permitted to vote on the Plan (the "**Shareholders**").[51] The Shareholders opposed the Plan on two grounds. First, the Shareholders submitted that any proposed class action settlement with EY should be approved solely under Ontario's *Class Proceedings Act* and that, in any event, the standard for granting third-party releases in CCAA proceedings was not satisfied. Second, the Shareholders argued that approval of the Settlement would render their opt-out rights in the class proceedings illusory. [52]

In considering the Shareholders' first argument, the Court applied the test set out in *Robertson v ProQuest Information and Learning Co*.[53] In *Robertson*, the Court stated that to obtain approval of a

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[47] *Equity Claims Appeal Decision, supra* note 39 at paras 36-54.

[48] *Ibid* at para 37.

[49] *Ibid* at para 56.

[50] *Ernst & Young Decision, supra* note 39.

[51] *Ibid* at para 26.

[52] *Ibid* at paras 40, 51-52.

[53] *Robertson v ProQuest Information and Learning Co*, 2011 ONSC 1647 at para 22 ("*Robertson*").

settlement under the CCAA, the moving party would have to establish that the transaction was fair and reasonable, the transaction would be beneficial to the debtor and its stakeholders generally, and the settlement was consistent with the purpose and spirit of the CCAA.[54]

Further, as the Settlement involved the release of third party claims against EY, the Court also applied the "nexus test" as set out in *ATB Financial v Metcalf and Mansfield Alternative Investments II Corp*.[55] In that case, the Court held that third-party releases were justified where there was a reasonable connection between the third party claim being compromised and the restructuring achieved by the plan.[56]

Having regard to the tests set out in *Robertson* and *ATB*, the Court held that the Settlement was fair and reasonably, provide substantial benefits to relevant stakeholders, was consistent with the purpose and spirit of the CCAA and satisfied the "nexus test" set out in *ATB*.[57]

In respect of the Shareholders' second argument, the Shareholders submitted that approval of the Settlement would vitiate the Shareholders' right to opt-out of class proceedings pursuant to Ontario's *Class Proceedings Act*. The Court held that the Shareholders' reasoning was inherently flawed since it was "not possible to ignore the CCAA proceedings."[58] As the claims arising out of the class proceedings were claims in the CCAA process, the class action claims could be subject to compromise and the subject of settlement within the CCAA proceedings.[59] Further, the Court stated:

> I do not accept that the class action settlement should be approved solely under the CPA. The reality facing the parties is that SFC is insolvent; it is under CCAA protection, and stakeholder claims are to be considered in the contest of the CCAA regime. The Objectors' claim against Ernst & Young cannot be considered in isolation from the CCAA proceedings. The claims against Ernst & Young are interrelated with claims as against SFC, as is made clear in the Equity Claims Decision and the Claims Procedure Order.[60]

While the Court agreed that the right to opt-out of a class action was a fundamental element of procedural fairness in Ontario's class action regime, this right had to be considered in the context of the CCAA, where a dissenting stakeholder would not be permitted the ability to opt-out of a restructuring.[61]

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[54] *Ibid* at para 22.

[55] *ATB Financial v Metcalf and Mansfield Alternative Investments II Corp*, 2008 ONCA 587 ("*ATB*").

[56] *Ibid* at para 70.

[57] *Ernst & Young Decision*, *supra* note 38 at paras 60-66.

[58] *Ibid* at para 40.

[59] *Ibid* at para 41.

[60] *Ibid* at para 72.

[61] *Ibid* at para 77.

For the foregoing reasons, the Court granted the Applicant's motion, approved of the Settlement together with the release, and dismissed the Shareholders' motion. The Shareholders' motion to appeal was dismissed.[62]

c. Implications of Sino-Forest

i. Characterization of Claim

The Equity Claims Decision reinforces the notion that in assessing whether a claim is an "equity claim" for the purposes of the CCAA, the court will consider the true substantive nature or character of the claim as opposed to the form of the claim. This approach is consistent with equity claims decisions made prior to the 2009 amendments to the CCAA.[63]

In *Bul River Mineral Corporation (Re)*, the Court adopted the substantive approach in classifying the claim of a shareholder as an equity claim under the CCAA. In this case, the shareholders claimed the return of their capital investment under the redemption rights of their preferred shares and also sought unpaid dividends. While the shareholders conceded that their claim would typically fall under the definition of "equity claim" under the CCAA, the shareholders argued that their equity claim was transformed into a debt claim as a result of obtaining judgment prior to the initial CCAA order.[64]

Considering the Equity Claims Decision, the Court noted that classifying the shareholders' claim as other than an equity claim would diminish recovery for "true" debt claimants.[65] Such a finding would be inconsistent with the policy objectives of the CCAA. As a result, the Court rejected the shareholder's argument, stating:

> … it is of no importance that prior to the court filing, a claimant with an equity claim has obtained a judgment. That judgment still, in substance, reflects a recovery of that equity claim and therefore, the claim comes within the broad and expansive definition in the CCAA. Accordingly, for the purposes of the CCAA, that claim or judgment must still, of necessity, bear that characterization in terms of any recovery sought within this proceeding. I conclude that any contrary interpretation, such as advanced by the Prestons, would result in the clear policy objectives under the CCAA being defeated.[66]

Having regard to the Equity Claims Decision and the recent decision of *Bul River*, it will be important for counsel, prior to mediation, to assess the client's position in respect of the nature of the claim they are asserting in the CCAA proceedings.

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[62] *Labourers' Pension Fund of Central and Eastern Canada v Sino-Forest*, 2013 ONCA 456.

[63] *Blue Range Resources Corp (Re)*, 2000 ABQB 4, 259 AR 30; *Return on Innovation v Gandi Innovations*, 2011 ONSC 5018, [2011] OJ No 3827 (QL); *Dexior Financial Inc (Re)*, 2011 BCSC 348.

[64] *Bul River Mineral Corporation (Re)*, 2014 BCSC 1732 at paras 83-84 ("*Bul River*").

[65] *Ibid* at para 110.

[66] *Ibid* at para 115.

Furthermore, where a defendant's claim is multi-faceted, it is advisable to make a distinction between those claims which may arguably be tied to an equity claim (such as a claim for contribution and indemnity pursuant to tort-feasors legislation) and those separate and distinct from an equity claim (such as a claim for defence costs). Defence costs can be high. If there are few unsecured creditors then $2 to $3 million in defence costs may be sufficient to block a 66% majority vote of unsecured creditors required for approval of a plan.

ii. Release of Third Parties

As outlined in the Ernst & Young Decision, where a debtor company obtains CCAA protection, the policy objectives of the CCAA become paramount to any proposed settlement. As stated by Parla, Griffin et al:

> In balancing the rights of the putative plaintiff class and CCAA stakeholders, it is logical that the mandate of the CCAA should take precedence over the rights of class members. If class member opt-out rights were upheld, the purpose of the CCAA proceedings would be undermined as a restructuring cannot be accomplished without finally extinguishing liability to all creditors and potential creditors who exist up to the date of filing. In contrast, compromising the rights of the class members still leaves them with a reasonable, albeit reduced, remedy. They stand in no different a place than other creditors whose claims are also compromised. This result is balanced, even though E&Y as a third party was provided with a benefit that it would not otherwise be entitled to, namely, a final release with no risk of class member opt-outs.

In approving a settlement within the context of the CCAA, the court must apply the test as set out in *Robertson* and consider:

a. whether the settlement is fair and reasonable;

b. whether it provides substantial benefits to other stakeholders; and

c. whether it is consistent with the purposes and spirit of the CCAA.[67]

Further, where the settlement provides for a release of third parties, the Court must also consider the factors set out in *ATB*, being:

a. whether the claims to be released are rationally related to the purpose of the plan;

b. whether the claims to be released are necessary for the plan to succeed;

c. whether the parties who are being released are contributing in a tangible and realistic way; and

d. whether the plan will benefit the debtor company and creditors generally.[68]

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[67] *Robertson, supra* note 53 at para 22

[68] *ATB, supra* note 55 at para 70.

Thus, when acting on behalf of third parties it will always be beneficial to consider whether the CCAA may be used as a tool to obtain a release of claims relating to and arising from claims against the debtor company. For example, the directors' and officers' insurer or the auditor of the debtor company might consider whether they can likely be released from all related claims in all jurisdictions, and whether an order granting recognition of the settlement order is required in parallel foreign bankruptcy proceedings.

iii. Inability to Opt Out of Restructuring

In the course of a typical fairness hearing for settlement of a class action, the court may hear from class members and must consider whether the proposed settlement is in the best interests of the class. Further, the settlement, if approved, will only bind those class members who have not opted out of the proceeding.

However, the Ernst & Young Decision demonstrates that claims advanced in class proceedings can be compromised within the context of a CCAA settlement even where the settlement does not provide for opt-out rights to dissenting class members.[69] Specifically, once the defendant company is granted CCAA protection, the overriding question in considering any proposed settlement is not what is in the best interests of the class, but what is in the best interests of the debtor company and its creditors generally. Further, as equity claimants, class members will generally not be entitled to vote on a proposed plan. Practically speaking, the CCAA process may permit a plan which resolves class actions where the class action plaintiff votes on the plan and members cannot exercise their right, under class proceedings legislation, to opt out of the plan/settlement.

4. CONCLUSION

The Sino-Forest Decisions serve as excellent examples of how class members and defendants may be impacted by the application of the CCAA. Once a debtor company has been granted CCAA protection, the dynamics of settlement shift such that any proposed settlement is viewed through the lens of what is in the best interests of the corporation and stakeholders generally.

Thus, it will be important for parties to assess what claims they are able to assert and negotiate with the monitor and others having regard to the strength of those claims. For equity claimants who generally are not permitted to vote on a proposed plan, this may mean pursuing and establishing a Proof of Claim subject to a Claims Procedure Order in the hopes of receiving a small piece of the debtor's estate. For defendants such as auditors and underwriters, this may mean aggressively pursuing third party releases in exchange for contributing to a settlement. Overall, the CCAA provides a statutory environment where class action litigation may be resolved, albeit through the compromise of claims.

[69] Julie Parla, Sean Griffin et al, "Class Actions", online: Lexpert <http://www.lexpert.ca>.