AUGUST 2012

INSOLVENCY AND RESTRUCTURING BULLETIN

Borden Ladner Gervais

SINO FOREST-SUBORDINATION OF EQUITY INTERESTS AND COLLATERAL DAMAGE

On 27 July 2012, Justice Morawetz of the Ontario Superior Court of Justice (Commercial List) released reasons for decision in the Sino-Forest CCAA case concerning the scope and effect of the 2009 amendments to the CCAA that subordinate "equity claims" to all other claims and provide that under a CCAA plan, no payment can be made in respect of equity claims until all other claims are paid in full. The decision confirms that shareholder claims for loss in the value of their equity interest as a consequence of misrepresentation or other acts or omissions by the company constitute equity claims and are subordinate to all other claims. The decision also provides that where a shareholder has a claim against an underwriter or an auditor for loss in the value of their equity interest, any claim for contribution or indemnity by the underwriter or auditor against the debtor company is also an equity claim and likewise subordinated. This second aspect of the decision raises significant policy issues.

Subsection 6(8) of the CCAA provides that no compromise or arrangement that provides for the payment of an equity claim is to be sanctioned by the court unless it provides that all claims that are not equity claims are to be paid in full before the equity claim is to be paid. Section 22.1 of the CCAA provides that all equity claims are in the same class and have no right to vote.

The terms "equity claim" and "equity interest" are defined in the CCAA as follows:

> "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;

So, an equity claim includes a claim by a shareholder against a debtor company for a loss suffered on the purchase or sale of shares of the company. Therefore, in general, a shareholder claim against a company for a loss suffered as a consequence of buying or investing in shares will be and must be subordinated to all other claims against the company under any plan.

The definition of "equity claim" includes any claim for indemnity or contribution in respect of a claim by a shareholder for a loss suffered on the purchase or sale of shares of the debtor company. In the Sino-Forest case, shareholders of the debtor company had commenced proceedings against the debtor company, non-applicant affiliates of the debtor company, the auditors of the debtor company and underwriters who had acted in respect of the issuance of shares by the debtor company. In general terms, it appears that the claims asserted against the defendants included claims for a monetary loss resulting from the ownership, purchase or sale of an equity interest in the debtor company. The auditors and underwriters argued that their potential claims against the debtor company were not claims for indemnification or contribution, but separate and independent claims and causes of action.

They also argued that the reference to claims for indemnification or contribution should be restricted to claims by shareholders and not others.

Morawetz, J. concluded that, on a plain reading of the definitions of "equity claim" and "equity interest", they extended to third party claims for indemnification or contribution for losses suffered by shareholders arising from the purchase or sale of shares in a debtor company.

The CCAA was amended in 2009 to subordinate equity claims to all other claims. One of the rationales for the amendment was that shareholders should bear the risk of their investment and that they should not be able to off-load any part of that risk upon the ordinary creditors of a debtor company in CCAA proceedings. This seems a rational approach, but it raises at least two policy concerns. First, one may ask why the subordination of equity claims effected by the 2009 amendments is limited to plans of arrangement and does not extend to liquidating CCAAs (or bankruptcies or receiverships). There may be a reasonable answer to that. There is pre-amendment case authority for the proposition that shareholder equity claims are subordinate to ordinary creditor claims or are not provable at all. Second, it seems a fair question to ask why auditors, underwriters or others who may be similarly situated should face the risk of *in solidum* liability to shareholders in circumstances where Parliament has rendered their contribution or similar claims against the debtor company worthless. So-called gatekeepers have in the past argued for proportionate liability. Here, the result is potentially the reverse – allowing shareholders to seek recovery from third parties who in turn are deprived by statute of a claim for contribution against the debtor company. Some might say that this does not have much to do with forcing shareholders to bear risk but about transferring risk to third parties.

AUTHOR

Michael MacNaughton | 416.367.6646 | mmacnaughton@blg.com

INSOLVENCY AND RESTRUCTURING GROUP

National Leaders

Patrick T. McCarthy Q.C.	Calgary	403.232.9441	pmccarthy@blg.com
Michael MacNaughton	Toronto	416.367.6646	mmacnaughton@blg.com

Regional Leaders

Patrick T. McCarthy Q.C	Calgary	403.232.9441	pmccarthy@blg.com
Marc Duchesne	Montréal	514.954.3102	mduchesne@blg.com
John O'Toole	Ottawa	613.787.3722	jotoole@blg.com
Michael MacNaughton	Toronto	416.367.6646	mmacnaughton@blg.com
Geoffrey Thompson	Vancouver	604.640.4151	gthompson@blg.com

Borden Ladner Gervais

BORDEN LADNER GERVAIS
LAWYERS | PATENT & TRADE-MARK AGENTS

Calgary
Centennial Place, East Tower
1900, 520 – 3rd Ave S W
Calgary, AB, Canada T2P 0R3
T 403.232.9500
F 403.266.1395
blg.com

Toronto
Scotia Plaza, 40 King St W
Toronto, ON, Canada M5H 3Y4
T 416.367.6000
F 416.367.6749
blg.com

Montréal
1000, rue De La Gauchetière Ouest
Suite 900
Montréal, QC, Canada H3B 5H4
Tél. 514.879.1212
Téléc. 514.954.1905
blg.com

Vancouver
1200 Waterfront Centre
200 Burrard St, P.O. Box 48600
Vancouver, BC, Canada V7X 1T2
T 604.687.5744
F 604.687.1415
blg.com

Ottawa
World Exchange Plaza
100 Queen St, Suite 1100
Ottawa, ON, Canada K1P 1J9
T 613.237.5160
F 613.230.8842 (Legal)
F 613.787.3558 (IP)
ipinfo@blg.com (IP)
blg.com

Waterloo Region
Waterloo City Centre
100 Regina St S, Suite 220
Waterloo, ON, Canada N2J 4P9
T 519.579.5600
F 519.579.2725
F 519.741.9149 (IP)
blg.com