

The Standard of Appellate Review for Standard Form Contracts versus CCAA Plans – *SFC Litigation Trust v. Chan*, 2019 ONCA 525

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The SFC Story

Allen Chan was the co-founder, chief executive officer and chairman of the board of directors of Sino-Forest Corporation (“SFC”). Between 2003 and 2011, SFC’s consolidated financial statements reported rapid growth, including in assets and revenues. Approximately \$2.99 billion was attributed to SFC’s asset of “BVI standing timber”. Sales of BVI standing timber in 2010 were reported to be approximately \$1.3 billion. SFC was able to raise \$3 billion in the debt and equity markets on account of its representation of the significant value of the BVI standing timber asset.

In 2011, a report by a short seller’s research company alleged that SFC did not hold anything close to the amount of timber assets reported on its financial statements. From there, the SFC story unravelled. Because SFC was unable to confirm ownership of the BVI standing timber, SFC advised that the prior years’ financial statements should not be relied upon. The Ontario Securities Commission ordered that trading in SFC securities stop. SFC defaulted on its debt obligations. As a result of the financial troubles, a number of class actions were commenced against SFC and its directors, auditors, underwriters and consultants.

On March 30, 2012, SFC obtained insolvency protection under the *Companies’ Creditors Arrangement Act* (“CCAA”) and in December of that year, the Superior Court sanctioned SFC’s CCAA Plan of Compromise and Reorganization (“Plan”). Under the Plan, SFC’s assets were transferred to creditor-controlled entities, which were formed for the purpose of holding SFC’s assets and realizing on them to achieve recoveries for SFC’s creditors, and SFC’s causes of action were transferred to the SFC Litigation Trust (“Litigation Trust”). In exchange, SFC’s creditors released their claims for repayment of debts owed to them by the company. The total recoveries from the sale of the assets by EPHL was \$438.5 million.

The Litigation Trustee’s Action Against Allen Chan

In 2014, the trustee of the Litigation Trust sued Mr. Chan alleging fraud and breach of fiduciary duties, among other things. After a lengthy trial, Justice Michael Penny found that Mr. Chan had directed a massive fraud in breach of his fiduciary duties to SFC, thereby causing SFC to misrepresent its assets and their value. But for Mr. Chan’s fraud, SFC would not have undertaken the obligations it did. The trial judge awarded \$2.6 billion in damages (equal to what he found to be SFC’s loss) and \$5 million in punitive damages against Mr. Chan.

The Appeal

On appeal, Mr. Chan advanced a number of arguments, including the following:

1. The Litigation Trustee was only entitled to make claims that were transferred to the Litigation Trust under the Plan, and this claim against Mr. Chan was not transferred to the Litigation Trust.
2. The damages award was flawed because the trial judge did not conduct a proper causation analysis and awarded compensation for losses not of SFC, but of its stakeholders. Therefore, the trial decision improperly exposed Mr. Chan to duplicate claims, thereby creating a risk of double recovery.
3. The doctrine of election prevented the Litigation Trustee's claim in that when SFC transferred the assets, contracts and businesses of its subsidiaries as contemplated by the Plan, there was an election to treat them as valid.

All grounds were held to be devoid of merit. The appeal was dismissed.

In respect of the first ground of appeal, that the Litigation Trustee was only entitled to make claims that were transferred to the Litigation Trust under the Plan, Mr. Chan relied on the following three arguments that center around the detail of what the Plan actually said: (1) the claims are the same as, or overlap with, the claims asserted in the class actions – which were not transferred to the Litigation Trust; (2) the claims constitute “excluded litigation trust claims” which were excepted from the transfer of claims to the Litigation Trust; (3) the claims constitute intercompany claims that were assigned to a creditor-controlled entity and not to the Litigation Trust.

Because Mr. Chan's three arguments were based on the “*meaning* of the Plan”, the Court reviewed the principles of contractual interpretation, which are applicable to a CCAA plan.

Mr. Chan argued that the standard of appellate review that should apply to the issue of whether the claim fell into a permissible claim that the Trustee could pursue was correctness. A correctness standard of appellate review applies to contractual interpretation where consistency of meaning is a primary concern and where there is no meaningful factual matrix to consider. As held by the Supreme Court of Canada in *Ledcor Construction Ltd. v. Northbridge Indemnity Insurance Co.*, 2016 SCC 37, a correctness standard is applicable to the interpretation of certain standard form contracts. This is because of the precedential value in the interpretation of the terms contained in a standard form contract. Contracts that are not “standard form” have no precedential value and, therefore, their interpretation raises questions of mixed fact and law, thereby allowing a deferential standard of appellate review (i.e., palpable and overriding error).

While acknowledging that CCAA plans often use language borrowed from other plans, giving rise to consistency concerns, the Court of Appeal concluded that a deferential standard of review should apply. It stated the following:

CCAA plans are developed to fit the unique circumstances of each restructuring. The overall purpose and intention of the individual plan are important determinants of its interpretation, to be considered against the backdrop of the factual aspects of the restructuring and the events that led up to it. The types of considerations that will go into a plan's interpretation will usually be fact and context-specific and the factual matrix will accordingly be important. The questions which arise in the interpretation of a plan will almost always be mixed questions of law and fact. All of this supports a deferential standard of appellate review, one that accords with the standard applicable generally to a trial judge's interpretation of a contract.

What did this mean for Mr. Chan? Mr. Chan had to contend with the facts and particularly the allegations leading up to the creation of the Plan that he was involved in a fraud. In the result, the deference given allowed for a Plan interpretation that the causes of action brought by the Trustee were permissible under the Plan.

Recall that the Plan was sanctioned by the Court and if the Litigation Trustee were not able to pursue a fraud claim against Mr. Chan, then someone would have made an error equating to unfairness to victims of the fraud. Justice has to be done.

It will be interesting to see whether leave to appeal to the Supreme Court of Canada will be sought and, if so, whether it will be

granted. Certainly, logic dictates that there must be facts specific to any CCAA plan, but where is the line drawn between such a scenario and a standard form contract that similarly imports fact-specific information into a standard form contract? What about the form of CCAA plans that, on a practical level, are often similar in format? How does the court reconcile this practical reality with the facts of this case? Perhaps these are questions that the Supreme Court can answer, as a first step, with a simple “yea” or “nay” to an application for leave to appeal.

Stay tuned.

The information and comments herein are for the general information of the reader and are not intended as advice or opinion to be relied upon in relation to any particular circumstances. For particular application of the law to specific situations, the reader should seek professional advice.

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