

Securities Class Action Services, LLC

Case Brief

Sino-Forest and Asset Recovery in Canada

Report Author

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Introduction

Over the past summer and fall newswires have been buzzing around claims of fraudulent financial representations allegedly made by the Canadian corporate giant Sino-Forest Corporation. The allegations and subsequent investigations have resulted in substantial drops in stock price and the suspension of trading for the company along with a peppering of class action claims filed in the Ontario Superior Court and the Superior Court of Quebec. With a global scope and a 2010 market capitalization of CAN\$5.7 billion, the Sino-Forest case has the potential to be a significant milestone in Canadian securities class actions and asset recovery.

Background

Sino-Forest Corporation is a commercial forest plantation and wood-product company with executive offices in Mississauga, Canada and in Hong Kong, China. Prior to the summer of 2011, it was the largest forestry company listed on the TSX.

The trouble for Sino-Forest began in June 2011 when short-seller, Carson Block, and his investment firm, Muddy Waters, LLC, published a 39 page report charging Sino-Forest with drastically overstating its holdings and defrauding the public. In the week following the report Sino-Forest's TSX stock plummeted by over 70%. Just six days after the report was published, the law firm of Rochon Genova LLP filed a shareholder class action against Sino-Forest in the Ontario Superior Court seeking certification of a global shareholder class. The following day the law firm of Siskinds, Desmuelles filed another shareholder action in the Superior Court of Quebec. On June 30th, that same day, the law firm of Koskie Minsky LLP [partnering with Siskinds LLP], issued a notice of shareholder action against Sino-Forest.

From the start of the controversy in June, Sino-Forest rejected the allegations of fraud. It launched an independent investigation by PricewaterhouseCoopers (PwC) costing an estimated \$35 million. On August 15th, Sino-Forest announced the results of the probe in a 43 page report. Buried deep in the report PwC noted that it could not verify that Sino-Forest actually owned all its forests in China, and was barred from seeing databases and other information sources.

On August 26th, the Ontario Securities Commission suspended trading of the TSX shares of Sino-Forest, stating that the company had en-

gaged in practices they "knew or should have known" were fraudulent. On September 26th, 2011, the law firm of Kim Orr Barristers P.C. filed a statement of claim with the Ontario Superior Court alleging securities fraud and seeking certification of a global shareholder class. On January 6, 2012, the Ontario Superior Court granted lead plaintiff status in the Sino-Forest case to Koskie Minsky and Siskinds kinds.

What to Watch in this Case

Investors should look to Sino-Forest as a very real opportunity for asset recovery given the significant involvement by the Ontario Securities Commission, the highly public nature of the alleged scandal, and the large institutions who have joined the suit. For example, Koskie Minsky LLP has submitted claims on behalf of both the Labourers' Pension Fund of Central and Eastern Canada and the International Union of Operating Engineers Local 793 Pension Plan for Operating Engineers in Ontario. Kim Orr Barristers claims boast The British Columbia Investment Management Corp. (bcIMC), British Columbia's biggest public sector pension manager. Kim Orr Barristers seeks CAN\$5.3 billion in damages and CAN\$500 million in punitive damages from Sino-Forest for losses incurred by shareholders who purchased shares from August 17, 2004 through June 2, 2011.

Investors, however, should be aware of caps on claims that could affect the case's ultimate settlement value. As a result of the "Bill 198" amendments enacted in Ontario in 2005, all three jurisdictions now have damages caps on statutory claims. These caps could potentially limit the settlement fund or judgment award in the Sino-Forest case. For example, the Ontario Securities Act limits liability for issuers to the greater of \$1 million or 5% of market capitalization.

Encouragingly, however, although damages for statutory claims are capped, damages for common law claims, which are asserted in the Sino-Forest case by all firms, are not. While they may be more difficult to prove, such claims could potentially increase a settlement payout or judgment award beyond statutory limits. Regardless, a settlement in Sino-Forest, even one with a statutory cap, is likely to produce a substantial settlement fund for shareholder recovery.

Expanding Asset Recovery Opportunities in Canada

While the Sino-Forest case represents yet another opportunity for shareholder recovery of market losses, the case is also illustrative of the expansion of securities class actions in Canadian courts. According to the ISS' Securities Class Action Services database, the number of outstanding securities class action lawsuits in Canadian courts reached an all-time high in 2010 and 2011. There were a total of eight new securities class action lawsuits filed in Canada in 2010 and eleven such cases filed in 2011. At the close of 2011 there were 21 Canadian securities class action settlements pending cash disbursement representing over \$83 million in settlement funds waiting for disbursement to investors.

Sino-Forest may also help to expand global securities class actions in Canada, especially in the wake of the U.S. Supreme Court decision in *Morrison v. NAB*. Following *Morrison*, it is unlikely that U.S. federal courts will entertain global securities class actions any time in the near future. However, the Ontario Securities Act allows actions against "responsible issuers," which includes a reporting issuer or "any other issuer with a real and substantial connection to

Ontario, any securities of which are publicly traded."

In a seminal case against IMAX decided in 2009, Ontario Superior court Justice van Rensburg applied this provision to certify Canada's first global class under the new law. The class included both plaintiffs who had bought their IMAX shares on the TSX as well as those who had bought their shares on the NASDAQ. While the precedential value of the IMAX case has not yet been fully established, the case against Sino-Forest will likely include investors within the class that purchased their shares in the U.S. This will undoubtedly raise the question of whether the ruling in IMAX will stand as precedent for certifying the global class in Sino-Forest. If it is so applied, Sino-Forest could propel Canada closer to replacing the U.S. as the safe harbor for global securities class actions.

The introduction of global securities class actions in Canada as well as the general trend of increasing class action activity indicates that Canada is a significant market for shareholder asset recovery. ISS' Securities Class Action Services will continue to monitor the Sino-Forest case and other developments in the Canadian provinces as Canada's class action system continues to evolve.

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