

**ONTARIO
SUPERIOR COURT OF JUSTICE**

*Cosimo Borrelli, in his capacity as trustee of the
SFC LITIGATION TRUST*

Plaintiff

- and -

ALLEN TAK YUEN CHAN

Defendant

STATEMENT OF CLAIM

Notice of Action issued on March 31, 2014

1. The plaintiff, Cosimo Borrelli, claims in the capacity of a representative and/or trustee (the "**Trustee**") of the Sino-Forest Corporation ("**SFC**") Litigation Trust pursuant to a Litigation Trust Agreement dated January 30, 2013 (the "**Trust Agreement**") and pursuant to a plan of compromise and reorganization (the "**CCAA Plan**") and an Order of the Ontario Superior Court of Justice (Commercial List) (the "**CCAA Court**") dated December 10, 2012 (the "**CCAA Plan Sanction Order**"):

- a. damages in the amount of CAD\$3 billion for losses suffered as a result of breach of contract, negligence, breach of duty (contractual, tortious, equitable, fiduciary, statutory, regulatory and/or other duties) including as a knowing recipient and/or a

- knowing assistor or director, officer or agent, misrepresentation, conspiracy, breach of trust, fraud, oppression, and unjust enrichment of the defendant;
- b. punitive damages in the amount to be specified prior to trial;
 - c. an order for an accounting of profit and tracing of profits made by the defendant, either directly or indirectly, in connection with his relationship with SFC;
 - d. an order for restitution and/or such other equitable remedy for the breaches of duties and other tortious conduct referred to in subparagraph 1(a);
 - e. an order pursuant to subsection 120(8) of the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44 (i) (the "**CBCA**") setting aside any and all transactions that SFC or its subsidiaries entered into with counterparties with which Chan has or had any interest; and / or (ii) ordering the defendant to account to the plaintiff for any profit or gain realized upon such transactions;
 - f. a declaration that the defendant breached section 241 of the CBCA, by carrying on the business or affairs of SFC in a manner that was oppressive or unfairly prejudicial or that unfairly disregarded the interests of SFC, its security holders, creditors and directors;
 - g. a declaration that SFC is a proper person to make an application under section 241 of the CBCA pursuant to subsection 238(d) of the CBCA;
 - h. pre-judgment and post-judgment interest on a compound basis or alternatively in accordance with the *Courts of Justice Act*, R.S.O. 1990, c. C-34;

- i. payment of applicable Harmonized Sales Tax on any sums awarded in favour of the plaintiff, including costs;
- j. costs of this action on a substantial indemnity scale; and
- k. such further and other relief as this Honourable Court deems just.

2. The claims asserted herein relate to the defendant's activities as an officer and a director of SFC and its subsidiaries and are claims that belonged to and could have been advanced by SFC, prior to those claims being transferred pursuant to the CCAA Plan as described below. The claims asserted herein are not claims of the trustees (on behalf of the former noteholders of SFC (the "**Noteholders**")) in connection with the notes issued by SFC (the "**Notes**"), such claims also having been transferred to the Trustee pursuant to the CCAA Plan.

3. Unless otherwise stated, all monetary amounts contained herein are expressed in US Dollars.

I. OVERVIEW

4. Until June 2011, SFC was one of Canada's most valuable forestry companies, and the largest single forestry company throughout the People's Republic of China (the "**PRC**"). Ultimately, the company's market capitalization grew to \$6 billion, based in large part on SFC's significant year-over-year growth.

5. SFC's story came to a dramatic conclusion in the summer of 2011. A short seller hedge fund, alone or in concert with other similar hedge funds, published a report in June of 2011 that contained serious allegations of fraud, corruption, and illegal activity at SFC. The report alleged, among other things, that SFC was a "multi-billion dollar ponzi scheme ... accompanied by

substantial theft."

6. SFC, through the work of an independent committee (the "**IC**") and a dedicated board of directors, sought to investigate and if possible dispute the allegations made by the short sellers. At the same time, SFC was required to respond to investigations brought by the Ontario Securities Commission (the "**OSC**") and the Royal Canadian Mounted Police, and ultimately proceedings brought by the OSC.

7. The defendant, Allen Tak Yuen Chan ("**Chan**"), and other members of SFC's senior management under his control, intentionally frustrated the investigative efforts of the IC and the financial and legal advisors conducting the investigation, providing false explanations to a number of the questions that had been raised by the hedge funds' report, the IC and the IC Advisors, SFC shareholders, SFC's auditors, Ernst & Young ("**E&Y**"), the OSC, and others.

8. Unable to obtain adequate, verifiable, and / or plausible explanations to the many questions that had been raised, SFC was ultimately unable to issue its third quarter 2011 financial statements. In March 2012, SFC filed for protection under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (the "**CCAA**"). After canvassing the market, SFC determined that it was unable to find a buyer willing to purchase its assets for an amount equal to its outstanding debt. Pursuant to the CCAA Plan Sanction Order, SFC's assets were effectively transferred to its creditors, with roughly \$6 billion in equity value having been wiped out.

9. Chan and certain other members of senior management including George Ho ("**Ho**"), Albert Ip ("**Ip**"), Alfred C.T. Hung ("**Hung**") and Simon Yeung ("**Yeung**") that reported to Chan (Ho, Ip, Hung and Yeung collectively being referred to as the "**Inside Management**") are responsible for the demise of SFC. Through a combination of activities that ran the gamut ranging from sloppy record keeping and general mismanagement, through to outright fraud and

theft, Chan used Inside Management, and other members of Hong Kong and China-based management, to cause SFC to materially overstate the value of SFC's revenues and assets and to conceal personal profits made in connection therewith. Among other things, Inside Management (acting on Chan's instructions and with his authorization, knowledge and acquiescence) and Chan:

- had operational and *de facto* control over allegedly arms-length purchasers of SFC's timber known as "authorized intermediaries" ("**AIs**") and the Suppliers of that timber ("**Suppliers**"), which control had not been disclosed to SFC, its auditors, or its directors;
- knew that certain of SFC's AIs and Suppliers were incapable of performing the obligations required of them by their contracts with SFC and/ or its subsidiaries (the "**Subsidiaries**", and collectively with SFC, "**Sino-Forest**");
- withheld and/or hid information from SFC's auditors;
- caused SFC to significantly overpay for assets sold by companies Chan secretly controlled;
- prepared, certified and/or published false or materially misleading financial statements (including interim financial statements) and public disclosure documents of SFC;
- concealed their unlawful activities from SFC through the use of personal non-company e-mail accounts and by issuing instructions to hide certain transactions from Sino Forest's accounting department in Hong Kong;
- forged Sino-Forest contracts to evade restrictions imposed by China's State

Administration of Foreign Exchange ("**SAFE**") and/or to establish banking credit that would not have otherwise been provided to Sino-Forest;

- entered into transactions that evidenced circular flows of funds created for unknown and improper purposes, the particulars of which are known only to Chan;
- manipulated short-term incentive program targets for SFC for the 2008 fiscal year, resulting in the payment of management bonuses beyond those properly due;
- entered into a number of transactions including transactions identified by the OSC that were suspicious if not outright fraudulent;
- failed to maintain SFC's records in a manner that would be expected of a publicly traded company, including by carrying out a practice of backdating contracts;
- caused moneys to be paid out by SFC and/or the Subsidiaries for no proper purpose; and
- prepared and/or published false information in connection with the debt or equity issues set out in Schedule A to this claim.

10. Chan participated in, authorized, had knowledge of or acquiesced in all actions conducted by Inside Management and the plaintiff claims against Chan for all losses and damages, equitable compensation and restitution necessary to compensate SFC for the losses caused in connection with or arising out of Chan's and Inside Management's wrongful acts or omissions in the direction and/or management of and/or dealings of SFC and/or its Subsidiaries.

II. THE PARTIES

11. The plaintiff, Cosimo Borrelli, is an individual resident in Hong Kong. Pursuant to the Trust Agreement, Mr. Borrelli was appointed as the Trustee of the SFC Litigation Trust.

12. Under the Trust Agreement and the CCAA Plan Sanction Order, the Litigation Trust Assets (as defined therein) of SFC, which included the Litigation Trust Claims (as defined therein), the Litigation Funding Amount (as defined therein), and any other assets acquired by the Litigation Trust on or after the effective date pursuant to the Trust Agreement or the CCAA Plan, were transferred to the SFC Litigation Trust.

13. The Litigation Trust Claims consist of any and all claims or causes of action which have been or may be asserted by or on behalf of (a) SFC against any and all third parties; or (b) the trustees (on behalf of the former noteholders in SFC) against any and all persons in connection with the notes issued by SFC, other than in either case (i) any claim, right or cause of action against any person that is released pursuant to Article 7 of the CCAA Plan; or (ii) any Excluded Litigation Trust Claim (as defined in the CCAA Plan).

14. Under the CCAA Plan Sanction Order, the CCAA Court ruled that there had been good and sufficient notice and service of the Plan Filing and Meeting Order and the Meeting Materials (as defined therein), which materials described the nature of the trust assets being transferred. The CCAA Plan Sanction Order further deemed effective the transfer, assignment and delivery of the Litigation Trust Claims, which were effected by means of legal assignment and transfer of the litigation claims asserted herein.

15. At all relevant times, SFC was a reporting issuer in the province of Ontario whose shares traded on the Toronto Stock Exchange (the "TSX"). SFC was a CBCA corporation. At all

relevant times, SFC's registered office was located in Mississauga Ontario, and its executive office was located in Hong Kong.

16. The defendant Chan is an individual resident of Hong Kong. From August 3, 2001 to August 28, 2011, Chan was the Chairman of the Board and Chief Executive Officer of SFC. At all material times, Chan was a director and an officer of SFC. Among other things, Chan certified that the June 2007 and December 2009 Prospectuses issued by SFC were accurate and that all material facts relating to the securities offered had been disclosed. Chan voluntarily resigned as Chairman, CEO and Director of SFC on August 28, 2011, and resigned as Founding Chairman Emeritus following notice that SFC had uncovered documents that ultimately led the OSC to cease trading SFC's securities.

17. Chan was named in an OSC Statement of Allegations in 2012 in relation to his involvement in the alleged massive fraud at SFC. Along with Inside Management, Chan was alleged by Staff of the OSC to have engaged in a complex fraudulent scheme to inflate the assets and revenue of SFC and was alleged to have made materially misleading statements in SFC's public disclosure record related to its primary business.

III. OVERVIEW OF SINO-FOREST'S BUSINESS

A. General

18. SFC held itself out as an integrated forest plantation operator and forest products company, with assets stated to be predominantly in the PRC. Its stated principal businesses included the ownership and management of forest plantation trees, the sale of standing timber, wood logs and wood products and the complementary manufacturing of downstream engineered-wood products.

19. In addition, SFC held an indirect majority interest in the Greenheart Group, a Hong Kong listed investment holding company, which, together with its subsidiaries, owned certain rights and managed hardwood forest concessions in the Republic of Suriname and pine plantation on freehold land in New Zealand.

20. As of March 30, 2011, a total of 137 entities made up the Sino-Forest group of companies: 67 PRC incorporated entities (with 12 branch companies), 58 BVI incorporated entities, 7 Hong Kong incorporated entities, 2 Canadian entities and 3 entities incorporated in other jurisdictions. Chan was the architect of this labyrinthian and unnecessarily complicated structure.

B. The Business Model

21. There are four types of rights associated with timber plantations in the PRC, namely (i) plantation land ownership, (ii) plantation land use rights, (iii) timber ownership, and (iv) timber use rights. All of these are separate rights and can be separately owned by different parties.

22. Generally, private enterprises cannot own plantation land in the PRC but may hold plantation land use rights for a specified duration (up to 70 years but typically 30 to 50 years), timber ownership and timber use rights. Foreign enterprises are not prohibited by law from acquiring timber ownership and timber use rights.

23. For its timber business in the PRC, SFC utilized two models, one involving BVI entities ("BVIs"), and the other involving subsidiaries incorporated in the PRC as wholly foreign owned enterprises ("WFOEs").

24. The BVI structure was the model primarily used by Sino-Forest for its forestry business in the PRC. By 2011, SFC had established 58 BVI companies. Not all of these BVIs were

involved in the BVI model or standing timber business. Of the 58, there were 20 involved in the BVI standing timber business while the remaining BVIs were either holding companies or used in Sino-Forest's log trading business.

25. Chan and Inside Management caused SFC to publicly state that the BVIs involved in the standing timber business acquired standing timber from Suppliers. The Suppliers were supposed to be third party aggregators who acquired the standing timber and land use rights from other Suppliers or from original timber owners. As non-PRC companies, the BVIs could not and did not acquire land use rights in the PRC, and instead only acquired the rights to timber in the PRC pursuant to the relevant standing timber purchase contracts.

26. The BVI model did not involve the BVIs concurrently acquiring the plantation land use rights or leases of the underlying plantation land with the purchase of standing timber, as the BVIs cannot legally acquire plantation use rights. However, the BVIs' supply contracts typically contained a right of first refusal for the BVIs to acquire, or nominate an affiliate to acquire, the plantation land use rights after the timber had been harvested.

27. The BVIs did not sell standing timber directly to customers. Instead, they conducted the sale of standing timber through AIs (which are also called "entrusted sales agents" in the BVI model) pursuant to "entrusted sales agreements". The AIs served as Sino-Forest's customers under the BVI model of its standing timber business.

28. The BVIs did not directly pay the Suppliers or receive payments from the AIs. Instead, the AIs were purportedly instructed by Chan and Inside Management to make "set-off payments". Pursuant to the instructions of Sino-Forest, AIs were supposed to make payments directly or indirectly to Suppliers for amounts owed by the BVIs to those Suppliers. As a result, no cash actually flowed directly through the BVIs. Sino-Forest was then to receive

confirmations from the AIs and Suppliers confirming that payments had been made and received respectively.

29. The nature of the BVI model meant that SFC could not obtain cash from its BVI model operations or monetize its BVI model assets without engaging in a complicated and uncertain process.

30. The BVI model only made sense at all insofar as the AIs and Suppliers were arm's length third party purchasers or vendors. Absent that arm's length, the Board and SFC's auditors could have no assurance of the legitimacy of the BVI transactions, as opposed to simply being composed of circular paper transactions for the benefit of insiders.

31. The WFOE structure was created in or about 2004. Commencing in 2004, the PRC's Ministry of Commerce permitted foreign investors to invest in PRC-incorporated trading companies and to participate in most areas of the commodity distribution industry, including the purchase of standing timber and land use rights throughout the PRC. Prior to this time, WFOEs were prohibited from engaging in the commodity distribution industry.

32. Unlike BVIs, WFOEs could acquire land use rights or land leases as well as standing timber rights, and could have bank accounts in the PRC. Because of the WFOEs' direct presence in the PRC, they could more readily obtain financing from PRC banks to finance their operations. WFOEs could log the timber and sell both logs and standing timber to end customers, which means they did not need to use AIs. The WFOEs purportedly directly paid the Suppliers for the standing timber and directly received payment from end customers instead of utilizing the set-off arrangement used by SFC's BVI entities in the BVI model.

C. SFC's Remarkable Growth

33. The BVI model was stated to be the main revenue and asset driver for SFC from 2006-2010. As of December 31, 2010, the reported book value of SFC's BVI timber assets was \$2.476 billion and the reported book value of the WFOE standing timber assets was \$298.6 million.

34. Purportedly based in large part upon the success of the BVI model, as of December 31, 2010, SFC reported annual revenues in excess of \$1.9 billion, a book value in excess of \$3.1 billion, an annual net income of \$395 million, and 799,700 hectares of timber plantations under management. SFC's 2010 reported revenues were four times its reported revenues in 2005 and double its reported revenues in 2008. Its December 31, 2010 book value was more than six times its book value as of December 31, 2005 and more than double its December 31, 2008 book value. Its reported net income for 2010 was nearly five times that reported in 2005 and 73% more than the 2008 reported net income.

35. By all accounts, the story of SFC's growth was truly remarkable. Based in large part upon this "success", SFC raised in excess of US\$2.1 billion and CDN \$800 million in Canada's debt and capital markets between 2007 and 2010. As of December 31, 2010, SFC had a TSX market cap of \$5.723 billion.

D. Chan Generously Compensated For SFC's Reported Success

36. Based upon Chan's representations that his relationships were critical for SFC's remarkable success, Chan was compensated generously. Despite serving effectively the same function for SFC for nearly 13 years, Chan's compensation spiked near the end of his tenure.

37. After receiving less than CAD\$100,000 in total annual compensation from 1998 through 2003, Chan's total reported annual compensation package increased from \$191,700 in 2004 to \$9,302,635 (including a \$7,000,000 non-equity bonus) in 2010. This spike in Chan's

compensation coincides with the introduction of the BVI model and SFC's increased reliance on Chan's relationships in the PRC. From 2005 to 2010, Chan's total reported compensation from SFC exceeded \$31.5 million (including in excess of \$17.5 in non-equity bonuses in his final three years).

38. Some or all of Chan's reported compensation was paid to Win Fair Holdings Group Limited ("**Win Fair**"), a company controlled by Chan. From 1995 to 2010, Sino-Forest paid Win Fair at least \$89 million, only a portion of which was attributable to Chan's reported compensation.

E. Despite Success, SFC Vulnerable to Chan's Consolidation of Control

39. Given the purportedly profitable nature of the BVI model, both SFC's auditor, E&Y, and its board of directors (the "**Board**") asked Chan on a number of occasions why SFC was the only forestry operator employing this incredibly successful model in the PRC. Chan repeatedly provided the same explanation: the BVI model was entirely dependent on the unique relationships and contacts that he and his team had within the PRC with AIs and Suppliers.

40. While trumpeting the value of his relationships with AIs and Suppliers, Chan consistently insisted that it was critical that the identity of Sino-Forest's AIs and Suppliers never be publicly disclosed and that maintaining the secrecy of the AIs and Suppliers was SFC's competitive advantage in the PRC.

41. Chan used the purported value of his relationships in the PRC to control the hiring process of a number of senior management, insisting that only "his people" had the requisite relationships to succeed. This resulted in Sino-Forest's dependence on Chan and Inside Management to maintain customer relationships, negotiate and finalize the purchase and sale of plantation fibre contracts and settle accounts receivable and accounts payable associated with

plantation fibre contracts.

42. As of 2006, this concentration of authority or lack of segregation of duties was identified as a "control weakness" in SFC's disclosure controls and procedures and internal controls over financial reporting resulting in the conclusion that such controls and procedures were "ineffective". This increased the risk of having a small number of senior management carry out a large scale fraud at the company's expense.

43. Despite the best efforts of the Board and E&Y, Chan regularly thwarted efforts to add additional outsiders to senior management and continuously insisted that only his people were able to perform the roles required by the unique business model that he had designed. Moreover, Chan continuously delayed retaining an outside independent firm to help with SFC's internal control documentation for its PRC subsidiaries.

44. While the Board and E&Y continued to pressure Chan to address the segregation of duties weakness in SFC's internal controls, Chan personally executed every purchase or sale agreement for standing timber to purportedly ensure the validity and reliability of every transaction. This meant that the legitimacy of Sino-Forest's business was largely dependent on Chan's integrity, honesty and ability to implement and manage the business model that he had purportedly designed to capitalize on his unique relationships within the PRC.

45. In addition to increasing the risk of a large-scale fraud, Chan's resistance to expanding Sino-Forest's management team resulted in his making hiring and retention decisions based upon individuals' loyalty to Chan as opposed to their honesty, integrity or competence. This misguided hiring and retention strategy led to a management team that was ill-equipped and incapable of properly managing a business as large and complicated as Sino-Forest's. Examples of Sino-Forest's ineffective management include:

- the use of operational and administration systems that were unsophisticated given the size and complexity of Sino-Forest's business; including:
 - (i) incomplete and inadequate record creation and retention practices;
 - (ii) critical contracts were not maintained in a central location;
 - (iii) significant volumes of critical electronic data was maintained across multiple locations on decentralized servers;
 - (iv) data on some servers in the PRC was deleted on an irregular basis, without a back-up system;
 - (v) a lack of an integrated accounting system meaning that accounting data was not maintained on a single, consolidated application;
 - (vi) a lack of proper centralized human resource records;
 - (vii) a lack of a centralized treasury function that was actively involved in the control or management of hundreds of local bank accounts;
- unorganized and inadequate sharing of information between the various Subsidiaries and departments within Sino-Forest;
- SFC personnel conducted company affairs using personal devices and non-corporate email addresses which were shared across selected groups of staff and changed on a periodic basis; and
- senior members of management lacked the requisite qualifications for the positions they held. As one illustrative example, the head of SFC's legal

department was not a lawyer and had never been qualified to practice law in any jurisdiction in the world.

46. Despite this mismanagement of Sino Forest's business operations, Chan resisted the introduction of any "outsiders" to his senior management team until the very end.

VII. THE DEMISE OF SINO-FOREST

A. Muddy Waters Report and the IC Investigation

47. On June 2, 2011, a short seller of SFC, Carson Block and his "research" company, Muddy Waters LLC ("**Muddy Waters**"), released an incendiary report (the "**Muddy Waters Report**"). The Muddy Waters Report alleged that SFC committed several frauds and described SFC as a "multi-billion dollar ponzi scheme ... accompanied by substantial theft."

48. Among other things, the Muddy Waters Report alleged that SFC did not hold the full amount of timber assets that it reported, that the timber assets actually held by SFC had been overstated, and that SFC overstated its revenue. In addition, the Muddy Waters Report alleged that SFC had engaged in undisclosed related-party transactions. In particular, both the Muddy Waters Report and two subsequent reports released by Muddy Waters alleged that Huaihua City Yuda Wood Limited ("**Yuda Wood**"), SFC's largest Supplier of standing timber between 2007 and 2010, was secretly controlled by SFC insiders.

49. The same day that the Muddy Waters Report was released, SFC's Board appointed the IC to investigate the allegations made in the Muddy Waters Report. The IC was composed of three independent, outside Canadian directors of SFC. The IC, in turn, retained independent legal and financial advisors in Canada, Hong Kong and the PRC, to investigate the issues raised in the Muddy Waters Report.

50. The scope of the IC's review was significant, reflecting the wide range of allegations contained in the Muddy Waters Report. The IC and its advisors worked to compile and analyze the vast amount of data required for their comprehensive review of Sino-Forest's operations and business, the relationships between SFC and other entities, and SFC's ownership of assets.

B. Regulatory Investigations

51. The Muddy Waters Report and the investigations arising therefrom had a ripple effect in causing substantial damage to SFC. As part of the fallout from the Muddy Waters Report, (i) SFC was sued in multiple class action proceedings across Canada and in the U.S., and (ii) SFC was the subject of an OSC investigation and was named in an OSC statement of allegations.

52. SFC attempted to cooperate with the OSC investigation and made extensive production of documents including documents sourced from jurisdictions outside of the OSC's power to compel production. SFC also facilitated interviews by the OSC with SFC personnel. In circumstances where OSC staff sought to examine SFC personnel resident in the PRC, SFC arranged to bring individuals to Hong Kong to be examined.

C. The IC Investigation

53. From the outset of their investigation, the IC Advisors sought the full cooperation and support of Chan and Inside Management. Initially, Chan and his team were ill-prepared or unwilling to address the IC's questions and concerns in an organized fashion and a significant amount of information that was requested was not provided.

54. In late August 2011, the IC Advisors located a number of documents evidencing SFC's senior management team's relationships with Yuda Wood and other interrelationships between AIs and/or Suppliers. These documents raised significant questions regarding the veracity of the

explanations that Chan and Inside Management had provided in response to the Muddy Waters allegations. Chan and Inside Management were interviewed regarding these documents but were unable or unwilling to provide any credible explanation to the issues raised by the documents.

55. Following the August interviews, Chan resigned as Chairman, CEO and as a director of SFC. The documents in question were shared with the OSC and caused the OSC to cease trade SFC's securities on August 26, 2011. Chan resigned as Founding Chairman Emeritus following notice that the OSC had cease traded SFC's securities. Inside Management was placed on administrative leave at that time.

56. It was not until Chan was replaced with W. Judson Martin as the new CEO of SFC that the cooperation the IC received from SFC's management improved significantly.

57. Subsequent to August 26, 2011, the IC's advisors identified additional documents that raised issues meriting comment and explanation from SFC personnel, and in particular, Chan and Inside Management. SFC's external counsel, in response to requests from the OSC, also identified documents of a similar nature. Further documents meriting comment and explanation were identified by E&Y and in interviews conducted by OSC staff.

58. The IC Advisors had identified a number of other situations where former Sino-Forest employees were or had been directors, officers and or shareholders of certain Suppliers and one AI. The IC Advisors also identified potential relationships between AIs and Suppliers.

59. On the instructions of the IC, the IC Advisors gave the details of these possible relationship issues to management for further follow up and explanation. In an effort to address the relationship issues, management, led by Chan, responded in the form of a report (the "**Kaitong Report**") by the Kaitong Law Firm, a Chinese law firm that advised SFC. The

Kaitong Report, which is discussed further below, provided information that sought to demonstrate that none of SFC's AIs or Suppliers were related parties. The IC concluded that much of the information provided in the Kaitong Report was unverified and likely unverifiable.

60. In retrospect, and with an appreciation of the facts articulated below, it is now clear that Chan and Inside Management intentionally misled the IC throughout its investigation and in fact actively frustrated the IC's ability to uncover the truth regarding their illicit and improper activities.

D Inability to Obtain an Audit Opinion

61. Unable to obtain adequate answers from Chan or Inside Management on certain of the questions that had been raised by Muddy Waters, the IC, E&Y, the OSC and others, as SFC reached the November 15, 2011 deadline to release its 2011 third quarter financial statements (the "**Q3 Results**"), the Audit Committee recommended and the Board agreed that SFC should defer the release of the Q3 Results until certain issues could be resolved to the satisfaction of the Board and E&Y. The issues included (i) determining the nature and scope of the relationships between SFC and certain of its AIs and Suppliers, as discussed in the Second Interim Report of the IC, and (ii) the satisfactory explanation and resolution of issues raised by certain documents identified by the IC's advisors, SFC's counsel, SFC's external auditors, and/or by OSC staff.

62. SFC's failure to file the Q3 Results and provide a copy of the Q3 Results to the trustee and to its Noteholders under its senior and convertible note indentures on or before November 15, 2011 constituted a default under those note indentures. Pursuant to the indentures, an event of default would have occurred if SFC failed to cure that breach within 30 days in the case of the senior Notes, and 60 days in the case of the convertible Notes, after having received written notice of such default from the relevant indenture trustee or the holders of 25% or more in

aggregate principal amount of a given series of Notes.

63. On December 12, 2011, after Chan and Inside Management had continued to fail to adequately answer the questions raised by the IC and E&Y, among others, SFC issued a press release announcing that it would not be able to release the Q3 Results within the 30-day period originally indicated. SFC further announced in that press release that, in the circumstances, there was no assurance that it would be able to release the Q3 Results, or, if able, as to when such release would occur. The press release also explained the circumstances that caused SFC to be unable to release the Q3 Results could also impact SFC's historic financial statements and SFC's ability to obtain an audit for its 2011 fiscal year.

64. To issue an audit opinion, E&Y stated that SFC would be required to address a number of outstanding audit issues. These issues had never been imposed as preconditions to E&Y's audit engagements in previous years. The new issues identified by E&Y required SFC to provide satisfactory responses to questions arising in relation to, among other things,:

- (a) SFC's relationship with Yuda Wood (a critical Supplier whose relationship with SFC is described more fully below);
- (b) the verification of certain issues surrounding SFC's relationships with AIs and Suppliers, including E&Y's ability to attend meetings with certain AIs and Suppliers;
- (c) the completion of an asset verification exercise accompanied by the engagement of independent forestry consultants;

- (d) a "proof of concept" exercise through which confirmations of the technology, methodology and reporting framework could be invoked for the wider area verification of the SFC forestry assets;
- (e) provision of legal opinions related to structure and tree title, among other things;
- (f) chain of BVI timber title, including access to source documents;
- (g) SFC's plan to remove funds from the PRC, including the provision of legal opinions as necessary;
- (h) International Financial Reporting Standards reconciliation; and
- (i) sales analysis of all BVI plantation sales by Supplier to customers.

65. Absent full cooperation from Chan and Inside Management, such cooperation to have included truthful, complete and adequate answers to the questions being raised, it was not possible for SFC to address these issues within an acceptable time period. Consequently, absent a resolution with the Noteholders, the indenture trustees would have been in a position to enforce their legal rights as early as April 30, 2012.

E. Defaults Under the Bonds

66. SFC's failure to make the \$9.775 million interest payment on the 2016 convertible Notes when due on December 15, 2011 constituted a default under that indenture. Under the terms of that indenture, SFC had 30 days to cure its default and make the required interest payment in order to prevent an event of default from occurring, which could have resulted in the acceleration and enforcement of the approximately \$1.8 billion in Notes which have been issued by SFC and

guaranteed by many of its subsidiaries outside of the PRC.

67. On December 18, 2011, SFC announced that it had received written notices of default dated December 16, 2011, in respect of its senior Notes due 2014 and its senior Notes due 2017. The notices, which were sent by the trustees under the senior note indentures, referenced SFC's previously-disclosed failure to release the Q3 Results on a timely basis. SFC reiterated in the December 18, 2011 press release that it did not expect to be able to file the Q3 Results and cure the default within the 30 day cure period.

68. In response to the receipt of the notices of default, among other considerations, on December 16, 2011, the Board established a Special Restructuring Committee of the Board comprised exclusively of directors independent of management of SFC, for the purpose of supervising, analyzing and managing strategic options available to SFC.

F. The Support Agreement and SFC Filed for CCAA Protection

69. Following extensive negotiations between SFC and its Noteholders, the parties agreed on the framework for a consensual resolution of SFC's defaults and the restructuring of its business, and entered into a Support Agreement on March 30, 2012.

70. The Support Agreement required SFC to pursue a plan of compromise on the terms set out in the Support Agreement in order to implement the agreed-upon restructuring transaction (the "**Restructuring Transaction**") and to simultaneously undertake a sales process (the "**Sales Process**") as an alternative to the Restructuring Transaction. As such, on March 30, 2012, SFC applied for protection from its creditors under the CCAA and the CCAA Court made an Initial Order granting a CCAA stay of proceedings against SFC and certain of its subsidiaries and appointing FTI Consulting Canada Inc. as the Monitor in the CCAA proceedings. The CCAA

Court also granted an order approving the Sales Process and authorizing and directing SFC, the Monitor and Houlihan Lokey to do all things reasonably necessary to perform each of their obligations thereunder.

G. The Sales Process

71. The Sales Process was intended to provide a "market test" by which third parties could propose to acquire SFC's business operations through a CCAA Plan as an alternative to the restructuring transaction provided pursuant to the Plan currently being pursued by SFC.

72. Following the bid deadline set out in the Sales Process, SFC, Houlihan Lokey and the Monitor determined that none of the letters of intent constituted a Qualified Letter of Intent as that term was defined in the Sale Process Order, which required among other things, cash consideration in an amount equal to 85% of the aggregate principal amount of the Notes, plus all accrued and unpaid interest on the Notes.

73. Even if vested free and clear of all of the Class Action and related Third Party Defendant indemnification claims, the Sales Process demonstrated that the realizable market value of SFC's business was less than the \$1.8 billion that SFC owed the Noteholders.

74. The difference between the value of SFC's assets as recorded in its financial statements and as publicly disclosed, and the reality of the Sales Process, was attributable to two factors, both of which were direct and foreseeable consequences of Chan's and Inside Management's conduct. First, as a company in distress and in insolvency proceedings, SFC by definition would not have realized fair value for its assets. Second, and more importantly, notwithstanding the thorough canvassing of the market and the openness of SFC to potential bidders through a comprehensive dataroom, bidders were unable to obtain sufficient comfort about the legitimacy or accuracy of

SFC's financial statements and the value of SFC's assets.

H. The CCAA Plan and Plan Sanction Order

75. Given that the Sales Process was not successful, SFC developed a Plan with its creditors that contemplated a new company and a further subsidiary ("Newco" and "Newco II", respectively) would be incorporated and SFC would transfer substantially all of its assets to Newco in compromise and satisfaction of all claims made against it. The result was that Newco would own, directly or indirectly, all of the Subsidiaries and SFC's interest in Greenheart and its subsidiaries as well as any intercompany debts owed by the Subsidiaries to SFC. Pursuant to the Plan, the shares of Newco were distributed to the affected creditors. Newco immediately transferred the acquired assets to Newco II.

76. As the value of the assets was less than amounts owed to SFC's secured creditors, there was no residual equity value remaining for existing SFC shareholders. Accordingly, the Plan contemplated the extinguishment of all existing equity of SFC in return for no consideration at all.

77. A creditor meeting was held on December 3, 2012 at which an overwhelming majority of SFC's affected creditors approved the Plan. The Plan was sanctioned by Justice Morawetz on December 10, 2012. One set of shareholders sought leave to appeal the Plan Sanction Order, but leave to appeal was denied by the Court of Appeal on June 26, 2013.

IV. THE EXTENT OF CHAN'S FRAUD IS REVEALED

78. Through the ongoing investigations and the CCAA process, the various lies that Chan had told to the IC, E&Y and SFC's counsel among others, during expensive and extensive investigations were ultimately exposed as works of fiction designed for the sole purpose of

hiding Chan's and Inside Management's illegal actions. Additional facts were ultimately uncovered that shed light on the true extent of the fraud that Chan and Inside Management had perpetrated on SFC.

A. SECRET CONTROL OF AIS AND SUPPLIERS

79. As described above, the Kaitong Report, which was prepared by the Kaitong law firm in conjunction with Chan and Inside Management, was prepared to address concerns regarding the interrelationships between Chan and other SFC personnel with Sino-Forest's AIs and Suppliers and purported to establish the independence and unrelated nature of the AIs and Suppliers.

80. The Kaitong Report explained that many Suppliers and AIs have "backers" who have strong business networks and good relations with various levels of the PRC Government. The Kaitong Report provided considerable information regarding relationships among Suppliers and AIs, and between them and Sino-Forest. The IC concluded that the information contained in the Kaitong Report was unverifiable.

81. Information has subsequently been discovered that directly contradicts the Kaitong Report and exposes the description of purportedly unrelated AIs and Suppliers contained therein as a complete fabrication. While Chan repeatedly represented to the IC, SFC's Board and E&Y, among others, that the AIs and Suppliers were independent and legitimate counterparties, quite the opposite was the case as Chan and Inside Management controlled a number of these purportedly independent entities.

82. A spreadsheet entitled "Companies held by managers and/or nominee shareholders overview" (the "**Nominee Company Caretaker List**"), which listed more than 120 of SFC's "Suppliers", AIs and other counterparties, was discovered on Chan's secretary's computer. The

Nominee Company Caretaker List indicates that the registered independent shareholders of these companies were "nominees" only, nominated by Chan to make it appear that contractual counterparties were independent third parties, when they were not. At all material times, Chan, through the use of "caretakers", owned, managed, controlled and directed these nominee or peripheral companies.

83. The Nominee Company Caretaker List indicates that at least nine Suppliers that were purportedly independent based on Chan's and Inside Management's explanations contained in the Kaitong Report, were in fact controlled by Chan through the use of caretakers and nominees. Those nine Suppliers (and the value of timber they purportedly sold to Sino-Forest) are: Gaoyao City Rundong Forestry Development Inc. (RMB 22,659,000); Guangxi Rongshui Taiyuan Wood Inc. (RMB 16,943,778); Guangxi Pingle Haosen Forestry Development Inc (RMB 61,208,311); Guangxi Hezhou City Kun'an Forestry Inc. (RMB 3,266,564,693); Guangxi Chihui Forestry Co. Ltd (RMB 311,684,472); Jiangxi Province Senchangtai Forestry Inc. (RMB 1,365,080,052); Yongzhou City Maoxiang Forestry Development Inc. (RMB 868,921,369); Guangdong Zhanjiang Bohu Wood Inc. (RMB 3,440,325,870) and Guangxi Dacheng Inc. (RMB 47,711,888). In total, these nine Suppliers, that were secretly controlled by Chan, purportedly sold approximately RMB \$9.4 billion in standing timber to Sino-Forest.

84. Chan conspired with Inside Management, Kaitong and its principal, John Zeng ("**Zeng**"), to create the necessary documentation required to make it appear as though Suppliers, AIs and other counterparties were independent third parties, when they were not. Such documentation included the establishment of nominee shareholders who held their interests on behalf of others. The dominant purpose of creating these entities in this manner was to hide the true relationship between Chan, Inside Management and these entities and to deceive SFC, its Board, E&Y and

the investing public.

85. By controlling the Suppliers, AIs, and other nominee companies, Chan and Inside Management were carrying out transactions which either overstated the economic substance of the transactions, or which were entirely fictitious.

86. Moreover, these Suppliers, AIs and other nominee companies were "related parties" under generally accepted accounting principles ("**GAAP**") and standards ("**GAAS**"). Related party transactions are considered to be not arm's length transactions that represent fair market value. The value of such transactions is susceptible to manipulation by insiders and therefore, under GAAP and GAAS, is not *per se* reliable for fair value determinations.

87. Insofar as SFC recorded any transactions with parties that were in fact related parties at Chan's direction, such misrepresentations placed SFC in significant peril with securities regulators and all of its stakeholders. Such transactions undermined the accuracy of SFC's books and records and materially contributed to SFC's inability to issue audited financial results, as discussed above. There was no legitimate business purpose either for carrying out transactions with such related parties, or for causing SFC to represent that such entities were unrelated third parties.

88. Chan personally profited from these inside relationships with the related party Suppliers, AIs, and other nominee companies. The full particulars of the relationships with each of the related party Suppliers, AIs and peripheral companies, are known only to Chan. Further particulars, including particulars of the secret profits made by Chan in connection with such related party entities, will be provided prior to trial.

89. The below are illustrative examples of the extent of control that Chan and Inside

Management had over AIs and Suppliers, the independency and legitimacy of which were the critical lynchpin to the legitimacy of the BVI model which was the main revenue and profit driver for SFC.

1. Kun'an

90. One of Sino-Forest's major Suppliers was Guangxi Hezhou City Kun'an Forestry Co., Ltd. ("**Kun'an**"). Kun'an was a PRC limited company that was established on January 20, 2009. Its registered office was located in Hezhou City, Guangxi, PRC. Over the years, SFC recorded and publicly disclosed that it had purchased hundreds of millions of dollars of timber assets from Kun'an. For example, in 2009, roughly 30% of all of SFC's plantation assets were purchased (by BVI entities) and leased (by Sino-Panel) from Kun'an.

91. Additionally, in March 2008 – nine months before Kun'an even existed – members of Inside Management, acting upon Chan's instructions and with his knowledge, authorization and acquiescence, caused Sino-Forest to record that Kun'an purchased \$49 million worth of timber assets from Sino-Forest. Particulars of that transaction are described in the section entitled "Gengma Fraud #2" below.

92. Contrary to Chan's representations to SFC, Kun'an was not an independent third party. Chan instructed and/or authorized Ip and Yeung to establish Kun'an. In fact, Chan personally selected Kun'an's name. Its manager was Huang Ran, a former or perhaps current employee (the facts surrounding his employment are known only to Chan) of Sino-Forest who was involved in numerous of the transactions referred to below.

93. By September 2009 – nine months after it was established and eighteen months after the company allegedly purchased \$49 million of timber assets from Sino-Forest – Yeung urged

Huang Ran to recruit "one or two clerks, tellers, or even merchandisers, to construct Kun'an to be a company with certain scale, instead of a one-person shell company." Another Sino-Forest employee, Qianhui Wu, responded using a personal address, agreeing with Yeung.

94. Undisclosed to SFC by Chan and Inside Management was that they actually controlled Kun'an. Kun'an appeared on the Nominee Companies' Caretaker List extracted from Chan's secretary's computer, indicating that Kun'an's registered shareholders were nominees only, nominated by Chan and Inside Management to make it appear that Kun'an was an independent third party, when it was not. At all material times, Chan and Inside Management, through the use of Huang Ran as a "caretaker", owned, managed, controlled and directed Kun'an.

2. Yuda Wood

95. Chan and Inside Management controlled Huaihua Yuda Wood Co. ("**Yuda Wood**"), which was allegedly Sino-Forest's largest Supplier from 2007 to 2010. During that time period, Sino-Forest paid Yuda Wood \$650 million.

96. Unknown to SFC's Board or E&Y, Yuda Wood was registered and capitalized by Chan and Inside Management, who also controlled bank accounts of Yuda Wood and key elements of its business. In or about July 1998, Chan and Inside Management incorporated Sonic Jita Engineering Co. Ltd., the parent company of Yuda Wood. In or about 2006, Yeung and Ip (acting under Chan's instructions and with his authorization, knowledge and acquiescence) assisted in the incorporation of Yuda Wood.

97. Ho (acting under Chan's instructions and with his authorization, knowledge and acquiescence) had authority to supervise a Yuda Wood bank account into which Sino-Forest deposited payments for timber assets allegedly purchased from Yuda Wood. At various times

Chan, Inside Management and other Sino-Forest personnel at their direction had access to Yuda Wood's documents and chops which are used in the PRC to legally authorize documentation.

98. Chan and Inside Management controlled Yuda Wood through their relationship with Huang Ran, Yuda Wood's legal representative.

99. After Yuda Wood's lack of independence was identified by Muddy Waters in its report, Chan, Inside Management and Huang Ran caused Yuda Wood to be deregistered. As quickly as Yuda Wood appeared and established a multi-hundred million dollar business, Yuda Wood disappeared entirely.

3. Bohu

100. Sino-Forest entered into a Master Framework Agreement with Guangdong Zhanjiang Bohu Wood Co., Ltd. ("**Bohu**") on December 10, 2007, pursuant to which Bohu was to supply Sino-Forest with 150,000 hectares of plantations (or approximately 18.75% of Sino-Forest's *total* plantations under management as of December 31, 2010) over a five year period.

101. Undisclosed to SFC by Chan and Inside Management was that they actually controlled Bohu. Bohu appeared on the Nominee Companies' Caretaker List extracted from Chan's secretary's computer, indicating that Bohu's registered shareholders were nominees only, nominated by Chan and Inside Management to make it appear that Bohu was an independent third party, when it was not. At all material times, Chan and Inside Management, through the use of "caretakers", owned, managed, controlled and directed Bohu.

4. Dongkou

102. Dongkou Shuanglian Wood Company Limited ("**Dongkou**") was Sino-Forest's most significant AI, purportedly purchasing approximately \$125 million in 2008, representing 14% of

SFC's revenue that year.

103. Undisclosed to SFC's Board or E&Y was the fact that Chan and Inside Management controlled Dongkou. Within 18 months of its incorporation in 2005, two Sino-Forest employees became the sole shareholders of Dongkou. Subsequently, Chan and Inside Management controlled Dongkou through one of SFC's Subsidiaries, Shaoyang Jiading Wood Products Co. Ltd. By 2007, at the direction of Ip and others, Sino-Forest employees drafted purchase contracts on Dongkou's behalf.

104. The fact that Dongkou was controlled by the inside management group of SFC meant that Dongkou was effectively a related party to SFC. By fraudulently holding Dongkou out as an independent third party and for causing SFC to treat Dongkou as a third party for accounting purposes, Chan and Inside Management, at a minimum, caused SFC's financial statements to be materially misstated.

5. *Other Related Parties*

105. As stated above, Chan and Inside Management developed the Nominee Companies Caretaker List, which listed approximately 120 of SFC's major Suppliers and AIs and other nominee companies that they controlled. The registered shareholders of each of these entities were nominees only, nominated by Chan and Inside Management to make it appear as though they were independent third parties when they were not.

106. In addition to the 120 counterparties listed in the Nominee Companies Caretaker List, Chan and Inside Management controlled other counterparties as well. As an illustrative example, neither Yuda Wood nor Dongkou, which as is explained above were controlled by Chan and Inside Management, were listed in the Nominee Companies Caretaker List, indicating

that the list is not a comprehensive list of all of the Sino-Forest counterparties that Chan controlled. The identity of all of the AIs, Suppliers and other counterparties that Chan controlled are known only to the defendant. Further particulars, including the identity of every entity with which Sino-Forest did business that was controlled by Chan or Inside Management, will be provided prior to trial.

107. Chan personally profited from his inside relationships with the related party Suppliers, AIs, and other nominee companies. The full particulars of these secret profits are known only to Chan. Further particulars will be provided prior to trial.

B. FRAUDULENT AND/OR QUESTIONABLE TRANSACTIONS

108. Chan and Inside Management caused Sino-Forest to enter into a number of transactions (the "**Transactions**") that were fraudulent and/or devoid of any legitimate business purpose. Some of the Transactions were identified by the OSC as fraudulent transactions, and were *per se* unlawful beyond any related party aspect of them. The Transactions cost SFC at least hundreds of millions of dollars and materially contributed to SFC's downfall.

109. In the alternative, if the Transactions were not outright fraudulent, they were sufficiently suspicious and devoid of legitimate business purpose that Chan, as a director and officer of a public company, should have studiously avoided them. Entering into such transactions constituted a breach of the duty of care that Chan owed to SFC both at common law and under the CBCA.

110. Chan and Inside Management perpetrated this massive fraud through the papering of literally hundreds of fictitious transactions, the full particulars of which are known only to Chan. Further particulars will be provided prior to trial. The below transactions are illustrative of the

brazen nature of the fraudulent conduct perpetrated by Chan and Inside Management.

a. Illegitimate Transactions with AIs

111. Prior to the release of the Muddy Waters Report on June 2, 2011, Sino-Forest collected 100% of their accounts receivable from the AIs in the BVI model. Every single account receivable was collected every single time. This raised questions for both SFC's Board and for E&Y who had never seen accounts receivables collected with 100% effectiveness.

112. Chan repeatedly answered these questions by falsely representing to both SFC's Board (such board meetings being held in Canada) and E&Y that the 100% collection rate was due to Chan's and Inside Management's relationships with the AIs and the respect that these AIs had for Chan personally.

113. These representations were false. The reason that 100% of accounts receivable were "collected" was because Chan and Inside Management manipulated SFC's books and created fictitious paper transactions to make it appear as though the BVI model was composed of legitimate transactions with legitimate counterparties.

114. The 100% "collection" rate on accounts receivable in the BVI model while Chan and Inside Management controlled SFC's books unsupervised is starkly contrasted with the 0% collection rate that was achieved once an independent court officer oversaw the collection process and the practice of papering fictitious transactions ceased.

115. As of December 31, 2011, \$887 million in accounts receivable were owing to SFC and its subsidiaries from six AIs for standing timber in the BVI model. An additional \$126 million in accounts receivable was owing on account of trading logs in the BVI model. Despite the Court appointed Monitor's best efforts throughout the entire CCAA process, not a single dollar of these

accounts receivable was collected during the Monitor's eleven month management of Sino-Forest's business. Further, corporate searches performed once the Monitor took over SFC's business in 2012 indicated that:

- three AIs, representing \$504 million of outstanding accounts receivable for timber trading in the BVI model had de-registered and no longer existed; and
- six AIs, representing more than \$63 million of outstanding accounts receivable for log trading in the BVI model had de-registered and no longer existed.

Similar to Yuda Wood above, as soon as these nine AIs appeared and purportedly entered into contracts with Sino-Forest worth nearly \$600 million, they disappeared without a trace.

116. The Monitor was unable to make any meaningful contact with any of the AIs (even those that did not deregister) and was never able to confirm that any of the AIs were legitimate arms-length entities that had entered legitimate commercial transactions with Sino-Forest.

117. The fact that the Monitor was unable to collect a single dollar of accounts receivable from the AIs despite the allegedly tremendous relationships that Chan and Inside Management had with these entities, coupled with the fact that the majority of these AIs immediately de-registered and ceased to exist, seriously undermines the legitimacy of all transactions with the AIs and the BVI model generally.

b. Illegitimate Transactions with Suppliers

118. The contracts that Sino-Forest entered into with the Suppliers in the BVI model contained numerous clauses compelling the Suppliers to assist with providing land rights certificates, dealing with the land owners and other matters which were critical to Sino-Forest's business operations in the BVI model.

119. Once it took over SFC's business operations, the Monitor undertook efforts to contact nine Suppliers who were responsible for supplying approximately 93% of the SFC's total book value and area (hectares) of BVI standing timber and sought to set up meetings with these Suppliers.

120. In its efforts to reach out to the Suppliers, the Monitor learned that two of the nine Suppliers had deregistered and ceased to exist. The Monitor was never able to confirm the corporate existence of a third Supplier. The Monitor was never able to meet with any of the nine Suppliers or confirm that they were legitimate arms-length corporate entities that had in fact supplied standing timber to Sino-Forest undermining the legitimacy of each and every one of Sino-Forest's Suppliers, the transactions worth billions of dollars that they purportedly entered into with Sino-Forest and the BVI model generally.

c. Illegitimacy of Counterparties in the WFOE Model

121. The Monitor also ran into accounts receivable collection problems in the WFOE model. As of December 31, 2011, Sino-Forest had outstanding receivables of approximately \$42 million for the sale of wood logs to nine entities in the WFOE model. Despite its best efforts, the Monitor was never able to collect any of these receivables.

122. In what became a disturbing trend, one entity owing accounts receivable in excess of \$10 million had deregistered and no longer existed. Moreover, despite its best efforts, the Monitor was never able to make any meaningful contact with any of the nine entities and was never able to confirm their status or if they had ever intended to honour their receivables. The Monitor made discreet site visits to the addresses of record of each of the nine entities and incredibly found no sign of the entity in question at seven of the nine site visits. This experience was consistent with the previous experiences of the IC Advisors who had been unable to locate any

evidence of Suppliers' operations at a number of the addresses provided by Chan and Inside Management.

123. The fact that these entities were not even at their addresses of record undermines their legitimacy and that of the transactions they entered into with Sino-Forest. The Monitor never determined what happened to the \$42 million in logs that had been "sold" to these companies. SFC alleges that these entities were controlled by Chan and Inside Management and were vehicles through which Chan and Inside Management carried out their fraud on SFC.

d. Greenheart

Overview

124. Through a series of transactions between 2007 and 2010 (the "**Greenheart Transactions**") SFC acquired a majority interest in Greenheart Resources Holdings Limited ("**GRHL**") by (i) acquiring shares in GRHL; and (ii) acquiring a majority interest in GRHL's majority shareholder, Omnicorp Limited ("**Omnicorp**") which restructured to become Greenheart Group Limited ("**Greenheart**"), a public company listed on the Hong Kong Stock Exchange. Undisclosed to SFC's Board and auditors, Chan secretly owned and controlled certain of the selling entities that sold GRHL shares and Greenheart securities to SFC.

125. Chan's undisclosed ownership position in the vendors made the Greenheart Transactions an undisclosed related party transaction and created an irreconcilable conflict that enabled Chan to make tens of millions of dollars by causing SFC to significantly overpay for the interests acquired in the Greenheart Transactions to his personal benefit.

Chan's Ownership Interest in a Struggling GRHL

126. As of May 2007, GRHL was not a significant entity. Its assets were composed of timber

assets that its shareholders had purchased for \$2 million a short time earlier. Moreover, it had run into operational difficulties that had caused its operations to grind to a halt.

127. Undisclosed to SFC's Board or its auditors, two of GRHL's significant shareholders were BVI companies that were beneficially owned and controlled by Chan. Through his beneficial ownership and control of Fortune Universe Ltd. ("**Fortune**") and Montsford Ltd. ("**Montsford**"), Chan beneficially owned in excess of 30% of GRHL's outstanding shares at that time.

128. While Lei Guangyu ("**Lei**")¹ was the sole director and shareholder of Fortune, and Zeng was the sole director and shareholder of Montsford, both Lei and Zeng were merely nominee shareholders designed to hide the fact that Chan was the real owner and controlling mind of both entities. At Chan's direction, Chan's secretary maintained the original share certificates and company chops for Fortune and Montsford throughout the relevant period to ensure that Chan always maintained ultimate control over the companies.

129. Chan not only hid his beneficial ownership in Fortune or Montsford from SFC's Board and its auditors, he also hid that in 2007, prior to SFC's purchases made pursuant to the Greenheart Transactions described below, Chan was secretly actively involved in the affairs of GRHL.

130. Through his active involvement in GRHL's affairs, Chan was fully aware of the significant issues that had caused its operations to be ground to a halt in May 2007. As is described in more detail below, just two months after seeing GRHL's operations ground to a halt, Chan caused SFC to invest \$6 million for a 13% stake in GRHL. Chan, in breach of his fiduciary duties to SFC, never disclosed his interest in GRHL and instead caused SFC to pay \$6

¹ In addition to being Chan's nominee shareholder of Fortune, Lei is listed as the legal representative of Shanghai Shenzhen Hongji Wood Co., Ltd, a major Sino-Forest AI, and is connected to other Suppliers in Sino-Forest's BVI network. The fact that he served as Chan's nominee for Fortune, undermines the legitimacy and independence of all of the AIs and Suppliers with which he was involved and the transactions that those entities entered into with Sino-Forest.

million for a 13% stake in \$2 million worth of assets without active ongoing operations.

131. In fact, Chan never disclosed his personal interest in GRHL or the limited value of its underlying assets at any point during the next three years during which he caused SFC to spend approximately \$120 million to purchase a controlling interest in GRHL.

The Greenheart Transactions

132. In July 2007, Chan caused SFC to enter into a timber purchase agreement with GRHL. As part of this agreement, SFC invested \$6 million to acquire a 13% stake in GRHL.

133. In or around August 2007, Omnicorp entered into an agreement with all shareholders of GRHL to acquire 60% of GRHL, with an option to acquire the remaining 40% within 18 months of the transaction. As a result, Chan caused SFC to sell a portion of its interest in GRHL to Omnicorp in November 2007, receiving in return a combination of Omnicorp shares, convertible bonds and cash.

134. In October 2007, Chan caused SFC to acquire additional Omnicorp bonds for \$1.7 million from other holders of the bonds.

135. In February 2009, Chan caused SFC to acquire an additional 55 million shares of Omnicorp and \$21.7 million of Omnicorp convertible bonds for \$4.3 million in cash and common shares of SFC.

136. By the end of 2009, SFC held a 20% stake in Omnicorp as well as convertible debentures that would increase SFC's holdings to 40% upon being exercised. At this time Omnicorp held 60% of GRHL, while SFC held an additional 5.2% stake in GRHL.

137. In early 2010, Chan caused SFC to complete its acquisition of 2,638,469,000 ordinary shares in GRHL representing approximately 34.4% of the issued share capital of GRHL for

consideration of \$33 million paid by the issuance of SFC common shares. The acquisition increased SFC's total holding to approximately 39.6% of the issued share capital of GRHL. The remaining 60.4% of GRHL remained held by Omnicorp, in which SFC was an approximate 20% shareholder.

138. Omnicorp restructured in 2010 to become Greenheart. Subsequently, on June 22, 2010, Chan caused SFC to enter into a share subscription agreement with Greenheart to purchase a total of 230 million ordinary shares of Greenheart at a subscription price of HK\$1.82 per share, for a total cash consideration of HK\$418.6 million or approximately \$53.9 million.

139. On September 27, 2010, SFC converted its Greenheart convertible bonds for 106.2 million ordinary shares of Greenheart. As a result of the share acquisition and the conversion, SFC increased its voting interest in Greenheart from 19.8% to 59.1% of Greenheart's issued share capital.

140. As a result of the above, as of December 31, 2010, SFC held 39.6% of the issued share capital of GRHL and a majority interest in Greenheart which owned the remaining 60.4% of GRHL's outstanding shares.

Chan's Secret Profit from the Greenheart Transactions

141. Through the machinations of the various Greenheart Transactions described above, SFC ultimately paid \$120 million (in cash and SFC common shares that traded on the TSX) for assets that the vendors (including Chan) had only paid \$2 million for a short time earlier (representing an incredible 6000% return on investment for Chan's personal investment in GRHL). Chan personally (through Fortune and Montsford) received \$22.1 of the \$120 million in SFC monies paid for the GRHL and Greenheart securities (\$3.7 million in cash and \$18.4 million in SFC

shares). The SFC shares that Chan acquired through these transactions appreciated to \$35 million before Chan sold them (through Fortune, Montsford and other nominee companies) in unreported insider trading on the TSX. Chan's secret profits from the Greenheart Transactions totaled at least \$38.7 million.

e. Improper Prepaid Deposits in Wood Log Trading Business

142. Sino-Forest paid \$157 million in prepaid deposits for wood log purchases in SFC's wood log trading business. Sino-Forest received nothing for these deposits. There was no legitimate commercial reason for Chan to authorize the payment of \$157 million for nothing. SFC alleges that all of these deposits were illegitimate and were merely a way of fraudulently funneling assets from SFC to Chan and others. The full particulars of each of these transactions are known only to Chan and further particulars, including Chan's relationship with each of the selling entities that received the "deposits" and the secret profits he made from each of these transactions, will be provided prior to trial.

143. The below transactions are illustrative examples of transactions in which Chan or Inside Management caused Sino-Forest to pay monies for nothing:

- In March 2011, at the initiation of Chan and Inside Management, SFC entered into two contracts with Guangxi Xunxiang Wood Import and Export Limited for the purchase of approximately 6,500 tons of Thai Redwood through a PRC distributor ("the **Thai Redwood Transaction**"). In connection with the entering into of those contracts, SFC paid a deposit of \$15 million in April 2011 and a further deposit of \$32 million in December 2011. Despite the Monitor's best efforts throughout the CCAA proceeding, it was never able to secure either the Thai Redwood promised

or the return of the \$47 million in deposits. Sino Forest's \$47 million was simply gone. "Guangxi Xunxiang Wood Import and Export Limited" appears on the Nominee Company Caretaker List as a company incorporated in Guangxi indicating that Chan and Inside Management controlled the counterparty to this transaction.

- Through a series of transactions involving multiple contracts, Chan and Inside Management caused SFC to transfer \$9.5 million to Elderbridge Limited, a BVI company, in March 2006. Inner Mongolian Forest and Timber Resources Co., Ltd. and Erlianhot Quande Resources Ltd. were both parties to contracts involved in this transaction and are both known to have been nominee companies secretly controlled by Chan and Inside Management. Sino-Forest never received anything for its \$9.5 million nor did Chan or Inside Management ever take any steps to try to recover the money; the \$9.5 million was simply gone.
- In 2010, Chan and Inside Management caused Sino-Forest to enter into an agreement with Trevista International Limited to secure an annual supply of Russian logs for 10 years. The agreement required a \$25 million deposit upon signing the agreement. Sino-Forest made incredibly small margins trading Russian logs and there was accordingly, no legitimate business reason to agree to pay such a significant deposit for such marginal returns. Sino-Forest received only a small fraction of deliveries under contracts in relation to which the deposit was paid. Neither Chan nor Inside Management ever took any steps to try to compel the supplier

to provide the remaining logs or return the balance of the deposit, approximately \$23 million. Again, the money was simply gone.

- Similarly, on February 15, 2011, Chan and Inside Management caused Sino-Forest to enter into an agreement to purchase logs from Prompt Sky Limited requiring Sino-Forest to pay a deposit of \$25.8 million. There was no legitimate business reason for this transaction and the payment of such a large deposit given the negligible returns Sino-Forest purported to make on its log trading business. Moreover, Sino-Forest never received the logs nor the return of the deposit. Again, neither Chan nor Inside Management ever took any steps to try to compel the supplier to provide the logs or return the deposit. The money was simply gone.

f. Improper Prepaid Deposits in Other Businesses

144. Similar to the scheme in Sino-Forest's log trading business, Chan and Inside Management caused Sino-Forest to enter a number of illegitimate transactions in its other non-core businesses which caused Sino-Forest to pay significant prepaid deposits for the purchase of various goods. Sino-Forest received nothing for these deposits. There was no legitimate commercial reason for Chan and Inside Management to authorize the payment of these sums for nothing. SFC alleges that all of these transactions were illegitimate and that the payment of these deposits was merely another way of fraudulently funneling assets from SFC to Chan, Inside Management and others. The full particulars of each of these transactions are known only to Chan and Inside Management and further particulars, including Chan's relationship with each of the selling entities that received the "deposits" and the secret profits he made from each of these transactions, will be provided prior to trial.

145. The below transactions are illustrative examples of transactions in which Chan or Inside Management caused Sino-Forest to pay monies for nothing:

- Chan and Overseas management caused Sino-Forest to enter into an agreement to purchase Indonesian lumber from Asian Forest International Company Limited on August 25, 2010. The agreement required Sino-Forest to pay Asian Forest International Company Limited a \$3 million deposit. Sino-Forest has never received the Indonesian lumber nor has it received the return of its \$3 million. Neither Chan nor Inside Management ever took any steps to recover Sino-Forest's \$3 million; the money was simply gone.
- Similarly, Chan and Inside Management caused Sino-Forest to enter into an agreement dated December 1, 2010, with Pt. Anka Lestari (Indonesia) for the purchase of Indonesian plywood. The agreement required Sino-Forest to pay Pt. Anka Lestari (Indonesia) \$7.5 million. Sino-Forest never received the Indonesian plywood nor did it receive the return of its \$7.5 million. Once again, neither Chan nor Inside Management ever took any steps to try to recover Sino-Forest's \$7.5 million; seemingly content to have funneled SFC's money to this unknown Indonesian entity.

g. Fictitious Prepaid License Payments

146. Chan and Inside Management caused Sino-Forest to purportedly make land lease payments for future periods in the normal course of its business. Some of these prepayments were for significant periods of time in the future, in certain cases for as much as 30 years. These payments were fraudulent and fictitious and were another means by which Chan and Inside

Management funneled monies from Sino-Forest to Chan, Inside Management and others.

h. The Tophand Limited Fraud

147. On January 15, 2010, Chan caused Sino-Forest to enter into a rental agreement with five PRC companies to rent 5 pieces of land and properties in Inner Mongolia Autonomous Region. Chan signed the rental agreement on behalf of Sino-Forest.

148. Pursuant to the rental agreement, Chan caused Sino-Forest to pay HK\$49.8 million to Tophand Limited ("**Tophand**"), which is at least 25 times the market rate for the rental property in question. There was no legitimate business reason for Chan to cause Sino-Forest to grossly overpay to rent property in Inner Mongolia Autonomous Region and this was just another way in which Chan funneled SFC's monies to Chan, Inside Management and others.

i. March Maple Fraud

149. The full particulars of the March Maple fraud described below are known only to Chan and Inside Management, and further particulars will be provided prior to trial. The fraud involved using SFC's funds to backstop bank loans made to an unrelated company, Shanghai March Maple Wood Products Company Limited ("**March Maple**"), that was secretly controlled by Chan and Inside Management. Moreover, when March Maple was unable to repay the loans (presumably because Chan and Inside Management had taken the money borrowed from the banks as opposed to use it for a legitimate business purpose), Chan and Inside Management had SFC "purchase" March Maple's sales channels to allow it to repay part of its bank borrowings.

150. March Maple was a purportedly independent company with no relationship to SFC that was incorporated in September 2004 by two local Chinese citizens (with no apparent connection to SFC) purportedly to start a retailing business in the PRC. Since its inception, March Maple

was solely financed by bank borrowings.

151. Despite the fact that March Maple had nothing to do with Sino-Forest or its business whatsoever, Chan and Inside Management caused two Subsidiaries, Sino-Maple (Shanghai) Company Limited and Jiafeng Wood (Suzhou) Company Limited to pledge collateral of RMB42 million and RMB 26 million respectively to facilitate March Maple's bank borrowings. Chan and Inside Management caused SFC to pledge these amounts without ever disclosing to SFC's Board or its auditors that SFC was transferring more than RMB60 million as collateral for the loans of an unrelated company.

152. In 2010, as a result of massive losses suffered by March Maple, its banks required it to repay part of the borrowings that were backstopped by Sino-Forest's collateral. Determining that March Maple needed an injection of cash to avoid foreclosure, Chan and Inside Management caused Sino-Forest to "purchase" March Maple's sale channels for RMB106 million. There was no legitimate business purpose for this "purchase" given that March Maple was suffering massive losses and was not carrying on any legitimate business warranting the purchase of its sale channels. In 2014, the banks enforced the security against the deposits of the two SFC subsidiaries causing loss to SFC of RMB 64,000,000.

153. There was no legitimate business purpose for Chan and Inside Management to cause SFC to pledge the deposits or secretly funnel approximately \$16 million to March Maple (through "purchasing" worthless sale channels). These transactions were simply another fraudulent way for Chan and Inside Management to funnel monies from SFC to themselves and others.

j. Dacheng Fraud

154. Chan and Inside Management committed a number of frauds through a series of

transactions in 2008 involving Guangxi Dacheng Timber Co. Ltd. ("**Dacheng**"). Dacheng was ostensibly a Supplier that sold timber assets to Sino-Forest at a price of RMB 47 million (approximately CAD \$8 million). The purchase price was funneled through Dacheng's bank accounts and returned back to Sino-Forest, shown to be revenue collected.

155. Further, Chan and Inside Management caused Sino-Forest to record these timber assets "purchased" from Dacheng twice in the books and for inflated amounts. In addition to recording these assets at the purchase price in the WFOE books, Chan and Inside Management caused Sino-Forest to record these same assets at a value of RMB 205 million (approximately CAD \$34 million) on the BVI books, notwithstanding that the BVI entities had nothing to do with the purchase of these assets and the assets had already been recorded on the WFOE subsidiaries' books.

156. Then, in 2009, Chan and Inside Management caused the BVI entities to record a "sale" of these standing timber assets that the BVI entities did not actually purchase (and which had already been double counted on the books) for RMB 326 million – a one-year gain of RMB 121 million from the numbers fictitiously recorded on the BVI books, or RMB 279 million (approximately CAD \$46 million) from the actual purchase price paid by the WFOE entities.

157. The Dacheng fraud gave the appearance that SFC was engaging in legitimate business activity, and in fact, highly lucrative activity through the purchase and sale of timber assets for a quick and virtually cost-free return on investment. Chan and Inside Management caused SFC's own funds to be circulated within the Sino-Forest enterprise, giving the illusion not only of building an asset base, but also building revenues for the operating arms of Sino-Forest.

158. The Dacheng fraud was emblematic of the frauds committed by Chan and Inside Management, with multiple levels of fraud often occurring within a single transaction or series of

transactions. The "proceeds" of the Dacheng transaction were then further employed in the purported acquisition of additional timber assets, resulting in a further compounding of the effects of the original fraud.

k. The "450,000 Fraud"

159. In 2009, Chan and Inside Management secretly used a number of companies to create a fictitious purchase and subsequent sale of 450,000 cubic metres of timber assets (the "**450,000 Assets**"). Every aspect of this series of transactions was fraudulent.

160. First, Chan and Inside Management caused SFC, through three subsidiaries of Sino-Panel, to "purchase" the 450,000 Assets from Guangxi Hezhou City Yuangao Forestry Development Co. Ltd ("**Yuangao**") in or about October 2009. This "purchase" was recorded on SFC's books as being valued at RMB 183 million (CAD \$31 million). But Yuangao was not, as was held out by Chan and Inside Management, an independent third party, but rather, a company secretly controlled by Chan and Inside Management through a former SFC employee, Huang Ran.

161. Only a few months later, SFC recorded a sale of the 450,000 Assets to three companies that were also held out by Chan and Inside Management to be independent third party companies, Gaoyao City Xinqi Forestry Development Co., Ltd. ("**Xinqi**"), Guangxi Rongshui Meishan Wood Products Factory ("**Meishan**"), and Guangxi Pingle Haoseng Forestry Development Co., Ltd. ("**Haoseng**"). But these companies were neither independent nor third parties. Instead, they were also secretly controlled by Chan and Inside Management, with Huang Ran again acting as Chan's and Inside Management's "caretaker".

162. In addition to the substratum of the 450,000 Asset transaction being completely

fraudulent, Chan and Inside Management compounded that fraud by creating a *gain* on the sale of the 450,000 Assets. In just a few short months, SFC had a gain of RMB 50 million on these assets – a 30% return over just two months. The RMB 233 million sale of standing timber was recorded in the books of SFC's WFOE subsidiaries and not its BVI subsidiaries that purportedly sold the assets.

163. Chan and Inside Management then created a number of circular transactions designed to give the appearance of reality to the 450,000 Asset fraud. Sino-Forest made payments, purportedly to settle accounts payable, to various Suppliers (including Yuangao). Those Suppliers then funneled money to Xinqi, Meishan, and Hoaseng, who used money to "purchase" the assets back from Sino-Forest.

164. The net effect of the 450,000 Asset frauds was to overstate the revenues of SFC by at least \$30 million, and to overstate the asset base of SFC by an amount that exceeded the value of the underlying assets, if any existed at all. The 450,000 Asset fraud had no economic substance and had no legitimate business purpose.

I. Gengma Fraud #1

165. In 2007, one of SFC's subsidiaries, Sino-Panel Gengma purchased certain land use rights and 105,750 Mu of standing timber from Gengma Dai and Wa Tribe Autonomous Region Forestry Co. ("**Gengma Forestry**") for a purchase price of RMB 102 million. This transaction was never recorded in the books and records of SFC or its subsidiaries.

166. Two months later, Chan and Inside Management directed another of SFC's subsidiaries, Sino Panel Yunnan to purchase these same assets – including the 105,750 Mu of standing timber – from another party, Yuda Wood for a price of RMB 509.3 million – roughly five times the

actual purchase price of the underlying assets as agreed four months earlier.

167. These assets – originally obtained for RMB 102 million but later recorded through a fictitious paper transaction with a related party controlled by Chan and Inside Management – were then "sold" in 2010 for an alleged sales price of RMB 1.6 billion (approximately CAD \$230 million).

168. The inflated price of the assets (RMB 509.3 million) was falsely recorded in SFC's public disclosure documents and audited financial statements for three full fiscal years. And then after the purported sale, Chan and Inside Management caused SFC to overstate its revenue by at least the differential of the real price to the artificially inflated price.

m. Gengma Fraud #2

169. In September 2007, SFC acquired certain standing timber located in the Yunnan Province (the "**Yunnan Plantation**") from Yuda Wood at a cost of \$21.5 million. However, notwithstanding the public disclosure of this purchase in 2007, SFC did not actually acquire the Yunnan Plantation until September 2008.

170. Then, in 2008 and 2009, Chan and Inside Management caused SFC to sell the Yunnan Plantation to Kun'an, a related party controlled by Chan and Inside Management, for almost double the purchase price, \$49 million. This sale transaction was recorded as occurring in March 2008 – six months before the assets were actually acquired in the first place.

171. The Yunnan Plantation transaction, if not entirely fictitious, at the minimum resulted in inflating SFC's revenue by recording the sale of assets that it did not actually have, at least at the time of the sale if at all. With Chan's authorization, knowledge or acquiescence, Inside Management personally debated who should be the "purchaser" of the Yunnan Plantation,

originally contemplating Yuda Wood as being the purchaser. They instead decided on Kun'an, which casts further doubt on the economic substance and/or reality of the transaction, as well as evidencing the control that Chan and Inside Management held over both Suppliers that were purportedly arms length entities.

n. Contracts Fabricated to Avoid SAFE Restrictions

172. Chan and Inside Management forged a number of contracts to evade restrictions imposed by China's State Administration of Foreign Exchange ("SAFE") and/or to establish banking credit that would not have otherwise been provided to SFC. Chan and Inside Management hid the fact that they were forging fictitious contracts with related and/or fictitious contracts for illicit and illegal purposes from SFC's Board and its auditors.

173. These fictitious contracts caused inaccuracies in SFC's financial statements and exposed SFC's to significant risk of liability from many different governmental bodies for Chan's and Inside Management's illegal activities. Moreover, the brazenness with which Chan and Inside Management willingly forged contracts and transactions to serve their personal purposes undermines the legitimacy of the BVI model in which Sino-Forest relied upon contractual rights to establish its ownership of its standing timber assets.

o. Eminens Limited

174. On October 30, 2009, Chan caused Sino-Forest to enter into a contract with Eminens Limited ("**Eminens**"), purportedly for the development of new forestry medicine. The agreement was to cover a period of 5 years from November 1, 2009 to October 31, 2014 and called for Sino-Forest to pay Eminens HK\$7.5 million in development expenses.

175. On July 7, 2010, Chan caused Sino-Forest to enter into a supplementary agreement with

Eminens pursuant to which Sino-Forest would pay RMB 50 million to Eminens, purportedly as a second phase development expense.

176. Chan caused Sino-Forest to pay Eminens HK \$7.5 million on November 24, 2009, \$2,205,882.50 on July 28, 2010, and RMB 8 million (made in US\$) on December 28, 2010 in relation to these contracts.

177. The managing director of Eminens is Pauline Chan, who is Chan's younger sister. There was no legitimate business reason for the Eminens transactions and these payments were simply another means by which Chan improperly funneled monies from SFC to Chan, Inside Management and others.

p. The Mandra Transactions

178. Through a two step acquisition process in 2005 (in which a 15% interest was acquired) and 2010 (in which the remaining 85% interest was acquired), Chan caused Sino-Forest to ultimately pay in excess of \$250 million (in cash and absorption of debt) for Mandra Resources Limited and its subsidiaries (the "Mandra Group").

179. At the time of the acquisitions, Chan was aware of significant difficulties with the Mandra Group's business that made it worth significantly less than the amounts paid. Nevertheless, Chan, in breach of his fiduciary and other duties, caused Sino-Forest to significantly overpay for these assets to SFC's detriment.

C. OTHER MATTERS

a. Absence of Evidence of Timber Asset Ownership

180. As a public company and a reporting issuer, SFC was expected to make complete and accurate disclosure about its assets. As the core management group at SFC, Chan and Inside

Management were responsible for internal and public reporting on operations, including SFC's acquisition of assets. At all material times, SFC had a reasonable expectation that assets Chan and Inside Management purchased with company funds were accompanied with appropriate evidence of legal ownership. Such evidence of legal ownership was further required by GAAP and GAAS to be properly recorded as actual acquisitions by the company.

181. Chan and Inside Management failed to obtain adequate supporting documentation and evidence of title for timber assets purchased and sold by SFC's BVI subsidiaries, which constituted most of SFC's timber assets and therefore the value of SFC. 80% by value of SFC's timber assets was purportedly evidenced by purchase contracts entered into by the BVI subsidiaries ("**Purchase Contracts**"). The Purchase Contracts purported to have three attachments: plantation rights certificates ("**Certificates**") or other ownership documents; timber survey reports ("**Survey Reports**"); and farmer's authorization letters ("**Farmers' Authorizations**"). Additionally, Chan and Inside Management purported to rely on PRC Forestry Bureau confirmations ("**Confirmations**") to evidence ownership.

182. Critical in any documents evidencing ownership is a sufficiently accurate description of what was being purchased. The Purchase Contracts and Confirmations did not sufficiently identify the trees or other timber assets purportedly purchased by SFC. It is not possible to identify approximately 80% of SFC's stated standing timber assets by reference to the Purchase Contracts and Confirmations.

183. The Confirmations were not legally recognized documents evidencing ownership or title of timber assets. The Confirmations were granted to Chan and Inside Management as favours and were not intended by the Forestry Bureau to be disclosed to third parties and were not intended to be relied upon as legal evidence of title. Moreover, many of the Confirmations were

in fact created by Chan and Inside Management (or employees working at their direction), and were backdated to suit Chan's and Inside Management's purposes.

184. During the IC's investigation, the IC Advisors could not obtain any insight into the internal authorization or diligence processes undertaken by the forestry bureaus in issuing confirmations and ultimately concluded that they did not have comfort regarding the methods by which those confirmations were obtained (see the section on Chan's and Inside Management's bribing of forestry bureau officials below).

185. During its investigation, the IC sought to reconfirm the forestry bureau confirmations with the forestry bureaus that had purportedly issued them, but were informed by Chan and Inside Management that it was not possible to do so given that this would jeopardize the valuable relationships Chan and Inside Management purportedly had with the forestry bureaus. Instead Chan and Inside Management hand-picked those forestry bureaus from which reconfirmations would be sought in order to "preserve relationships". Even when they were allowed to handpick which forestry bureaus would be asked to produce reconfirmations, Chan and Inside Management were unable to find a single forestry bureau that was willing to reconfirm the confirmations in the form in which they had purportedly been originally provided. Certain forestry bureaus were unwilling to provide any reconfirmations whatsoever while others were only willing to provide significantly more limited reconfirmations. This undermines the legitimacy of the Confirmations that Chan and Inside Management purportedly obtained from various local forestry bureaus and upon which SFC relied as proof of ownership of its timber assets in the BVI model.

186. Moreover, the other supporting documentation required to be attached to the Purchase Contracts was either insufficient or missing entirely. Without limiting the generality of the

foregoing:

- none of the Purchase Contracts had any Farmers' Authorizations attached. Absent such authorizations, there was no evidence that title to timber was properly transferred to the "Supplier" prior to the purported transfer to SFC; and
- the Survey Reports were conducted by a single firm who had a conflict of interest, Zhanjiang Southern Forestry Products Quality Supervision Co., Ltd. ("**Zhanjiang Southern**"). At all material times, Lu Qiding ("**Qiding**"), an SFC employee and a key member of its timber acquisition team who subsequently "retired" when questions were originally raised, was a 10% shareholder of Zhanjiang Southern. At all material times, another 80% of the shares of Zhanjiang Southern were held by a former SFC employee. Drafts of these reports, which were held out to be drafted by an independent company, existed on computers of SFC employees who reported to Qiding, Chan and Inside Management. These Survey Reports were relied upon by SFC's auditors, and Chan and Inside Management intended for the auditors to rely on the Survey Reports.

187. The absence of sufficient legal evidence to demonstrate SFC's ownership of billions of dollars of timber assets was a material contributor to SFC's inability to obtain an audit opinion and to market the assets for sale to a third party in the Sales Process, defined and described above. The magnitude of this problem was aggravated by the serious questions raised about the independence of AIs and Suppliers and prior representations by Chan and Inside Management, as described above.

b. Improper Payments to Various Officials

188. Chan and Inside Management used SFC monies to provide improper and illegal gifts and cash payments to a number of individuals including forestry bureau officials, department of forestry personnel, local and national tax bureau officials, SAFE officials, Commercial Bureau officials, local magistrates and officials and bankers. There was no legitimate business reason for these payments.

189. Chan and Inside Management hid these improper and illegal payments from SFC's Board and its auditors and frequently used private email accounts to discuss the making of these payments. Accordingly, the full particulars of these improper payments are known only to Chan and Inside Management and further particulars will be provided prior to trial. The below are illustrative examples of the brazenness with which Chan and Inside Management attempted to pay off various officials:

- By email dated January 19, 2007, Jason Chen, a Sino-Forest employee who reported to Inside Management, wrote to Ip advising that:

It's now the end of the year. According to the local convention, it would be necessary to send gifts to the local officers and authorities. This would impact whether or not we are able to do our business smoothly after the Spring Festival, especially for the logging quota in 2007 and the normal operation of our current factory.

The email attached a list of names for consideration and approval with a list of 58 names all from the ranging from Forestry Bureau officials, to municipal government officials, to county government officials. Certain amounts are also proposed to be paid to county magistrates and deputy county magistrates and mayors totaling RMB 266,000. Chan and Inside Management authorized the

improper payments set out in this email demonstrating how Chan and Inside Management used improper payments to various Government officials to obtain logging quotas and other favours. This practice certainly undermines the legitimacy of forestry bureau confirmations which were provided as a favour to Chan and Inside Management.

- By email dated January 30, 2010, Jiang Youbin, a Sino-Forest employee who reported to Inside Management wrote to Yeung's secretary, Janis Law, and asked for Yeung's approval for a number of improper payments to various government officials. Mr. Youbin's email provided the following explanation for the payments:

The Chinese New Year is coming, in order to thanks the support our companies received from various level of government in 2009. According to customs, we will visit the government officials in the relevant government departments before the Chinese New Year and the total estimate cost for the visits is RMB 129,100.

The chart setting out the proposed payments to various government officials contained a list of the type of services sought or provided by the government official such as "local tax" or "transfer and related services". These improper payments were ultimately approved by Chan and Inside Management.

- In 2010, one of Sino-Forest's Suppliers paid a "kickback" to a bank manager of RMB 50,000 and Chan and Inside Management approved the reimbursement of that payment. The Supplier's representative himself explained the reason for providing the kickback:

Because the amount of fund transferred by Haerbin Oubangde for Sino was too large, the People's Bank has noticed and started to

monitor. The purpose of the kickback is to avoid further monitoring.

Chan and Inside Management did not want the bank monitoring the accounts and transactions in question because they were concerned that such monitoring would uncover their improper and illegal acts. Accordingly, they authorized the payment of a "kickback".

c. Revenue Recognition

190. As an audited public company, SFC was required to accurately disclose the quantum of revenue earned in the quarter in which it was actually earned. For the purchase and sale of standing timber, revenue is recognized in the quarter in which all of the following have occurred: (a) the Purchase Contract is entered into which establishes a fixed and determinable price; (b) collection is reasonably assured; and (c) the significant risks and rewards of ownership have been transferred to the customer.

191. For the BVI subsidiaries, an individual employee at SFC would create contracts in the quarter or quarters *after* the revenue was recognized through a mail merge function in a word processor. There is no evidence that these contracts were even sent to the counterparties with which SFC was ostensibly entering into the transactions, and in some cases, the contracts were created after payments under the contracts had allegedly been made.

192. At a minimum, this practice of creating contracts in quarters after the revenue was recognized was inconsistent with public disclosure made by SFC regarding its revenue recognition policies. Finally, this practice created substantial risk of inaccuracies and put into further question the legitimacy of the claim that SFC's AIs and Suppliers were independent third parties.

193. This practice of creating contracts in the quarter or quarters after the transactions actually occurred was known to and implemented under the direction of Chan and Inside Management. In fact, Chan signed each and every contract with Suppliers and AIs to purportedly ensure their accuracy. Instead of ensuring their accuracy, Chan knowing signed backdated contracts in breach of SFC's revenue recognition policy of which he was well aware.

d. Manipulation of Financial Information to Artificially Inflate Bonuses

194. As part of his compensation package for 2008, SFC's CFO, David Horsley ("**Horsley**"), had a "bonus objectives achievement assessment" whereby SFC would pay Horsley a bonus if SFC brought 12 million cubic metres of fiber to market. An initial draft of SFC's year-end MD&A showed that for fiscal year 2008, SFC only sold a total of 11.1 million cubic metres of fiber to market. The consequence of missing this objective was a cumulative loss to applicable SFC management of \$1.8 million in bonuses.

195. After discussing the matter further with Chan, within two days SFC had "discovered" another 1.2 million cubic metres of sales, and within four days, SFC realized that, in fact, SFC had sold 12.8 million cubic metres of fiber. This all occurred almost three months after year-end, and had the direct and intended consequence of having SFC meet its bonus objective, with Horsley and others being paid the bonus that Horsley originally feared would be met using the actual data from the company.

196. Chan bought the loyalty of SFC's senior management with SFC's own monies by allowing them to improperly manipulate SFC's financial reporting to achieve requisite bonus thresholds.

VIII. LIABILITY TO SFC

197. Chan is liable to SFC for breaching his duties as a director and an officer of SFC. At all relevant times, Chan was a director and an officer who participated in, authorized, permitted or acquiesced in the wrongful conduct described above.

198. Under section 120 of the CBCA, Chan had an obligation to disclose to SFC the nature and extent of any interest that he had in counterparties entering into material contracts and material transactions with SFC. Regardless of what was disclosed, section 120 of the CBCA requires that any related party transactions were reasonable and fair to SFC when they were approved. By reason of the facts described above, Chan breached this obligation and failed to act in the manner that was required of an officer and director of a publicly traded company.

199. Pursuant to subsection 120(8) of the CBCA, Chan is liable to SFC for any and all profits or gains he realized (either directly or indirectly) from the related party transactions described above.

200. Under section 122 of the CBCA, Chan owed a duty of care to SFC to (a) act honestly and in good faith with a view to the best interests of the corporation, and (b) to exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances. By reason of the facts described above, Chan breached this duty of care and failed to act in a manner that was required of an officer and director of a publicly traded company.

201. Chan breached section 241 of the CBCA, by carrying on the business or affairs of SFC in a manner that was oppressive or unfairly prejudicial or that unfairly disregarded the interests of SFC, its security holders, creditors and directors.

202. By reason of the facts described above, Chan breached express and implied terms of his

employment agreements with SFC and its subsidiaries. Among other things, Chan was required to conduct himself and the operations of SFC in a manner that was lawful. Chan was further required to comply with SFC Codes of Conduct, which he breached by virtue of the facts described above.

203. Chan further owed SFC fiduciary duties, as a result of the positions of trust and confidence he held. SFC was vulnerable to the unilateral exercise of discretion and power by Chan. By reason of the facts described above, Chan breached his fiduciary duties to SFC.

204. Chan conspired with Inside Management to overstate the value of SFC's revenue and assets and to cause SFC to release financial statements that were untrue. In certain instances, as described above, the predominant purpose of such conspiracy was for Chan and Inside Management, or certain of them, to obtain pecuniary benefits. In other cases, the predominant purpose is unknown as a result of the clandestine nature of the conspiracy and the particular opaqueness created by the overseas operations, the use of "shell" companies and nominee shareholders, among other things, but in all instances the predominant purpose was not to advance the legitimate business interests of SFC and its stakeholders. Chan and Inside Management took steps in furtherance of the conspiracy as described above.

205. Chan is liable to SFC for the fraud he committed as particularized in the facts set out above.

206. By virtue of the facts set out above, Chan is liable to SFC for negligent and/or fraudulent misrepresentation. SFC relied on the representations described above to its detriment, and the damages SFC suffered in furtherance of such reliance were reasonably foreseeable and proximate.

207. By virtue of the facts set out above, Chan has been unjustly enriched by his wrongful acts and omissions. SFC suffered a corresponding deprivation by reason of Chan's wrongful acts. There was no juristic reason for Chan's resulting enrichment. The plaintiff is entitled to a constructive trust with respect to such enrichment.

208. Chan is alternatively liable to SFC as a knowing recipient of trust moneys and/or a knowing assistor of breaches of trust and fiduciary duty by others, for the reasons set out above. At all material times, Chan owed fiduciary duties or trust obligations to SFC and knew that others in senior management had such trust and fiduciary obligations. Chan willfully assisted in the breach of such trust and fiduciary obligations, including through the handling and receipt of SFC monies that had been impressed with a trust.

IX. DAMAGES

209. By virtue of the facts set out above, SFC has suffered damages. Such damages were reasonably foreseeable by Chan, and proximate to the wrongful acts described above.

210. Chan is liable for the acts relating to his conduct and that of Inside Management described above.

211. Between 2007 and 2010, SFC raised in excess of \$2.1 billion and CAD\$800 million in Canada's debt and capital markets. The monies raised were cash held by SFC. Based upon Chan's fraudulent misrepresentations and conduct described above, this cash was spent on Sino-Forest's business operations. SFC believed it was using this money to buy trees, not to facilitate a fraud. Even where amounts were "legitimately" expended, such as for example, the leasehold costs for office space, such amounts were expended with the reasonable expectation that they were to be used as offices for a legitimate enterprise, not a fraud that only served to enrich Chan

and his cabal. SFC had in excess of \$3 billion in cash and it lost every penny "investing" in Chan's fictitious and fraudulent business model. Chan is liable for the full amount of these damages, further particulars of which will be provided prior to trial.

212. To add insult to injury, and as described above, Chan lied and misled SFC's Board, its auditors and the IC, causing it to spend tens of millions of dollars investigating fictitious transactions and stories concocted by Chan to hide the nefarious manner in which he had stolen and wasted billions of dollars. Chan is liable to SFC for the significant sums of money wasted investigating his fictitious accounts of events. Further particulars of these damages will be provided prior to trial.

213. SFC has taken all reasonable steps to mitigate its damages.

214. The particulars of such damages are not yet fixed and will be provided prior to trial.

215. By virtue of the conduct described above, an award of punitive or exemplary damages is appropriate. Chan's conduct was high handed and demonstrated reckless and wanton disregard for SFC and its stakeholders. Chan's activities were particularly egregious and warranting punitive or exemplary damages.

216. In addition to the general, punitive and exemplary damages described above, by reason of the facts described above, Chan had conducted himself in a manner that disentitles him to retain the compensation that he received directly and indirectly from SFC, whether in the form of salary, bonuses, options, or otherwise. In light of all of the circumstances, SFC received no value for the services provided by Chan in connection with his employment, and such compensation should be returned to SFC.

X. WAIVER OF TORT

217. In the alternative to the causes of action pleaded above, to the extent that the Honourable Court determines that waiver of tort is a separate cause of action, by virtue of the facts described above, Chan is liable under the doctrine of waiver of tort. As set out above, Chan engaged in unlawful conduct, and as a direct result of that unlawful conduct, has obtained profits that ought to be disgorged in equity.

218. To the extent that the Honourable Court determines that waiver of tort is instead a remedy, by virtue of the facts described above, this is an appropriate case for such an election to waive compensation as a remedy and to instead claim the wrongdoer's ill-gotten gain to the extent Chan's gain is in excess of any amount of general damages awarded, as claimed in paragraph 1(a) above. Such an election would be appropriate for the following reasons, among others:

- the profits received by Chan were acquired in circumstances that he may not in good conscience retain them;
- the integrity of the capital markets would be undermined if the court did not require an accounting;
- the actions taken by Chan described above could not have been taken absent his tortious conduct; and
- Chan engaged in wrongful conduct as particularized above.

XI. STATUTORY REFERENCES

219. The plaintiff pleads and relies upon rules 17.02 (g) and (n) of the *Rules of Civil Procedure*, R.R.O. 1990, Reg. 194, for service of this Notice of Action on Chan outside of

Ontario because it relates to torts committed in Ontario and the plaintiff is authorized by the CBCA to commence this proceeding in Ontario against Chan. Further, the action is asserted by the Trustee pursuant to the CCAA Court and the Plan, both of which were made in Ontario.

220. The plaintiff pleads and relies upon sections 120, 122 and 241 of the CBCA.

XII. VENUE

221. The plaintiff proposes that this action be tried at the City of Toronto.

Dated: April 30, 2014

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Lawyers for the Plaintiff

Schedule A – Debt and Equity Issues

Issue no.	Nature of Issue
1.	The issue of the aggregate principal amount of \$345,000,000 of 5.00% Convertible Senior Notes Due 2013 issued pursuant to the indenture dated 23 July 2008, by and between SFC, the entities listed as subsidiary guarantors therein, and The Bank of New York Mellon, as trustee, as amended, modified or supplemented.
2.	The issue of the aggregate principal amount of \$399,517,000 of 10.25% Guaranteed Senior Notes Due 2014 issued pursuant to the indenture dated 27 July 2009, by and between SFC, the entities listed as subsidiary guarantors therein, and Law Debenture Trust Company of New York, as trustee, as amended, modified or supplemented.
3.	The issue of the aggregate principal amount of \$460,000,000 of 4.25% Convertible Senior Notes Due 2016 issued pursuant to the indenture dated 17 December 2009, by and between SFC, the entities listed as subsidiary guarantors therein, and The Bank of New York Mellon, as trustee, as amended, modified or supplemented.
4.	The issue of the aggregate principal amount of \$600,000,000 of 6.25% Guaranteed Senior Notes Due 2017 issued pursuant to the indenture dated 21 October 2010, by and between SFC, the entities listed as subsidiary guarantors therein, and Law Debenture Trust Company of New York, as trustee, as amended, modified or supplemented.
5.	The issue of a private placement by Greenheart Group Limited of 250 convertible notes to General Enterprise Management International Limited for gross proceeds of \$24,750,000 in 2010.
6.	The issue of a public offering by SFC of 15,900,000 common shares for gross proceeds of CAD\$201,135,000 in 2007.
7.	The issue of a public offering by SFC of 21,850,000 common shares, which included the exercise in full by the underwriters of the over-allotment option to purchase 2,850,000 common shares, for gross proceeds of CAD\$367,080,000 in 2009.
8.	The issue of a public offering by SFC of 30,000,000 common shares for \$296,800,000 in 2009.

Issue no.	Nature of Issue
9.	The issue of a public offering by Hing Lee (HK) Holdings Limited of 45,000,000 shares and 5,000,000 shares for US\$6,600,000 in 2009.
10.	The issue of a private placement by SFC of 26,000,000 common shares to institutional investors for gross proceeds of CAD\$237,900,000 in 2007.
11.	The issue of a private placement by SFC of 7,220,000 Class A subordinate-voting shares to institutional investors in Canada for \$12,400,000 in 2003.
12.	The issue of a private placement by Greenheart Group Limited of 70,000,000 common shares for gross proceeds of HK\$210,000,000 in 2007.
13.	The issue of a private placement by Greenheart Group Limited of 30,000,000 common shares for gross proceeds of HK\$27,000,000 in 2007.
14.	The issue of a private placement by Mandra Forestry Finance Limited of \$195,000,000 in debt securities in 2005.

SFC LITIGATION TRUST
Plaintiff

- and -

ALLEN TAK YUEN CHAN
Defendant

Court File No. CV-13-481761

**ONTARIO
SUPERIOR COURT OF JUSTICE**

Proceeding commenced at Toronto

STATEMENT OF CLAIM

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