Court File No.

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

IN THE MATTER OF THE *COMPANIES CREDITORS' ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF SINO-FOREST CORPORATION

Applicant

APPLICATION UNDER THE *COMPANIES CREDITORS' ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED

FACTUM OF THE APPLICANT
SINO-FOREST CORPORATION
(Initial Order Returnable March 30)

March 30, 2012

BENNETT JONES LLP
One First Canadian Place
Suite 3400, P.O. Box 130
Toronto, Ontario
M5X 1A4

Robert W. Staley (LSUC #27115J)
Kevin Zych (LSUC #33129T)
Derek J. Bell (LSUC #43420J)
Jonathan Bell (LSUC #55457P)
Tel: 416-863-1200
Fax: 416-863-1716

Lawyers for the Applicant

TABLE OF CONTENTS

Page

I. OVERVIEW **1**

II. THE FACTS **2**

A. The Applicant 3

B. Events Leading To The Application 4

1. The Muddy Waters Report 4
2. The Independent Committee Investigation 4
3. The OSC, HKSFC and RCMP Investigations 5
4. Cease trade Order 6
5. Class Action Lawsuits 6
6. Failure to Release Q3 Results 7
7. Default Under Indentures 8
8. Restructuring Committee 9
9. The Waiver Agreements 9
10. Audit Issues 10
11. Deterioration of the Business 10
12. The Support Agreement and the Sale Process 12

III. ISSUES AND THE LAW **14**

A. Compliance with the CCAA 14

B. Stay of Proceedings 17

C. Administration Charge 19

D. Directors' Charge 20

E. Sales Process 22

F. Postponement of Annual Shareholders' Meeting 25

G. Foreign Proceedings 27

H. Financial Advisor Agreement 27

IV. RELIEF SOUGHT **28**

I. OVERVIEW

1. The Applicant, Sino-Forest Corporation ("SFC"), seeks an Initial Order and Sale Process Order under the *Companies' Creditors Arrangement Act*, R.S.C. 1985 c. C. 36 (the "CCAA") in the form contained in the Application Record.

2. SFC is a debtor company as defined in the CCAA and is insolvent. As a result of recent events that significantly eroded the business of SFC, there have been a number of defaults under various SFC note indentures. After extensive arm's length negotiations, SFC has entered into a Support Agreement with a substantial number of its noteholders, which requires SFC to pursue a CCAA Plan as well as a Sale Process.

3. The restructuring transactions contemplated by this CCAA proceeding are intended to:

   a. separate Sino-Forest's business operations from the problems facing SFC outside the PRC by transferring the intermediate holding companies that own "the business" and SFC's intercompany claims against its subsidiaries to a newly formed company owned primarily by the noteholders in compromise of their claims;

   b. effect a Sale Process to determine whether anyone will purchase SFC's business operations for an amount of consideration acceptable to SFC and its noteholders, with potential excess being made available to Junior Constituents (defined below);

c. create a structure that will enable litigation claims to be pursued for the benefit of SFC's stakeholders, including significant litigation against Muddy Waters LLC and Carson Block; and

d. allow Junior Constituents some "upside" in the form of a profit participation if Sino-Forest's business operations acquired by the noteholders are monetized at a profit within seven years from Plan implementation.

4. The relief sought in this application includes: (i) a stay of proceedings against SFC, its current or former directors or officers, any of SFC's property, and in respect of certain of SFC's subsidiaries with respect to the note indentures issued by SFC; (ii) granting a directors' charge and an administration charge on certain of SFC's property; (iii) approving the engagement letter of SFC's financial advisor, Houlihan Lokey; (iv) relieving SFC of any obligation to call and hold an annual meeting of shareholders until further order of this Court; and (v) approving sale process procedures.

5. SFC meets the technical requirements of the CCAA, and urgently requires CCAA protection in order to preserve and obtain value for its stakeholders.

II. THE FACTS

6. The facts with respect to this Application are more fully set out in the Affidavit of W. Judson Martin, sworn March 30, 2012, in support of this Application. All capitalized terms used but not defined herein have the meaning ascribed to them in the Affidavit.

A. The Applicant

7. SFC was formed under the *Business Corporations Act* (Ontario) upon the amalgamation of Mt. Kearsage Minerals Inc. and 1028412 Ontario Inc., pursuant to articles of amalgamation dated March 14, 1994. On June 25, 2002, SFC filed articles of continuance under the *Canada Business Corporations Act*, R.S.C. 1985 c. C-44 (the "CBCA").

Affidavit of W. Judson Martin at para. 28.

8. Since 1995, SFC has been a publicly listed company on the TSX with its shares traded under the symbol "TRE". SFC's registered office is in Mississauga, Ontario and its principal executive office is in Hong Kong.

Affidavit of W. Judson Martin at para. 36.

9. A total of 137 entities make up the Sino-Forest 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.

Affidavit of W. Judson Martin at para. 40.

10. SFC currently has 3 employees. Collectively, the Sino-Forest Companies employ a total of approximately 3553 employees, with approximately 3460 located in the PRC and approximately 90 located in Hong Kong.

Affidavit of W. Judson Martin at para. 94.

11. Sino-Forest is a publicly listed major integrated forest plantation operator and forest productions company, with assets predominantly in the PRC. Its principal businesses include the

sale of standing timber and wood logs, the ownership and management of forest plantation trees, and the complementary manufacturing of downstream engineered-wood products.

Affidavit of W. Judson Martin at para. 32.

12. Substantially all of Sino-Forest's sales are generated in the PRC. In the year ended December 31, 2010, sales to customers in the PRC of standing timber, logs, and other wood-based products accounted for substantially all of Sino-Forest's revenue.

Affidavit of W. Judson Martin at para. 91.

B. Events Leading To The Application

1. The Muddy Waters Report

13. On June 2, 2011, Muddy Waters published a Report (the "MW Report") alleging, among other things, that SFC is a "near total fraud" and a "Ponzi scheme".

Affidavit of W. Judson Martin at para. 114.

2. The Independent Committee Investigation

14. On June 2, 2011, the same day that the MW Report was released, the Board of Directors appointed an Independent Committee (the "IC"), which in turn retained independent legal and financial advisors in Canada, Hong Kong and the PRC, to investigate the allegations set out in the MW Report.

Affidavit of W. Judson Martin at para. 117.

15. The scope of the IC's investigation was significant and involved compiling and analyzing vast amounts of data for a comprehensive review of Sino-Forest's operations and business, the relationships between Sino-Forest and other entities, and Sino-Forest's ownership of assets.

Affidavit of W. Judson Martin at para. 124.

16. The IC delivered two interim reports to the Board, and on January 31, 2012, SFC released the redacted Final Report of the IC. Following the delivery of the Final Report, the IC ceased its activities, and any outstanding issues were referred to SFC's Audit Committee or Restructuring Committee.

Affidavit of W. Judson Martin at paras. 125, 139, 158-159.

3. The OSC, HKSFC and RCMP Investigations

17. On June 8, 2011, the Ontario Securities Commission (the "OSC") publicly announced that it was investigating matters related to SFC. That investigation is ongoing.

Affidavit of W. Judson Martin at para. 118.

18. In June 2011, the Hong Kong Securities and Futures Commission (the "HKSFC") commenced an investigation into Greenheart Group, which SFC had acquired a majority interest in less than a year earlier. In addition to its investigation of Greenheart Group, the HKSFC has been assisting the OSC with its investigation.

Affidavit of W. Judson Martin at paras. 119-120.

19. In late August 2011, counsel for the IC received an inquiry from the RCMP requesting cooperation in connection with an investigation into the allegations in the MW Report.

Representatives of the IC met with and provided information to the RCMP, and the RCMP has made information requests from time to time.

Affidavit of W. Judson Martin at para. 138.

20. Sino-Forest has attempted to cooperate with the OSC, HKSFC and RCMP investigations and intends to continue to cooperate with these investigations. Sino-Forest has, mainly with respect to the OSC investigation, responded to extensive inquiries, made extensive production of documents, and facilitated interviews with Sino-Forest personnel.

Affidavit of W. Judson Martin at paras. 121-122.

4. Cease Trade Order

21. On August 26, 2011, the OSC issued a cease trade order with respect to the securities of SFC and with respect to certain senior management personnel. With the consent of SFC, the cease trade order was extended by subsequent orders of the OSC.

Affidavit of W. Judson Martin at paras. 136-137.

5. Class Action Lawsuits

22. SFC and certain of its officers, directors and employees, along with SFC's current and former auditors, technical consultants and various underwriters involved in prior equity and debt offerings, have been named as defendants in eight class action lawsuits in Canada. Additionally, on January 27, 2012, a class action was commenced against SFC and other defendants in the Supreme Court of the State of New York.

Affidavit of W. Judson Martin at paras. 176 & 180.

6. Failure to Release Q3 Results

23. 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 its Q3 Results until certain issues could be resolved to the satisfaction of the Board and SFC's auditor. On November 15, 2011, SFC issued a press release to that effect. The press release also stated that SFC would try to release the Q3 Results within 30 days.

Affidavit of W. Judson Martin at paras. 144-146.

24. On December 12, 2011, SFC issued a press release announcing that despite its diligent work to resolve outstanding issues, it would not be able to release the Q3 Results within the 30 day period originally indicated. The press release also stated that, in the circumstances, there was no assurance that SFC would be able to release the Q3 Results or, if able, when such a release would occur.

Affidavit of W. Judson Martin at paras. 148-149.

25. The circumstances that caused SFC to be unable to release the Q3 Results could also impact SFC's historical financial statements and its ability to obtain an audit for its 2011 fiscal year. On January 10, 2012, SFC cautioned that its historic financial statements and related audit reports should not be relied upon.

Affidavit of W. Judson Martin at paras. 150 & 154.

7. Default Under Indentures

26. SFC has issued four series of notes (two senior notes and two convertible notes), with a combined principal amount of approximately $1.8 billion, which remain outstanding and mature at various times between 2013 and 2017. The notes are supported by various guarantees from subsidiaries of SFC, and some are also supported by share pledges from certain of SFC's subsidiaries.

Affidavit of W. Judson Martin at paras. 37, 44-48.

27. SFC's failure to file the Q3 Results, and provide a copy of same to the trustee and to its noteholders on or before November 15, 2011, constituted a default under the 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.

Affidavit of W. Judson Martin at para. 147.

28. In its December 12, 2011 press release, SFC announced that the Board had determined not to make the $9.775 million interest payment on SFC's 2016 convertible notes that was due on December 15, 2011. This constituted a default under 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.

Affidavit of W. Judson Martin at paras. 149 & 151.

29. 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.

Affidavit of W. Judson Martin at para. 152.

8. Restructuring Committee

30. On December 16, 2011, in response to the notices of default, 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.

Affidavit of W. Judson Martin at para. 153.

9. The Waiver Agreements

31. On January 12, 2012, SFC announced that holders of a majority in principal amount of SFC's senior notes due 2014 and its senior notes due 2017 agreed to waive the default arising from SFC's failure to release the Q3 Results on a timely basis. Pursuant to the waiver agreements, SFC agreed to, among other things, make the $9.775 million interest payment on its 2016 convertible notes that was due on December 15, 2011, curing that default.

Affidavit of W. Judson Martin at paras. 155-156.

32. The waiver agreements expire on the earlier of April 30, 2012 and any earlier termination of the waiver agreements in accordance with their terms. In addition, should SFC fail to file its audited financial statements for its fiscal year ended December 31, 2011 by March 30, 2012 (and

upon the necessary notices being sent and cure periods expiring), the indenture trustees would again be in a position to accelerate and enforce.

Affidavit of W. Judson Martin at para. 157.

10. Audit Issues

33. SFC has made considerable efforts to address issues identified by SFC's Audit Committee and the IC and by its external auditor, Ernst & Young LLP, as requiring resolution in order for SFC to be in a position to obtain an audit opinion in relation to its 2011 financial statements.

Affidavit of W. Judson Martin at para. 12.

34. However, notwithstanding SFC's best efforts, many of these issues cannot be resolved to the satisfaction of SFC's auditor or cannot be resolved within a timeframe that would allow SFC to comply with its obligations under its note indentures. Therefore, absent a resolution with the noteholders, the indenture trustees would be in a position to enforce their legal rights as early as April 30, 2012, which would result in the acceleration and enforcement of the approximately $1.8 billion in notes.

Affidavit of W. Judson Martin at para. 13.

11. Deterioration of the Business

35. Although the allegations in the MW Report have not been substantiated, the allegations have had a catastrophic negative impact on Sino-Forest's business activities and have created substantial uncertainty regarding the future of Sino-Forest's business in the minds of the Sino-

Forest Companies' stakeholders in the PRC, including its lenders, customers, suppliers, employees and governmental officials.

Affidavit of W. Judson Martin at paras. 175 & 182.

36. Following the release of the MW Report, the value of SFC's shares substantially dropped, and there has been a material decline in the market value of SFC's common shares and notes. Credit ratings were lowered and ultimately withdrawn.

Affidavit of W. Judson Martin at paras. 191-192.

37. The various investigations discussed above and the class action lawsuits have required, and will continue to require, significant resources to be expended by the directors, officers and employees of Sino-Forest, including a substantial amount of fees and expenses. This has affected Sino-Forest's ability to conduct its operations in the normal course of business. The business has effectively been frozen and has ground to a halt.

Affidavit of W. Judson Martin at paras. 183 & 190.

38. In order to conserve cash, Sino-Forest has only completed cash purchases which were previously committed to and has not made any new commitments; therefore, it has not grown its asset base as it would have but for the MW Report. The Sino-Forest Companies have also had an extremely difficult time collecting outstanding receivables as a result of the perceived uncertainty surrounding them in the PRC. At the same time, they are also receiving increased demands on their payables.

Affidavit of W. Judson Martin at paras. 184-186.

39. In addition, SFC has been unable to secure or renew certain existing onshore banking facilities and has been unable to obtain offshore letters of credit to facilitate its trading business. All offshore banking facilities have been repaid and frozen, or cancelled. Various projects and contracts have been stopped or are unable to be fulfilled. And relationships with the PRC government, local government and suppliers have become strained, making it increasingly difficult to conduct any business operations.

Affidavit of W. Judson Martin at paras. 187-189.

12. The Support Agreement and the Sale Process

40. Following extensive arm's length negotiations between SFC and the Ad Hoc Noteholders, the parties entered into a Support Agreement. The Support Agreement provides that SFC will pursue a CCAA Plan on the terms set out in the Support Agreement in order to implement the agreed-upon restructuring transaction.

Affidavit of W. Judson Martin at paras. 196-197.

41. The restructuring transaction would, among other things:

(i) separate Sino-Forest's business operations from the problems facing SFC outside the PRC (such as the default under its note indentures and the inability to obtain an audit) by transferring Sino-Forest's business operations to a new entity to be owned primarily by the noteholders ("SF Newco");

(ii) provide stakeholders with claims ranking behind the noteholders (the "Junior Constituents") some "upside" in the form of a profit participation if Sino-Forest's

business operations acquired by the noteholders are monetized at a profit within seven years; and

(iii) create (and provide funding for) a framework for the prosecution of certain litigation claims for the benefit of SFC's stakeholders, including significant litigation against Muddy Waters LLC and Carson Block.

Affidavit of W. Judson Martin at paras. 15 & 198.

42. The Support Agreement also provides that each noteholder that is a signatory thereto will vote its notes in favour of the Plan at any meeting of creditors, and that SFC will undertake a Sale Process, in accordance with the Sale Process Procedures, which have been developed in consultation with the proposed Monitor and accepted by the parties to the Support Agreement.

Affidavit of W. Judson Martin at paras. 16 & 197.

43. The Sale Process is intended to provide a "market test" by which third parties may propose to acquire Sino-Forest's business operations through a CCAA Plan (in a manner that would under certain scenarios potentially allow Junior Constituents to share in the proceeds of a sale even though the noteholders may not be paid in full) as an alternative to the SF Newco restructuring transaction between SFC and its noteholders contemplated by the Support Agreement.

Affidavit of W. Judson Martin at para. 17.

44. The allegations in the MW Report have resulted in a substantial erosion of Sino-Forest's business, and if the business is to be saved in a manner beneficial to SFC's stakeholders, it is imperative that SFC take steps to demonstrate that Sino-Forest's business is being separated from

the uncertainty created by the MW Report. The commencement of a restructuring under the CCAA and the Sale Process is urgently required in order to preserve SFC's enterprise value.

Affidavit of W. Judson Martin at paras. 21, 175 & 202.

III. ISSUES AND THE LAW

45. SFC submits that the Initial Order and the Sale Process Order should be granted on the basis that this Application complies with the requirements of the CCAA, and the circumstances make the relief sought appropriate.

A. Compliance with the CCAA

46. The CCAA applies in respect of a "debtor company" or "affiliated debtor companies" where the total claims against the debtor or its affiliates exceeds $5 million.

CCAA, subsection 3(1).

47. The terms "company" and "debtor company" are defined in section 2 of the CCAA:

> "company" means any company, corporation or legal person incorporated by or under an Act of Parliament or of the legislature of a province and any incorporated company having assets or doing business in Canada, wherever incorporated, except banks, authorized foreign banks within the meaning of section 2 of the *Bank Act*, railway or telegraph companies, insurance companies and companies to which the *Trust and Loan Companies Act* applies;
>
> "debtor company" means any company that
>
> (i) is bankrupt or insolvent,
>
> (ii) has committed an act of bankruptcy within the meaning of the *Bankruptcy and Insolvency Act* or is deemed insolvent within the meaning of the *Winding-up and Restructuring Act*, whether or not proceedings in respect of the company have been taken under either of those Acts,
>
> (iii) has made an authorized assignment or against which a bankruptcy order has been made under the *Bankruptcy and Insolvency Act*, or

(iv) is in the course of being wound up under the *Winding-up and Restructuring Act* because the company is insolvent.

CCAA, s. 2

48. SFC is a corporation continued under the CBCA, and does not fall within any of the excluded categories listed above, and therefore is a "company" as defined in the CCAA.

Affidavit of W. Judson Martin at para. 212.

49. A "debtor company" includes a company that is insolvent; insolvency is not defined in the CCAA. The courts have interpreted this term by reference to the three tests of insolvency set out in subsection 2(1) of the *Bankruptcy and Insolvency Act*, R.S., 1985, c. B-3. A company is an insolvent "debtor company" under the CCAA if any one of the following conditions exist:

(i) the company is for any reason unable to meet its obligations as they generally become due;

(ii) the company has ceased paying its current obligations in the ordinary course of business as they generally become due; or

(iii) the aggregate of the company's property is not, at a fair valuation, sufficient, or, if disposed of at a fairly conducted sale under legal process, would not be sufficient to enable payment of all its obligations, due and accruing due.

Re Stelco Inc., [2004] O.J. No. 1257 at paras. 21-22, 28; leave to appeal to C.A. refused, [2004] O.J. No. 1903; leave to appeal to S.C.C. refused, [2004] S.C.C.A. No. 336.

50. Consistent with the remedial purposes of the CCAA, the first branch of the test has been found wide enough that a financially troubled corporation will be insolvent if it is "reasonably expected to run out of liquidity within a reasonable proximity of time as compared with the time reasonably required to implement a restructuring".

> *Re Stelco Inc.*, *supra*, at para. 26.
>
> *ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp.*, [2008] O.J. No. 1818 (Sup. Ct. J.) at paras. 12 & 32.

51. The issued and outstanding convertible and senior notes of SFC total approximately $1.8 billion. The waiver agreements with respect to SFC's default under the senior notes expire on April 30, 2012 (if not terminated earlier in accordance with their terms). But for the Support Agreement, which requires SFC to pursue a CCAA Plan, the indenture trustees under the notes would be entitled to accelerate and enforce the rights of the noteholders as soon as April 30, 2012. As such, SFC is "reasonably expected to run out of liquidity within a reasonable proximity of time" and would be unable to meet its obligations as they come due or continue as a going concern. SFC is insolvent under the CCAA.

> Affidavit of W. Judson Martin at paras. 215-216.

52. SFC has total claims/liabilities against it substantially in excess of the $5 million statutory requirement.

> Affidavit of W. Judson Martin at para. 213.

53. As a CBCA company that is insolvent with debts in excess of $5 million, SFC meets the statutory requirements for relief under the CCAA.

B. Stay of Proceedings

54. The overarching goal of an interim order is to maintain the *status quo* while the debtor develops a plan. The Court should exercise its power under the CCAA and at common law in order to maintain the *status quo* allowing the debtor to develop a plan and obtain consensus of its creditors.

> *Re Lehndorff General Partner Ltd.*, [1993] O.J. No. 14 at para. 5.

55. It is well established that under section 11 of the CCAA, the court has broad jurisdiction to grant a stay of proceedings to give a debtor company a chance to put forward a plan of compromise or arrangement that will be acceptable to its creditors and the court:

> The CCAA is intended to facilitate compromises and arrangements between companies and their creditors as an alternative to bankruptcy and, as such, is remedial legislation entitled to a liberal interpretation. It seems to me that the purpose of the statute is to enable insolvent companies to carry on business in the ordinary course or otherwise deal with their assets so as to enable plan of compromise or arrangement to be prepared, filed and considered by their creditors and the court. In the interim, a judge has great discretion under the CCAA to make order so as to effectively maintain the status quo in respect of an insolvent company while it attempts to gain the approval of its creditors for the proposed compromise or arrangement which will be to the benefit of both the company and its creditors.
>
> *Re Lehndorff General Partner Ltd.*, [1993] O.J. No. 14 at para. 5.
>
> CCAA, section 11.02.

56. Courts have an inherent jurisdiction to impose stays of proceedings against non-applicant third parties where it is important to the reorganization and restructuring process, and where it is just and reasonable to do so. This power has been exercised where the business operations of the Applicant and the third parties are intertwined, and where the third party is not subject to the jurisdiction of the CCAA (generally, partnerships or individuals that would not meet the definition of "company" under the CCAA).

Re Lehndorff General Partner Ltd., [1993] O.J. No. 14 (Gen. Div.) at paras. 10, 14-16, 21.

Re Woodward's Ltd., [1993] B.C.J. No. 42 (S.C.) at paras. 32-33.

Re Canwest Publishing Inc., 2010 ONSC 222 at paras. 33-34.

57. SFC requires a stay of proceedings to pursue and implement the Restructuring Transaction in an attempt to complete a going concern restructuring of its businesses. In the interim, the class actions lawsuits, as well as any other potential actions, need to be stayed so that SFC can focus on formulating a Plan and a successful restructuring.

Affidavit of W. Judson Martin at para. 217.

58. One of the main purposes of these CCAA proceedings is to avoid the harm to all of SFC's stakeholders were any of the noteholders to take enforcement steps in relation to SFC's subsidiaries. While SFC has an agreement with holders of approximately 40% of the notes, and expects that more than 50% will vote in favour of this agreement, as of the date of filing there are still 60% of the noteholders who could theoretically take steps against SFC's subsidiaries or their assets that could jeopardize the prospects of a successful restructuring.

59. Given these circumstances, it is both necessary and appropriate to extend the stay of proceedings that might be taken by any noteholder, indenture trustee or security trustee (in respect of the notes issued by SFC) in respect of SFC's subsidiaries. If SFC's subsidiaries were forced to respond to proceedings in respect of the notes issued by SFC, it would divert valuable resources away from the restructuring efforts and may also jeopardize any successful restructuring involving the notes. Akin to partnerships and individuals, the relevant SFC subsidiaries do not qualify as "debtor companies" under the CCAA, but the business operations of SFC and its subsidiaries are significantly intertwined such that it is necessary, and just and

reasonable, that the stay of proceedings be extended to the subsidiaries in respect of the notes. Moreover, SFC has agreed to provide such reasonable access as the Monitor may request to the business operations, records and employees of its subsidiaries.

C. Administration Charge

60. Section 11.52 of the CCAA provides the court with the statutory jurisdiction to grant an Administration Charge in respect of the fees and expenses of the Monitor (including any financial, legal or other experts engaged by the Monitor); any financial, legal or other experts engaged by the company for the purpose of the CCAA proceedings; and any financial, legal, or other experts engaged by any other interested person if the court is satisfied that the security or charge is necessary for their effective participation in the CCAA proceedings.

CCAA, section 11.52.

61. In addition to the factors provided for in section 11.52, the following factors may also be considered:

(i) the size and complexity of the businesses being restructured;

(ii) the proposed role of the beneficiaries of the charge;

(iii) whether there is an unwarranted duplication of roles;

(iv) whether the quantum of the proposed charge appears to be fair and reasonable;

(v) the position of the secured creditors likely to be affected by the charge; and

(vi) the position of the Monitor.

Re Canwest Publishing, 2010 ONSC 222 at para. 54.

62. The Administration Charge in the form set out in the Initial Order is appropriate and necessary in these circumstances for the following reasons:

(i) The size and complex nature of SFC's businesses requires the specialized knowledge and expertise of the proposed beneficiaries of the Administration Charge, each of which will play a critical role in the CCAA proceedings.

(ii) It is unlikely that these proposed beneficiaries will participate in the CCAA proceedings absent the Administration Charge.

(iii) There is no unwarranted duplication of roles between the proposed beneficiaries.

(iv) The Administration Charge is fair and reasonable in the circumstances.

(v) There are no secured creditors that are likely to be affected by the Charge.

(vi) The Monitor supports the Administration Charge.

(vii) The Administration Charge does not seek a superpriority charge ranking ahead of secured creditors.

Affidavit of W. Judson Martin at paras. 221-223 & 230.
Monitor's Report.

D. Directors' Charge

63. Section 11.51 of the CCAA provides the court with the statutory jurisdiction to grant a charge in favour of any director of the company to indemnify the director against obligations and liabilities that they may incur as a director of the company after commencement of the CCAA

proceedings. Such an order may not be made if the company could obtain adequate indemnification insurance for the director at a reasonable cost.

CCAA, section 11.51.

64. The purpose of such a charge is to keep the directors "in place during the restructuring by providing them with protection against liabilities they could incur during the restructuring." Retaining the current directors avoids destabilization and assists in the restructuring, enabling the debtor company to keep its experienced board of directors. The Court must be satisfied that the amount of the charge is appropriate in light of the obligations and liabilities that may be incurred.

Re Canwest Global Communications Corp., [2009] O.J. No. 4286 (Sup. Ct. J.) at paras. 48 & 52.

65. The Directors' Charge in the form set out in the Initial Order is appropriate and necessary in these circumstances for the following reasons:

(i) The continued participation of the directors is essential to a successful restructuring of SFC, as the specialized expertise, knowledge and relationships developed by these directors cannot be replicated or replaced.

(ii) Absent the Directors' Charge, the directors will not continue their participation in the restructuring of SFC.

(iii) The insurance policies currently in place contain exclusions and limitations of coverage which may leave SFC's directors without coverage in certain circumstances. For example, coverage may be denied on the basis that the claims are excluded, that coverage limits have been exhausted, or that matters fall within

the coverage provided by prior insurance policies (which are already responding to a number of significant claims that have the potential to exhaust or exceed the applicable limits). There is also no guarantee that SFC will be able to renew the policies when they expire at the end of 2012. SFC does not have sufficient funds to satisfy the contractual indemnities provided by SFC to its directors, should the directors incur obligations and liabilities after the commencement of these proceedings. In the present circumstances, it is not possible to obtain, at a reasonable cost, satisfactory coverage for the directors.

(iv) The Directors' Charge is fair and reasonable in the circumstances, particularly due to the size and complexity of SFC's business and the corresponding potential exposure of the directors to personal liability.

(v) There are no secured creditors that are likely to be affected by the Charge.

(vi) The Directors' Charge would rank behind the Administration Charge.

(vii) The Monitor supports the Directors' Charge.

(viii) The Directors' Charge does not seek a superpriority charge ranking ahead of secured creditors.

Affidavit of W. Judson Martin at paras. 224-231.
Monitor's Report.

E. Sales Process

66. The CCAA must be given a broad and liberal interpretation to achieve its objectives and facilitate the restructuring of an insolvent company. A sale by the debtor, which preserves its

business as a going concern, is consistent with these objectives, and the court has the jurisdiction to authorize a sale under the CCAA in the absence of a plan.

Re Nortel Networks Corp., [2009] O.J. No. 3169 (Sup. Ct. J.) at paras. 47-48.

67. The following factors may be considered when determining whether to authorize a sale under the CCAA in the absence of a plan:

(i) Is a sale transaction warranted at this time?

(ii) Will the sale benefit the whole "economic community"?

(iii) Do any of the debtors' creditors have a *bona fide* reason to object to a sale of the business?

(iv) Is there a better viable alternative?

Re Nortel Networks Corp., [2009] O.J. No. 3169 (Sup. Ct. J.) at para. 49.

68. As a result of the uncertainty created by the MW Report and subsequent developments, it is impossible to know at this time what an interested third party might be willing to pay for the underlying business operations of SFC once they are separated from the problems facing SFC outside the PRC (such as the default under its note indentures and the inability to obtain an audit in respect of its 2011 financial results), which are impacting business operations in the PRC. It is only by running the Sale Process that SFC and this Honourable Court can determine whether there is an interested party that would be willing to purchase SFC's business operations for an amount of consideration that is acceptable to SFC and its noteholders while also making excess funds available to Junior Constituents.

69. The Sale Process will benefit the entire economic community as it provides the Sino-Forest Companies with an opportunity to preserve their business and operations, and continue as a going concern while at the same time determining whether anyone will purchase SFC's business operations for an amount that can maximize value for all of SFC's stakeholders.

70. All stakeholders benefit from maximizing the value that can be obtained during the Sale Process. In order to maximize value, the Sale Process must be commenced immediately for the following reasons:

(i) The business of the Sino-Forest Companies is seasonal and the vast majority of transactions occur in the third and fourth quarter. As such, all stakeholders will be prejudiced if the restructuring is not completed as soon as possible and by the end of the third quarter at the latest.

(ii) The cloud of uncertainty hanging over SFC means that the value of the Sino-Forest Companies' business operations is decreasing by the day and any delay in commencing the Sale Process will diminish the value that could ultimately be available to stakeholders.

(iii) The complexity of the assets and the fact that there is a limited universe of potential buyers necessitates the Sale Process beginning immediately, in order to ensure completion in the timeframe allowing for maximum recovery.

Affidavit of W. Judson Martin at para. 174-175, 205-209.

71. There is no reason to believe that any creditors have a *bona fide* reason to object to the Sale Process. Moreover, no creditors will be prejudiced by the granting of the Sale Process

Order as they retain their rights to raise any objections to a proposed sale at a future motion to approve an asset sale.

Affidavit of W. Judson Martin at para. 210.

72. The Sale Process provides the best potential for recovery for all of SFC's stakeholders, and there is no better viable alternative. Given that the Sale Process is most likely to maximize value for all stakeholders if it is commenced immediately, the granting of the Sale Process Order is appropriate and necessary at this time.

Affidavit of W. Judson Martin at para. 209.

F. Postponement of Annual Shareholders' Meeting

73. Subsection 133(1) of the CBCA provides that the "directors of a corporation shall call an annual meeting of shareholders...not later than fifteen months after holding the last preceding annual meeting but no later than six months after the end of the corporation's preceding financial year." SFC is therefore required to call its annual general meeting no later than June 30, 2012.

CBCA, section 133.

74. Pursuant to subsection 133(3) of the CBCA, "the corporation may apply to the court for an order extending the time for calling an annual meeting." In addition to the authority provided by subsection 133(3), courts have exercised their jurisdiction under the CCAA to delay or postpone an annual meeting of shareholders. This has been done where time and resources would be diverted if the time was not extended; the preparation for and holding of the meeting would likely impede the timely and desirable restructuring; the incumbent directors would continue

pursuant to subsection 106(6) of the CBCA; and financial and other information would be available on the internet.

> *Re Canwest Global Communications Corp.*, [2009] O.J. No. 4286 (Sup. Ct. J.) at paras. 53-54.

75. In this case, it is impractical for SFC to call and hold its annual general meeting and therefore an order relieving SFC of this obligation is appropriate and necessary for the following reasons:

(i) Preparing the proxy materials required for an annual meeting of shareholders and holding the annual meeting would divert the attention of senior management of the Sino-Forest Companies away from implementing the Restructuring Transaction, would require significant financial resources, and could impede a successful restructuring.

(ii) At this time, SFC is unable to prepare financial statements which are required at an annual general meeting pursuant to the CBCA.

(iii) Pursuant to subsection 106(6) of the CBCA, the incumbent directors of SFC will continue to hold office until their successors are elected.

(iv) The shareholders will not be deprived of access to the financial information of SFC, as certain financial and other information is and will continue to be available to the public through SFC's court filings which will be easily accessible on the proposed Monitor's website.

> Affidavit of W. Judson Martin at paras. 232-238.
> CBCA, section 106(6).

G. Foreign Proceedings

76. SFC seeks to have the Monitor authorized, as the foreign representative of SFC, to apply for recognition of these proceedings, as necessary, in any jurisdiction outside of Canada, including as "Foreign Main Proceedings" in the United States pursuant to Chapter 15 of the *U.S. Bankruptcy Code.* Such an order is necessary to facilitate the restructuring as, among other things, SFC faces class action lawsuits in New York, the notes are governed by New York law, the indenture trustees under the notes are located in New York, and certain of the SFC subsidiaries may face proceedings in foreign jurisdictions in respect of certain notes issued by SFC.

Affidavit of W. Judson Martin at paras. 44, 180 & 239.

H. Financial Advisor Agreement

77. Section 11 of the CCAA provides the court with authority to allow a debtor company to enter into agreements which facilitate restructuring under the CCAA.

Re Stelco Inc. (2005), 78 O.R. (3d) 254 (C.A.) at para. 18.

78. Bennett Jones LLP, as counsel to SFC, entered into an agreement with Houlihan for financial advisory and investment banking services to SFC. The Agreement provides, among other things, that if SFC commences proceedings under the CCAA, SFC will promptly seek to have the Court approve (i) the Financial Advisor Agreement, and (ii) Houlihan's retention by SFC under the terms of the Agreement, including the payment to be made to Houlihan thereunder.

Affidavit of W. Judson Martin at paras. 241-242.

79. Houlihan has greatly assisted SFC in its restructuring efforts to date and has gained a thorough and intimate understanding of the Sino-Forest business. The continued involvement of Houlihan is essential to the completion of the Restructuring Transaction.

Affidavit of W. Judson Martin at paras. 243-244.

80. Both SFC and the Monitor believe that the quantum and nature of the remuneration provided for in the Financial Advisor Agreement is fair and reasonable. Specifically, the restructuring fees are only payable if a restructuring transaction is completed and the quantum of those fees is dependent on various factors intended to measure the success of the restructuring.

Affidavit of W. Judson Martin at para. 245.
Monitor's Report.

81. In these circumstances, an order approving the Financial Advisor Agreement is appropriate and essential to a successful restructuring of SFC.

IV. RELIEF SOUGHT

82. The Applicant requests that this Court grant relief by making an order substantially in the form of the Initial Order and the Sale Process Order included in the Application Record.

ALL OF WHICH IS RESPECTFULLY SUBMITTED
THIS 30th DAY OF MARCH 2012.

Bennett Jones LLP

SCHEDULE "A"

AUTHORITIES CITED

1. *Re Stelco Inc.* (2005), 78 O.R. (3d) 254 (C.A.)
2. *ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp.*, [2008] O.J. No. 1818 (Sup. Ct. J.)
3. *Re Lehndorff General Partner Ltd.,* (1993) 17 C.B.R. (3d) 24 (Ont. Gen. Div.)
4. *Re Woodward's Ltd.,* [1993] B.C.J. No. 42 (S.C.)
5. *Re Canwest Publishing Inc.,* 2010 ONSC 222
6. *Re Canwest Global Communications Corp.,* [2009] O.J. No. 4286 (Sup. Ct. J.)
7. *Re Nortel Networks Corp.,* [2009] O.J. No. 3169 (Sup. Ct. J.)
8. *Re Stelco Inc.,* [2004] O.J. No. 1257; leave to appeal to C.A. refused, [2004] O.J. No. 1903; leave to appeal to S.C.C. refused, [2004] S.C.C.A. No. 336

SCHEDULE "B"

STATUTES AND REGULATIONS CITED

***Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36**

2. (1) In this Act,

"company" means any company, corporation or legal person incorporated by or under an Act of Parliament or of the legislature of a province, any incorporated company having assets or doing business in Canada, wherever incorporated, and any income trust, but does not include banks, authorized foreign banks within the meaning of section 2 of the *Bank Act*, railway or telegraph companies, insurance companies and companies to which the *Trust and Loan Companies Act* applies;

"debtor company" means any company that

(*a*) is bankrupt or insolvent,

(*b*) has committed an act of bankruptcy within the meaning of the *Bankruptcy and Insolvency Act* or is deemed insolvent within the meaning of the *Winding-up and Restructuring Act*, whether or not proceedings in respect of the company have been taken under either of those Acts,

(*c*) has made an authorized assignment or against which a bankruptcy order has been made under the *Bankruptcy and Insolvency Act*, or

(*d*) is in the course of being wound up under the *Winding-up and Restructuring Act* because the company is insolvent;

Application

3. (1) This Act applies in respect of a debtor company or affiliated debtor companies if the total of claims against the debtor company or affiliated debtor companies, determined in accordance with section 20, is more than $5,000,000 or any other amount that is prescribed.

11.02 (1) A court may, on an initial application in respect of a debtor company, make an order on any terms that it may impose, effective for the period that the court considers necessary, which period may not be more than 30 days,

(*a*) staying, until otherwise ordered by the court, all proceedings taken or that might be taken in respect of the company under the *Bankruptcy and Insolvency Act* or the *Winding-up and Restructuring Act*;

(*b*) restraining, until otherwise ordered by the court, further proceedings in any action, suit or proceeding against the company; and

(*c*) prohibiting, until otherwise ordered by the court, the commencement of any action, suit or proceeding against the company.

Stays, etc. — other than initial application

(2) A court may, on an application in respect of a debtor company other than an initial application, make an order, on any terms that it may impose,

(*a*) staying, until otherwise ordered by the court, for any period that the court considers necessary, all proceedings taken or that might be taken in respect of the company under an Act referred to in paragraph (1)(*a*);

(*b*) restraining, until otherwise ordered by the court, further proceedings in any action, suit or proceeding against the company; and

(*c*) prohibiting, until otherwise ordered by the court, the commencement of any action, suit or proceeding against the company.

Burden of proof on application

(3) The court shall not make the order unless

(*a*) the applicant satisfies the court that circumstances exist that make the order appropriate; and

(*b*) in the case of an order under subsection (2), the applicant also satisfies the court that the applicant has acted, and is acting, in good faith and with due diligence.

Restriction

(4) Orders doing anything referred to in subsection (1) or (2) may only be made under this section.

2005, c. 47, s. 128, 2007, c. 36, s. 62(F).

11.51 (1) On application by a debtor company and on notice to the secured creditors who are likely to be affected by the security or charge, the court may make an order declaring that all or part of the property of the company is subject to a security or charge — in an amount that the court considers appropriate — in favour of any director or officer of the company to indemnify the director or officer against obligations and liabilities that they may incur as a director or officer of the company after the commencement of proceedings under this Act.

Priority

(2) The court may order that the security or charge rank in priority over the claim of any secured creditor of the company.

Restriction — indemnification insurance

(3) The court may not make the order if in its opinion the company could obtain adequate indemnification insurance for the director or officer at a reasonable cost.

Negligence, misconduct or fault

(4) The court shall make an order declaring that the security or charge does not apply in respect of a specific obligation or liability incurred by a director or officer if in its opinion the obligation or liability was incurred as a result of the director's or officer's gross negligence or wilful misconduct or, in Quebec, the director's or officer's gross or intentional fault.

2005, c. 47, s. 128;
2007, c. 36, s. 66.

11.52 (1) On notice to the secured creditors who are likely to be affected by the security or charge, the court may make an order declaring that all or part of the property of a debtor company is subject to a security or charge — in an amount that the court considers appropriate — in respect of the fees and expenses of

(*a*) the monitor, including the fees and expenses of any financial, legal or other experts engaged by the monitor in the performance of the monitor's duties;

(*b*) any financial, legal or other experts engaged by the company for the purpose of proceedings under this Act; and

(*c*) any financial, legal or other experts engaged by any other interested person if the court is satisfied that the security or charge is necessary for their effective participation in proceedings under this Act.

Priority

(2) The court may order that the security or charge rank in priority over the claim of any secured creditor of the company.

2005, c. 47, s. 128;
2007, c. 36, s. 66.

***Canada Business Corporations Act*, R.S.C. 1985, c. C-44**

106. (1) At the time of sending articles of incorporation, the incorporators shall send to the Director a notice of directors in the form that the Director fixes, and the Director shall file the notice.

Term of office

(2) Each director named in the notice referred to in subsection (1) holds office from the issue of the certificate of incorporation until the first meeting of shareholders.

Election of directors

(3) Subject to paragraph 107(*b*), shareholders of a corporation shall, by ordinary resolution at the first meeting of shareholders and at each succeeding annual meeting at which an election of directors is required, elect directors to hold office for a term expiring not later than the close of the third annual meeting of shareholders following the election.

Staggered terms

(4) It is not necessary that all directors elected at a meeting of shareholders hold office for the same term.

No stated terms

(5) A director not elected for an expressly stated term ceases to hold office at the close of the first annual meeting of shareholders following the director's election.

Incumbent directors

(6) Notwithstanding subsections (2), (3) and (5), if directors are not elected at a meeting of shareholders the incumbent directors continue in office until their successors are elected.

133. (1) The directors of a corporation shall call an annual meeting of shareholders

(*a*) not later than eighteen months after the corporation comes into existence; and

(*b*) subsequently, not later than fifteen months after holding the last preceding annual meeting but no later than six months after the end of the corporation's preceding financial year.

Calling special meetings

(2) The directors of a corporation may at any time call a special meeting of shareholders.

Order to delay calling of annual meeting

(3) Despite subsection (1), the corporation may apply to the court for an order extending the time for calling an annual meeting.

IN THE MATTER OF THE *COMPANIES CREDITORS' ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED AND IN THE MATTER OF A PLAN OR COMPROMISE OR ARRANGEMENT OF SINO-FOREST CORPORATION

Court File No.

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

Proceedings commenced in Toronto

FACTUM OF THE APPLICANT

BENNETT JONES LLP
One First Canadian Place
Suite 3400, P.O. Box 130
Toronto, Ontario
M5X 1A4

Robert W. Staley (LSUC #27115J)
Kevin Zych (LSUC #33129T)
Derek J. Bell (LSUC #43420J)
Jonathan Bell (LSUC #55457P)
Tel: 416-863-1200
Fax: 416-863-1716

Lawyers for the Applicant