

**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

**FACTUM OF THE RESPONDING PARTY,**  
**THE BOARD OF DIRECTORS OF SINO-FOREST CORPORATION**  
(Motion returnable October 9-10, 2012)

October 3, 2012

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**TO: THE SERVICE LIST**

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**(Motion returnable May 8, 2012)**

**PART I. OVERVIEW**

1. The class action plaintiffs (the "Plaintiffs") seek to proceed with uncertified class proceedings against: a) all non-settling defendants in the Ontario and Quebec class actions, including Sino-Forest Corporation and its directors and officers; or b) alternatively, only the auditor and underwriter defendants in the Ontario and Quebec class actions, together with three individual defendants, without regard for Sino-Forest's insolvency and the resulting protection afforded to Sino-Forest and its directors and officers under the *Companies' Creditors Arrangement Act* ("CCAA"). Granting the Plaintiffs' motion would: a) elevate the Plaintiffs' interests above other creditors; b) unduly interfere with or frustrate Sino-Forest's restructuring efforts; and c) be prejudicial to Sino-Forest, its directors and officers and Sino-Forest's creditors and other stakeholders.

2. The Plaintiffs now seek to lift the stay of proceedings (the "Stay") ordered by this Court on March 30, 2012 (the "Initial Order"), to permit the Plaintiffs to proceed with two

motions respecting the Ontario class action (the “Ontario Class Action”) outside of these CCAA proceedings regarding: a) leave under Part XXIII.1 of the *Securities Act* (the “Leave Motion”) and b) certification under the *Class Proceedings Act, 1992* (the “Certification Motion”), as well as various relief regarding a related class proceeding commenced in Quebec (the “Quebec Class Action”).

3. The Board of Directors of Sino-Forest (the “Board”, and each current member a “Director”) opposes lifting the Stay to permit the Leave and Certification Motions to proceed against Sino-Forest and the Directors.

4. The Initial Order expressly stays proceedings like the Class Actions against Sino-Forest and its former and current directors and officers (the “Directors and Officers”). This critical relief is typically granted in a CCAA proceeding. The Stay is designed to permit Sino-Forest and the Board to develop a plan to compromise Sino-Forest’s debts for the benefit of all stakeholders. It is crucial that Sino-Forest and the Directors and Officers remain protected by the Stay. The Directors are charged with managing and supervising the business and affairs of Sino-Forest and play an instrumental role in steering Sino-Forest through the myriad of challenges raised by the restructuring process. The Plaintiffs have failed to show that the present circumstances warrant departing from usual CCAA practice of insulating a debtor corporation and its board from the burdens of distracting litigation during CCAA proceedings.

5. To fully insulate Sino-Forest and the Board from the inherently detrimental nature of the class actions commenced in various jurisdictions, including the Ontario Class Action and the Quebec Class Action (collectively, the “Class Actions”), this Court should similarly refuse the Plaintiffs’ alternative motion to lift the Stay as against only Ernst & Young LLP, BDO Limited, the underwriter defendants, Allen T.Y. Chan, David J. Horsley and Kai Kit Poon

(collectively, the “Third Party Defendants”). If the Class Actions are stayed in respect of Sino-Forest and the Directors and Officers, but permitted to proceed against the Third Party Defendants, there is a significant risk that resources and attention currently focussed on the restructuring will be diverted. As exemplified in the Ontario Class Action, due to the interrelated nature of the Plaintiffs’ claims, there will inevitably be requests for information from Sino-Forest and key personnel. There is also a serious risk of inconsistent judicial findings, as well as findings of fact prejudicial to Sino-Forest and the Director and Officer Defendants which may result from the Class Actions continuing without their participation.

6. Furthermore, the Class Actions have resulted in claims for indemnification against Sino-Forest the value of which will remain uncertain long past the tight window of opportunity Sino-Forest has to restructure. A successful restructuring of Sino-Forest will not be possible unless the claims arising from the Class Actions, including the Plaintiffs’ claims, are adjudicated and valued within the CCAA process.

## **PART II. FACTS**

### **A. The CCAA Proceeding**

7. On March 30, 2012, this Court made the Initial Order granting Sino-Forest protection from its creditors and appointing FTI Consulting Inc. as the monitor (the “Monitor”) in this CCAA proceeding.<sup>1</sup> As a part of the Initial Order, this Court granted the Stay against, at a minimum, Sino-Forest and its Directors and Officers until April 30, 2012. By order dated September 28, 2012, the Stay Period (as defined in the Initial Order) was extended until October 11, 2012.

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<sup>1</sup> *Companies’ Creditors Arrangement Act*, R.S.C. 1985, c. C-36 [CCAA].

8. This Court also made the Sales Process Order approving the sales process procedures attached thereto on March 30, 2012.

9. On August 31, 2012, this Court issued a Plan filing and Meeting Order, which, among other things, accepted Sino-Forest's draft Plan of Compromise and Reorganization (the "Plan") for filing, subject to any objections being raised at the sanction hearing stage.<sup>2</sup>

10. Under the protection and stability provided by the Stay, Sino-Forest and its Board continue to work diligently on all aspects of the restructuring in conjunction with Sino-Forest's advisors and the Monitor.<sup>3</sup>

11. It is critical to the success of the restructuring that the members of the Board – as the directing minds of Sino-Forest and as experienced and knowledgeable businessmen – remain fully engaged in the restructuring process.<sup>4</sup>

## **B. The Class Actions**

12. The release of a report by Muddy Waters Research on June 2, 2011 led to the issuance of the Class Actions in Ontario, Saskatchewan, Quebec and New York State, and may lead to further proceedings against Sino-Forest, certain of its Directors and Officers, and the Third Party Defendants.

13. Following a lengthy carriage dispute in Ontario among three competing groups of representative plaintiffs, the Plaintiffs in the Ontario Class Action, styled *Trustees of the*

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<sup>2</sup> Affidavit of W. Judson Martin sworn September 24, 2012 (the "Martin Affidavit of September 24"), paras. 10-11, Exhibit "E" to the Affidavit of W. Judson Martin sworn October 3, 2012 (the "October Martin Affidavit"), Motion Record of Sino-Forest for the motion returnable October 9-10, 2012 ("Motion Record of Sino-Forest"), Tab 2(e).

<sup>3</sup> October Martin Affidavit, para. 21, Motion Record of Sino-Forest for the motion returnable October 9-10, 2012 ("Motion Record of Sino-Forest"), Tab 2, p. 10.

<sup>4</sup> *Id.*, paras. 21-22.

*Labourers' Pension Fund of Central and Eastern Canada et al. v. Sino-Forest Corporation et al.* (Court File No. CV-11-431153-00CP), were awarded carriage.<sup>5</sup>

14. The Plaintiffs in the Ontario Class Action are members of a proposed class of purchasers of Sino-Forest's securities (including notes) from March 19, 2007 to June 2, 2011.<sup>6</sup>

15. While the Plaintiffs have made various allegations in their statement of claim in the Ontario Class Action (the latest iteration of which was filed April 18, 2012, the "Fresh As Amended Statement of Claim"), essentially the central allegation is that all defendants – including Sino-Forest, the Director and Officer Defendants, and the Third Party Defendants – made, consented to, authorized or permitted misrepresentations in Sino-Forest's public disclosure.<sup>7</sup>

16. Certain of the Director and Officer Defendants are currently members of the Board. As against these current Board members, the Plaintiffs have made serious allegations that merit a vigorous response and that would divert significant attention of the Board away from Sino-Forest's restructuring efforts if not for the Stay.<sup>8</sup> These allegations include oppression under the *Canada Business Corporations Act*,<sup>9</sup> unjust enrichment, negligent misrepresentation in the primary and secondary markets, and primary and secondary market misrepresentation under Parts XXIII and XXIII.1 of the *Securities Act*.<sup>10</sup>

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<sup>5</sup> Affidavit of Daniel Bach sworn April 11, 2012 ("Bach Affidavit of April 11"), para. 7, Motion Record of the Plaintiffs' dated April 11, 2012 ("Plaintiffs' Motion Record of April 11"), Tab 2, p. 31.

<sup>6</sup> Fresh As Amended Statement of Claim filed April 18, 2012, para. 1.

<sup>7</sup> *Id.*, paras. 14, 70.

<sup>8</sup> Bach Affidavit of April 11, para. 82, Plaintiffs' Motion Record of April 13, Tab 2, p. 53.

<sup>9</sup> *Canada Business Corporations Act*, R.S., 1985, c. C-44, Part XX.

<sup>10</sup> *Securities Act*, R.S.O. 1990, c. S.5.

17. In total, the Plaintiffs are seeking more than \$9 billion in damages from the defendants, including \$6.5 billion for damages in the secondary market as against all but the underwriter defendants.<sup>11</sup> For the large proportion of this amount that arises from the Plaintiffs' common law secondary market misrepresentation claims, the Plaintiffs claim jointly and severally as against all defendants, including each of the individual defendants who are former and current members of the Board.<sup>12</sup> In reasons released July 27, 2012, this Honourable Court held that claims against Sino-Forest resulting from the ownership, purchase or sale of equity interests in Sino-Forest, including the claims by the Plaintiffs on behalf of current or former shareholders, are "equity claims" as defined in the CCAA (the "Equity Claims Decision").<sup>13</sup>

18. Sino-Forest itself is at the centre of the Plaintiffs' allegations. Most if not all of the allegations against the Third Party Defendants are also made against Sino-Forest, and each allegation arises from the same essential events. As the reporting issuer in this purported securities class action, the actions of Sino-Forest itself will be central to the determination of most, if not all, of the Plaintiffs' claims.

19. The Plaintiffs' claims are interwoven among the co-defendants, and are likely to result in many of the same questions of fact and law in respect of Sino-Forest, the Director and Officer Defendants, and the Third Party Defendants. For example, in support of their negligent misrepresentation claim, the Plaintiffs rely on a single alleged misrepresentation that they allege was made by all defendants other than Pöyry (Beijing) Consulting Company Limited ("Poyry"), namely, that Sino-Forest's financial statements complied with Canadian generally accepted

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<sup>11</sup> Fresh As Amended Statement of Claim, para. 2(f).

<sup>12</sup> *Id.*, paras. 2(f), 221-230.

<sup>13</sup> Martin Affidavit of September 24, para. 6, Exhibit "E" to the October Martin Affidavit, Motion Record of Sino-Forest, Tab 2(e), p. 126.



accounting principles.<sup>14</sup> The question of whether or not this representation was a misrepresentation will be central to determination of liability for every one of the defendants (except Poyry).

20. Similarly, many of the Third Party Defendants have made indemnity claims as against Sino-Forest and its directors and officers. These claims for indemnification have been made on the basis of contract, common law, and statutory claim-over provisions.<sup>15</sup>

21. The Ontario Class Action is in its infancy and has not been certified. By order dated March 26, 2012, Justice Perell scheduled the Plaintiffs' Leave Motion, the Certification Motion, and any motions under Rule 21 of the *Rules of Civil Procedure* to be heard together in November, 2012. Responding affidavits from the defendants for the Leave and Certification Motions were to be served on June 11, 2012. As a result of the Stay, the timetable has not been adhered to and no steps have been taken in respect of these motions.<sup>16</sup> No statements of defence have been delivered. While the mediation held September 4 and 5, 2012 (the "Mediation") pursuant to the mediation order issued by this Honourable Court on July 25, 2012 did not result in a settlement, Sino-Forest disclosed over 18,000 documents to the parties who participated in the Mediation and informal settlement discussions have continued.<sup>17</sup>

22. The parties in the Ontario Class Action entered into a tolling agreement on March 6, 2012 in respect of the Plaintiffs' claims for which leave is required under the *Securities Act*

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<sup>14</sup> *Id.*, para. 224; Motion Record of Sino-Forest, Tab 2(e), pp. 246.

<sup>15</sup> October Martin Affidavit, para. 23, Motion Record of Sino-Forest, Tab 2, p. 11.

<sup>16</sup> Affidavit of Daniel E.H. Bach sworn September 24, 2012 (the "Bach Affidavit of September 24"), paras. 29-30, Motion Record of the Plaintiffs for the motion returnable October 9-10, 2012, tab Tab 2, p. 17.

<sup>17</sup> October Martin Affidavit, paras. 24-29, Motion Record of Sino-Forest, Tab 2, pp. 11-12.

(the “Tolling Agreement”). The Tolling Agreement suspends the limitation period for these claims until February 28, 2013.

**C. The Plaintiffs’ CCAA Motion**

23. The Plaintiffs purport to represent the current and former shareholders and the former noteholders of Sino-Forest, including those noteholders who may continue to hold notes that they acquired between March 19, 2007 and June 2, 2011. They have not been certified as representatives in the Ontario Class Action. No representation order has been made in this proceeding.

24. The Plaintiffs have sought a lift of the Stay to allow the Leave Motion and the Certification Motion to proceed as against a) all non-settling defendants; or b) alternatively, only the Third Party Defendants. In support of this relief, the Plaintiffs have led no evidence demonstrating the urgency or necessity of a lift stay to pursue these motions at this time, aside from the possibility that the decision on the Leave Motion might not be released before the expiry of the Tolling Agreement, which is five months in the future.<sup>18</sup>

25. By contrast, the preparation of responding materials and cross-examinations for what are sure to be heated Leave and Certification Motions would divert significant attention of the Board away from Sino-Forest’s restructuring efforts both in terms of Sino-Forest’s approach to the Ontario Class Action and because the Directors are themselves defendants in that action. Similarly, Sino-Forest, its management and its Directors are likely to be obliged to be involved

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<sup>18</sup> Bach Affidavit of April 11, para. 14, Plaintiffs’ Motion Record of April 13, Tab 2, p. 33.

in the Ontario Class Action even if it proceeds only against the Third Party Defendants, given the obvious possibility that the rights of all defendants will be affected.<sup>19</sup>

### PART III. LAW AND ARGUMENT

#### A. The Plaintiffs Would Face A Heavy Burden In Seeking To Lift The Stay of Proceedings

26. The Initial Order expressly stays proceedings like the Ontario Class Action, against Sino-Forest and its Directors and Officers.<sup>20</sup>

27. The power to stay proceedings is the key component of the CCAA process. The purpose of a stay is to preserve the *status quo* and hold creditors at bay while the debtor company attempts to develop a plan to compromise its debts for the benefit of all stakeholders. To achieve this purpose the stay of proceedings is designed to prevent “manoeuvres for positioning” among creditors.<sup>21</sup>

28. The CCAA gives a court express statutory authority to grant a broad stay of proceedings against a debtor company and its directors.<sup>22</sup> This statutory stay power is “augmented by the Court’s inherent jurisdiction to grant a stay in appropriate circumstances.”<sup>23</sup>

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<sup>19</sup> October Martin Affidavit, para. 21, Motion Record of Sino-Forest, Tab 2, p. 10. See, also, Martin Affidavit of March 30, para. 183; Exhibit “A” to the October Martin Affidavit, Motion Record of Sino-Forest, Tab 2(a), p. 64.

<sup>20</sup> Initial Order, paras. 17-18, 24; Exhibit “B” to the October Martin Affidavit, Motion Record of Sino-Forest, Tab 2b, pp. 91, 93-94.

<sup>21</sup> *Stelco Inc. (Re)*, 2005 CarswellOnt 1188 (CA) at para. 36; *Re Canadian Airlines Corp*, 2000 CarswellAlta 622 (QB) [*Canadian Airlines*] at paras. 12-19.

<sup>22</sup> CCAA, *supra*, ss. 11.02-11.03.

<sup>23</sup> *SNV Group Ltd. (Re)*, 2001 BCSC 1644 at para. 14, citing *Woodward’s Ltd. (Re)*, 1993 CarswellBC 530 (SC) [*Woodward’s*] at para. 32, *Lehndorff General Partner Ltd., Re*, 1993 CarswellOnt 183 (Gen Div) [*Lehndorff*] at para. 16, and *T. Eaton Co. (Re)*, 1997 CarswellOnt 1914 (Gen Div) at para. 6; *Timinco Limited (Re)*, 2012 ONSC 2515 [*Timminco*] at para. 15.

29. Lifting a stay of proceedings is a discretionary decision. A party faces “a very heavy onus” when applying to a court for an order lifting the stay of proceedings. A court should consider whether there are “sound reasons” for lifting the stay consistent with the objectives of the CCAA, including considering the balance of convenience, relative prejudice to the parties and, where relevant, the merits of the proposed action.<sup>24</sup>

30. Courts have identified very limited circumstances in which a stay may be lifted, none of which are present in this case:

- (i) The applicant shows that the plan of compromise or arrangement is likely to fail.
- (ii) The applicant shows hardship.
- (iii) The applicant creditor shows necessity for payment (where the creditors’ financial problems are created by the order, or where failure to pay the creditor would cause it to close and thus jeopardize the debtor company’s existence).
- (iv) The applicant would be severely prejudiced by a refusal to lift the stay and there would be no resulting prejudice to the debtor company or the positions of creditors.
- (v) The applicant must take steps to protect a right which could be lost by the passage of time.

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<sup>24</sup> *Re Canwest Global Communications Corp.*, 2011 ONSC 2215 [*Canwest*] at para. 27; *ICR Commercial Real Estate (Regina) Ltd. v. Bricore Land Group Ltd.*, 2007 SCKA 72 at para. 68.

- (vi) The applicant shows that, after the lapse of a significant time period, the debtor company is no closer to proposing a plan than at the commencement of the stay period.
- (vii) The applicant secured creditor shows there is a real risk that its secured loan will become unsecured.
- (viii) The applicant must perfect a right that existed prior to the commencement of the stay period or lose that right.
- (ix) The applicant shows that it is in the interests of justice to do so.<sup>25</sup>

31. As more fully developed below, CCAA courts uniformly deny motions to lift stays by class action plaintiffs seeking to have their claims against the debtor company and its directors and officers adjudicated outside a court supervised CCAA process. In denying such plaintiff motions, the courts determined that the purpose of the CCAA – to reorganize an insolvent corporation within a relatively short period for the benefit of all stakeholders – was furthered by having a single process for resolving all related claims.

32. While a court granting a stay is required to balance the interests of the affected parties, “[t]he possibility that one or more creditors may be prejudiced should not affect the court’s exercise of its authority to grant a stay of proceedings under the CCAA because this effect is offset by the benefit to all creditors and to the company of facilitating a reorganization. The court’s primary concerns under the CCAA must be for the debtor and *all* of the creditors.”<sup>26</sup>

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<sup>25</sup> *Canwest, supra* at para. 26 and *Canadian Airlines, supra* at para. 20, both citing Professor Richard H. McLaren in his book “*Canadian Commercial Reorganization: Preventing Bankruptcy*” (Aurora: Canada Law Book, 1994+).

<sup>26</sup> *Lehndorff, supra* at para. 30.

**B. The Plaintiffs Have Not Met Their Burden**

33. Lifting the Stay to permit the Plaintiffs to pursue Sino-Forest and the Directors and Officer Defendants in the Ontario Class Action would not serve the objectives of the CCAA, and would instead impair Sino-Forest's restructuring efforts. A successful restructuring will require Sino-Forest and the Directors and Officers to be insulated from the burdens of litigation. Lifting the Stay will impair Sino-Forest's restructuring efforts.

34. Courts have refused to lift a stay to permit actions to proceed against directors (and of course the debtor company) where the consequence would be to divert the board's focus or "executive time" away from the restructuring.<sup>27</sup> As this Court noted in *Nortel Networks Inc. (Re)*:

In my view, the Nortel restructuring is at a critical stage and the energies and activities of the Board should be directed towards the restructuring. ... To permit the ERISA Litigation to continue at that time would, in my view, result in a significant distraction and diversion of resources at a time when that can be least afforded.<sup>28</sup>

35. Similar concerns in the present circumstances demonstrate that there are no sound reasons for lifting the Stay. Lifting the Stay protecting the Directors and Officers (and of course Sino-Forest) would greatly prejudice Sino-Forest's restructuring efforts by distracting management and the Board from devoting their undivided attention to the restructuring. The Plaintiffs have delivered voluminous materials in support of their Leave and Certification Motions, and the defendants would need to respond with significant records of their own. These motions would be complex, hard fought, and expensive. If the Ontario Class Action progressed, litigation would entail, among other things, negotiating a discovery agreement and collecting and

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<sup>27</sup> *Nortel Networks Inc. (Re)*, 2009 CarswellOnt 4806 (SCJ) [*Nortel*] at para. 36; *Air Canada (Re)*, 2003 CarswellOnt (SCJ) at para. 26, citing *Sairex GmbH v. Prudential Steel Ltd.*, 1991 CarswellOnt 9109 (Gen Div) at para. 40.

<sup>28</sup> *Nortel, supra* at para. 26.

producing the required documentation, preparing past and current directors and officers for depositions, and addressing the strategic issues raised by the litigation – all of which require Board and management attention.

36. Additionally, the Ontario Class Action would impose a significant strain on Sino-Forest's limited financial resources, both in respect of the Leave and Certification Motions and in the future if the matter proceeds to trial.<sup>29</sup> Sino-Forest's legal and other advisor-related resources that are currently focussed on the restructuring would necessarily be diverted to the Leave and Certification Motions, and to any future steps in the Ontario Class Action.

37. Moreover, the Plan contemplates a release for Sino-Forest and certain current and former directors of Sino-Forest from claims arising within the Class Actions. It would be a waste of time and judicial resources to require Sino-Forest and these individuals to respond to motions and to file statements of defence within the Class Actions before it is known whether or in respect of which of the claims they will ultimately be released.<sup>30</sup>

38. By contrast, the Plaintiffs have shown no prejudice as compared to Sino-Forest and its Directors and Officers. Indeed, none of the circumstances identified by courts in which a stay may be lifted are present in this case. The Plaintiffs have provided no evidence of hardship, necessity for payment, any right that needs perfecting, or a secured loan that will become unsecured through the passage of time.

39. Insofar as the Plaintiffs would submit that they must be permitted to proceed with the Leave Motion to protect their rights under Part XXIII.1 of the *Securities Act* from expiration

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<sup>29</sup> October Martin Affidavit, para. 21, Motion Record of Sino-Forest, Tab 2, p. 10.

<sup>30</sup> *Id.*, para. 22, Motion Record of Sino-Forest, Tab 2, pp. 10-11.

of the relevant limitation period, this consideration is insufficient to lift the Stay in the present circumstances for two reasons. First, due to the Tolling Agreement, which has suspended the limitation period until February 28, 2013, there is no pressing need to lift the Stay for the Leave Motion at this time. Second, regardless of any tolling agreement, the Plaintiffs' claims will be addressed and valued within the CCAA process alongside other creditors as is the case in any CCAA proceeding.

40. Examples abound of CCAA courts denying motions to lift stays where plaintiffs sought to have their claims against the debtor company and its directors adjudicated in a class action proceeding.<sup>31</sup> As Justice Farley exemplified in *Air Canada (Re)*, such motions will be denied when, as in this case, class action plaintiffs seek to gain an advantage over other creditors in the CCAA proceeding:

As it appears envisaged by the plaintiffs, they wish to proceed unimpeded by either the claims process in place or otherwise, in pursuing their litigation against AC and UA "in the ordinary course." As discussed, that litigation would be of major proportions, complexity and importance to these insolvent but attempting to reorganize corporations and their stakeholders. The effect on these restructuring efforts would be a fairly large multiple of cuts in the death of a thousand cuts which I was concerned about in the *Re Air Canada (Regulators' Motions)* released July 21, 2003.<sup>32</sup>

41. In denying such motions, the courts determined that the purpose of the CCAA – to reorganize an insolvent corporation within a relatively short period for the benefit of all stakeholders – was furthered by having a single process for resolving all related claims. The purpose of the CCAA will similarly be furthered in the present circumstances if the Stay is maintained.

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<sup>31</sup> See for example: *Air Canada (Re)*, 2004 CarswellOnt 481 (SCJ) [*Air Canada*]; *Muscletech Research & Development Inc. (Re)*, 2006 CarswellOnt 6230 (SCJ) [*Muscletech*]; *Grace Canada Inc. (Re)*, 2005 CarswellOnt 6648 (SCJ) [*Grace*]; and *Canadian Red Cross Society (Re)* 1999 CarswellOnt 3234 (SCJ).

<sup>32</sup> *Air Canada*, *supra* para. 7.



**C. The Class Actions Should Be Stayed As Against All Parties**

42. The Plaintiffs appear to accept for the purposes of this motion that the Stay currently extends to all defendants in the Class Actions, including the Third Party Defendants. On that basis, this Court should deny both the principal and the alternative relief sought by the Plaintiffs and should refuse to lift the Stay to allow the Plaintiffs to proceed against either all non-settling defendants or the Third Party Defendants. However, to the extent the Plaintiffs only dispute that the Stay currently extends to the Third Party Defendants, the Board submits that this Court should exercise its discretion to extend the Stay to the Third Party Defendants for all the reasons set out below.

43. Lifting the Stay to allow the Plaintiffs to proceed with the Class Actions against only the Third Party Defendants is inconsistent with the objectives of the CCAA. A Stay in respect of all Third Party Defendants facilitates Sino-Forest's restructuring efforts by effectively and fairly evaluating the Plaintiffs' claims against Sino-Forest and the Director and Officer Defendants alongside other creditors of Sino-Forest in a manner that respects the time-sensitive nature of Sino-Forest's circumstances and the CCAA proceeding. By contrast, a partial stay of proceedings undermines these goals.

44. The CCAA is remedial legislation which should be given a large and liberal interpretation.<sup>33</sup> Courts have held that the discretion to stay proceedings should be interpreted broadly to accomplish this remedial purpose, and in particular to enable operational continuance of the debtor company.<sup>34</sup> To this end, courts have interpreted the stay power to extend to judicial or extra-judicial conduct which could seriously impair the debtor company's ability to continue

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<sup>33</sup> *ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp.*, 2008 ONCA 587 at para. 44, leave to appeal to SCC denied [2008] SCCA No. 337.

<sup>34</sup> *Canwest*, *supra* at para. 24, citing *Nortel Networks Corp. (Re)*, 2009 ONCA 833 at para. 33 and *Lehndorff*, *supra* at para. 10.

in business while it negotiates a plan to compromise its debts.<sup>35</sup> This power is sufficiently broad to affect the position of non-parties to the CCAA process. As noted by Justice Farley in *Lehndorff General Partner Ltd. (Re)*:

The power to grant a stay of proceeding should be construed broadly in order to permit the CCAA to accomplish its legislative purpose and in particular to enable continuance of the company seeking CCAA protection. The power to grant a stay therefore extends to a stay which affected the position not only of the company's secured and unsecured creditors, but also all non-creditors and other parties who could potentially jeopardize the success of the plan and thereby the continuance of the company.<sup>36</sup>

45. Similarly, Justice Campbell noted in the asset-backed commercial paper proceedings that CCAA stays have been granted to protect non-parties:

S. 11 of the CCAA provides for stays of proceedings against the debtor companies. It is silent as to the availability of stays in favour of non-parties. The granting of stays in favour of non-parties has been held to be an appropriate exercise of the Court's jurisdiction. A number of authorities have supported the concept of a stay to enable a "global resolution."<sup>37</sup>

46. A stay of the Class Actions against just Sino-Forest and the Directors and Officers is insufficient to fully protect Sino-Forest's restructuring from the adverse effects of the Class Actions. The Class Actions, and their inevitably lengthier timeframe, are inherently detrimental to the restructuring process. A successful restructuring depends on timely adjudication and valuation of all of Sino-Forest's liabilities arising from the claims in the Class Actions, including the Plaintiffs' claims. Claims for contribution and indemnity have been made among defendants within the CCAA, and are likely to be made within the Class Actions, if and when they proceed. The value of these indemnification claims will remain uncertain until the Class Actions are

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<sup>35</sup> *Campeau v. Olympia & York Developments Ltd.*, 1992 CarswellOnt 185 (Gen Div) [*Campeau*] at paras. 19-20, citing *Quintette Coal Ltd. v. Nippon Steel Corp.*, 1990 CarswellBC 384 (CA) at para. 17.

<sup>36</sup> *Lehndorff*, *supra* at para. 10.

<sup>37</sup> *ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp.*, 2008 CarswellOnt 2652 (SCJ) at para. 48, citing *Campeau*, *supra* at paras. 23-25 and *Muscletech*, *supra* at para. 3.

resolved, which will likely occur years past the tight window of opportunity Sino-Forest has to restructure if the Class Actions are allowed to proceed on a typical litigation timetable for similar actions. In light of these indemnification claims, a successful restructuring will not be possible unless all such claims are adjudicated and valued within the CCAA process.

47. Courts have ordered stays of proceedings against third-party co-defendants of the debtor company if permitting the proceedings in question to proceed against co-defendants would impair restructuring efforts.<sup>38</sup> Such extensions of the stay have also been granted where, due to the interrelated aspects of the claims, there would be a “considerable risk of record taint” if the action were to proceed without the debtor company, or where lifting the stay would result in “a lack of single control” over insolvency proceedings.<sup>39</sup>

48. These very concerns will materialize if the Class Actions, and particularly the Ontario Class Action, are permitted to proceed against the Third Party Defendants. As exemplified by the Ontario Class Action, the liabilities of Sino-Forest, the Director and Officer Defendants, and the Third Party Defendants are invariably intertwined, raising several identical questions of fact and law. Due to the interrelated nature of the Plaintiffs’ claims, it is likely that some continued involvement of Sino-Forest will be sought in adjudicating the Plaintiffs’ claims against the Third Party Defendants. There is also a serious risk of inconsistent judicial findings, as well as findings of fact prejudicial to Sino-Forest and the Director and Officer Defendants which may result from the Class Actions continuing without their participation.<sup>40</sup> Permitting only a portion of the Class Actions to proceed will result in a multiplicity of proceedings that should and can be avoided.

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<sup>38</sup> *Campeau, supra* and *Muscletech, supra*; See, also, *Timminco, supra* at paras. 23-24.

<sup>39</sup> *Grace, supra* at paras. 12-16.

<sup>40</sup> *Timminco, supra* at para. 24.

49. In deciding whether to lift a stay of proceedings, a court weighs the interests of the debtor company against the interests of those affected by the stay. A stay will be granted where the benefit achieved by the debtor company outweighs the prejudice to affected parties.<sup>41</sup>

50. Whereas Sino-Forest and the Director and Officer Defendants will be greatly prejudiced if the Ontario Class Action is permitted to proceed, staying the entire Ontario Class Action would not significantly prejudice the Plaintiffs in this case. The CCAA provides a process for identifying, quantifying and addressing all claims relevant to Sino-Forest's restructuring. The CCAA is designed to minimize the cost, time and resources (including judicial and court resources) necessary to resolve such claims. The Plaintiffs will not be materially prejudiced by participating in a court ordered or supervised claims process. The Plaintiffs' claims may even be dealt with more expeditiously than through a class action proceeding, as observed by Justice Blair in *Campeau v. Olympia & York Developments Ltd.*:

In making these orders, I see no prejudice to the Campeau plaintiffs. The processing of their action is not being precluded, but merely postponed. Their claims may, indeed, be addressed more expeditiously than might have otherwise been the case, as they may be dealt with — at least for the purposes of that proceeding — in the C.C.A.A. proceeding itself. On the other hand, there might be great prejudice to Olympia & York if its attention is diverted from the corporate restructuring process and it is required to expend time and energy in defending an action of the complexity and dimension of this one. While there may not be a great deal of prejudice to National Bank [the co-defendant] in allowing the action to proceed against it, I am satisfied that there is little likelihood of the action proceeding very far or very effectively unless and until Olympia & York — whose alleged misdeeds are the real focal point of the attack on both sets of defendants — is able to participate.<sup>42</sup>

51. Moreover, permitting a portion of the Class Actions, including the Ontario Class Action, to proceed outside the CCAA process would permit those claims to be evaluated and

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<sup>41</sup> *Nortel, supra* at para. 36, citing *Woodward's, supra*.

<sup>42</sup> *Campeau, supra* at para. 24.

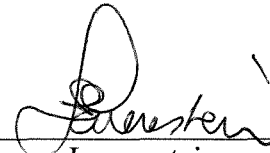
possibly remedied on an entirely different basis than the claims of other creditors. This would facilitate the very manoeuvring by creditors the stay of proceedings is designed to prevent.

**PART IV. ORDER REQUESTED**

52. The Board respectfully requests an Order dismissing the motion sought by the Plaintiffs, with costs.

**ALL OF WHICH IS RESPECTFULLY SUBMITTED**

October 3, 2012



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Larry Lowenstein



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for: Edward A. Sellers



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Geoffrey Grove

Lawyers for the Board of Directors of  
Sino-Forest Corporation

**SCHEDULE “A”**

**LIST OF AUTHORITIES**

1. *Air Canada (Re)*, 2003 CarswellOnt (SCJ)
2. *Air Canada (Re)*, 2004 CarswellOnt 481 (SCJ)
3. *ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp.*, 2008 ONCA 587, aff’ing 2008 CarswellOnt 2652 (SCJ)
4. *Campeau v. Olympia & York Developments Ltd.*, 1992 CarswellOnt 185 (Gen Div)
5. *Canadian Airlines Corp. (Re)*, 2000 Carswell Alta 622 (Q.B.)
6. *Canadian Red Cross Society (Re)* 1999 CarswellOnt 3234 (SCJ)
7. *Canwest Global Communications Corp. (Re)*, 2010 CarswellOnt 5225 (SCJ)
8. *Canwest Global Communications Corp. (Re)*, 2011 CarswellOnt 2392 (SCJ)
9. *Grace Canada Inc. (Re)*, 2005 CarswellOnt 6648 (SCJ)
10. *ICR Commercial Real Estate (Regina) Ltd. v. Bricore Land Group Ltd.*, 2007 SCKA 72
11. *Lehndorff General Partner Ltd., Re*, 1993 CarswellOnt 183 (Gen Div)
12. *Muscletech Research & Development Inc. (Re)*, 2006 CarswellOnt 6230 (SCJ)
13. *NFC Acquisition GP Inc. (Re)*, 2012 CarswellOnt 3142 (SCJ)
14. *Nortel Networks Inc. (Re)*, 2009 CarswellOnt 4806 (SCJ), aff’d 2009 ONCA 833
15. *Quintette Coal Ltd. (Re)*, 1990 CarswellBC 384 (CA)
16. *SNV Group Ltd. (Re)*, 2001 BCSC 1644
17. *Sairex GmbH v. Prudential Steel Ltd.*, 1991 CarswellOnt 215 (Gen. Div.)
18. *Stelco Inc. (Re)*, 2005 CarswellOnt 1188 (CA)
19. *Timminco Limited (Re)*, 2012 ONSC 2515
20. *Woodward’s Ltd. (Re)*, 1993 CarswellBC 530 (SC)

## SCHEDULE “B”

### STATUTORY PROVISIONS

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

##### **Stays, etc. — initial application**

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).

### **Stays — directors**

11.03 (1) An order made under section 11.02 may provide that no person may commence or continue any action against a director of the company on any claim against directors that arose before the commencement of proceedings under this Act and that relates to obligations of the company if directors are under any law liable in their capacity as directors for the payment of those obligations, until a compromise or an arrangement in respect of the company, if one is filed, is sanctioned by the court or is refused by the creditors or the court.

### **Exception**

(2) Subsection (1) does not apply in respect of an action against a director on a guarantee given by the director relating to the company's obligations or an action seeking injunctive relief against a director in relation to the company.

### **Persons deemed to be directors**

(3) If all of the directors have resigned or have been removed by the shareholders without replacement, any person who manages or supervises the management of the business and affairs of the company is deemed to be a director for the purposes of this section.

2005, c. 47, s. 128.



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

Court File No: CV-12-9667-00CL

*Ontario*  
**SUPERIOR COURT OF JUSTICE  
COMMERCIAL LIST**

Proceeding commenced at Toronto

**FACTUM OF THE RESPONDING PARTY,  
THE BOARD OF DIRECTORS OF SINO-FOREST  
CORPORATION**  
**(Motion returnable October 9-10, 2012)**

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