

Court of Appeal File No. M42068  
Court File No. CV-12-9667-00CL

***COURT OF APPEAL FOR ONTARIO***

**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**

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

**Responding Factum of BDO Limited**

**(Motion for Leave to Appeal from Sanction Order)**

February 25, 2013

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## **PART I - OVERVIEW**

1. BDO Limited opposes the motion by Invesco Canada Ltd., Northwest & Ethical Investments L.P., and Comité Syndical National de Retraite Bâtirente Inc. (collectively, the “Objecting Parties”) for leave to appeal from two paragraphs 40 and 41 of the December 10, 2012 Order of Justice Morawetz that sanctioned the Plan of Compromise and Reorganization of Sino-Forest Corporation (the “Sanction Order”).

2. Paragraphs 40 and 41 of the Sanction Order approve a framework under Article 11 of the Sino-Forest Plan, dated December 3, 2012, for third party defendants to pending Sino-Forest-related class actions to in the future seek releases within the Sino-Forest restructuring proceedings, should they settle the claims against them. The framework under Article 11 of the Plan makes any such releases subject, *inter alia*, to further court approval.

3. BDO audited Sino-Forest for two years: 2005 and 2006. Similar to Ernst & Young LLP and the 13 parties identified as the Underwriters in the Objecting Parties’ factum, BDO is named as a defendant in the Ontario class action based upon allegations that it failed to meet duties to prevent and/or disclose alleged misrepresentations by Sino-Forest in its financial statements and certain other public documents.

4. Also similar to Ernst & Young and the Underwriters:

(a) BDO participated in the Sino-Forest proceedings under the *Companies Creditors’ Arrangement Act* (the “CCAA”) by, among other things, filing Proofs of Claim against Sino-Forest and its officers and directors pursuant to a Claims Procedure Order issued by Justice Morawetz, dated May 14, 2012;

(b) BDO had the portion of its claims against Sino-Forest seeking indemnity for the claims against it by purchasers of Sino-Forest shares subordinated as equity claims under the CCAA pursuant to an Order of Justice Morawetz, dated July 26, 2012 (the “Equity Claims Order”);

(c) Notwithstanding the Equity Claims Order, BDO still had significant indemnity claims against Sino-Forest that were not subordinated, as they arose from note holder claims against BDO, as well as significant indemnity claims against Sino-Forest’s officers and directors that were not subordinated; and

(d) BDO had unsuccessfully appealed to this Court the Equity Claims Order and the time for seeking leave to further appeal that Order to the Supreme Court of Canada had not yet expired as of the date of the Sino-Forest sanction hearing and the Order from which leave to appeal is sought.

5. BDO initially opposed the Sino-Forest restructuring Plan and was one of the few creditors to vote against the Plan on December 3, 2012 and BDO was the last to sign on to the Plan – just two days before the December 7, 2012 sanction hearing before Justice Morawetz.

6. BDO’s support of the Plan largely resulted from the inclusion in the Plan of Article 11 – which is the provision that the Objecting Parties seek to remove from the Plan on their proposed appeal, should this Court grant leave to appeal.

7. Contrary to the submissions of the Objecting Parties, Article 11 of the Plan does not itself release BDO or any other third party defendants to the various Sino-Forest proceedings,

for that matter. Rather, Article 11 allows only for the *possibility* that BDO can seek a release within the CCAA proceeding should it in the future settle the claims against it.

8. It will only be on possible future motions to approve third party settlements that the Objecting Parties' concerns relating to third party releases might arise, not before then.

9. The portions of the Sanction Order and Plan that the Objecting Parties seek to somehow remove from the Plan after the fact, were integral parts of a Plan that was extensively negotiated amongst numerous parties and overwhelmingly approved by the creditors.

10. Article 11 of the Plan cannot be severed from the Plan as a whole without depriving the interested parties, including BDO, of what they bargained for. Nor are there good reasons to do so – given that the principal concerns about third party releases identified by the Objecting Parties do not arise under Article 11 of the Plan or from the paragraphs of the Sanction Order on which leave to appeal is sought.

11. There is nothing to be accomplished by the proposed appeal. This motion for leave to appeal should therefore be dismissed.

## **PART II - THE FACTS**

### **A. BDO's role as Sino-Forest's auditor:**

12. BDO was the auditor of Sino-Forest between 2005 and August 2007, when it was replaced by Ernst & Young LLP ("E&Y").

13. BDO issued audit reports (the "BDO Audit Reports") in respect of the 2005 and 2006 annual financial statements for Sino-Forest, the last of which was issued on March 19, 2007.

14. BDO audit reports were incorporated by reference into one Sino-Forest Prospectus issued in June 2007 for the public sale of Sino-Forest shares, as well as three Sino-Forest Offering Memoranda, issued in July 2008, June 2009 and December 2009 pursuant to which Sino-Forest Notes were sold publically.

15. BDO resigned as auditor for Sino-Forest in August 2007 and was replaced at that time by Ernst & Young LLP ("E&Y").

16. It is notable that, while the Ontario Securities Commission has commenced regulatory proceedings against Sino-Forest, some of its former officers and directors, and one of its former auditors, no such regulatory proceedings have been commenced against BDO.

Statements of Allegations of the Ontario Securities Commission, dated May 22, 2012 and December 3, 2012, and Ontario Securities Commission News Release, dated December 3, 2012; Motion Record of the Appellants ("Appellants' Record"), Vol. 1, Tab 3O and Vol. 2, Tabs 3P and 3Q.

### **B. The Ontario Class Action:**

17. Almost four years after BDO resigned as Sino-Forest's auditor, a short seller, Muddy Waters LLC, issued a June 2, 2011 report (the "Muddy Waters Report") that alleged fraud and

other misfeasance at Sino-Forest. Sino-Forest's share price immediately dropped precipitously.

18. In the wake of the Muddy Waters Report a number of class actions were commenced against Sino-Forest along with its current and former officers, directors, and auditors, as well as against the underwriters of several Sino-Forest share and note offerings.

Judson Martin Affidavit, sworn November 29, 2012, paras. 8 – 13; Appellants' Record, Tab 3N, pp. 288 – 289.

19. BDO has been named as a defendant in the Ontario class action, *The Trustees of the Labourers' Pension Fund of Central and Eastern Canada et al. v. Sino-Forest Corporation et al.* (CV-11-431153-00CP) (the "Ontario Class Action").

Fresh as Amended Statement of Claim, dated April 18, 2012; Appellants' Motion Record, Vol. 2, Tab 10, pp. 589 – 716.

20. The Ontario Class Action seeks to certify a class action on behalf of all persons who purchased Sino-Forest securities – both Sino-Forest shares and Sino-Forest notes - in Canada during the Class Period (which is defined as March 19, 2007 to June 2, 2011), as well as all Canadian residents who purchased Sino's securities outside of Canada during that period.

Fresh as Amended Statement of Claim, dated April 18, 2012, paras. 1(m) and 1(n); Appellants' Motion Record, Vol. 2, Tab 10, p. 596

21. The largest portion of the claim in the Ontario Class Action seeks to certify a claim for \$6.5 Billion on behalf of all purchasers of Sino-Forest securities on the secondary market during the Class Period (the "Secondary Market Claim").

Fresh as Amended Statement of Claim, dated April 18, 2012, para. 2(f); Appellants' Motion Record, Vol. 2, Tab 10, p. 603

22. Subject to certification, BDO has also been sued on behalf of primary market purchasers of Sino-Forest securities – again including purchasers of both shares and debt securities.

Those claims are as follows:

- (a) On behalf of all of the Class Members who purchased Sino common shares in the distribution to which a June 2007 Prospectus issued by Sino (the “June 2007 Prospectus”) related, a claim for general damages in the sum of **\$175,835,000**;
- (b) On behalf of all of the Class Members who purchased Sino common shares in the distribution to which a December 2009 Prospectus issued by Sino (the “December 2009 Prospectus”) related, a claim for general damages in the sum of **\$319,200,000**;
- (c) On behalf of all the Class Members who purchased Sino’s 5% Convertible Senior Notes due 2013 pursuant to a July 2008 Offering Memorandum issued by Sino (the “July 2008 Offering Memorandum”), a claim for general damages in the sum of **US\$345 million**;
- (d) On behalf of all the Class Members who purchased Sino’s 10.25% Guaranteed Senior Notes due 2014 pursuant to the June 2009 Offering Memorandum issued by Sino (the “June 2009 Offering Memorandum”), a claim for general damages in the sum of **US\$400 million**; and
- (e) On behalf of all the Class Members who purchased Sino’s 4.25% Convertible Senior Notes due 2016 pursuant to the December 2009 Offering Memorandum

issued by Sino (the “December 2009 Offering Memorandum”), a claim for general damages in the sum of **US\$460 million**.

Fresh as Amended Statement of Claim, dated April 18, 2012, paras. 2(g), (i), (j), (k), and (l); Appellants’ Motion Record, Vol. 2, Tab 10, pp. 603 – 604.

23. It is alleged in the Ontario Class Action that the 2005 Audit Report and the 2006 Audit Report each contain the same statement by BDO; a statement that is alleged to have misrepresented that, in the opinion of BDO, Sino’s 2005 and 2006 annual financial statements “...present fairly, in all material respects, the financial position of Sino as at December 31, 2005 and December 31, 2006 and the results of its operations and cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.”

Fresh as Amended Statement of Claim, para. 198; Appellants’ Motion Record, Vol. 2, Tab 10, pp. 674 – 676.

24. The damages claimed against BDO and the other defendants stem from the losses alleged to have been suffered by purchasers of Sino-Forest securities when the value of those securities dropped following the June 2, 2011 release of the Muddy Waters Report.

Fresh as Amended Statement of Claim, dated April 18, 2012, para. 8; Appellants’ Motion Record, Vol. 2, Tab 10, p. 607

**C. The Sino-Forest CCAA Proceedings:**

25. On March 30, 2012, Sino-Forest sought and obtained an order (the “Initial Order”) protecting Sino-Forest from its creditors under the CCAA. Among other things, all proceedings were stayed as against Sino-Forest and its officers and directors under the Initial



Order. On May 8, 2012, the CCAA Court ordered that the stay under the Initial Order also applied to all third party defendants to the various class actions, including BDO.

Endorsement of The Honourable Justice Morawetz, dated December 12, 2012, paras. 19;  
Appellants' Motion Record, Tab 7, pp. 548-549.

26. BDO does not propose to repeat what has been said in the other responding factums about the steps taken in the Sino-Forest CCAA proceeding. BDO agrees with and adopts the factual summary found in the E&Y Responding factum, paragraphs 11 through 22, inclusive.

27. BDO participated in all of major steps in the Sino-Forest CCAA proceeding. This included filing claims against Sino-Forest and its officers and directors under the Claims Procedure Order, participating in the mediation held in September 2012, and as a party to the Equity Claims Motion heard on June 26, 2012 and the subsequent appeal from the result thereon heard on November 13, 2012.

28. As with most of the other third party defendants to the Ontario Class Action, BDO initially opposed the Sino-Forest Plan that had been proposed under the CCAA.

29. BDO's support for the Plan was secured, in part, through the addition of Article 11 to the Plan. Article 11 provided a framework for future approval of a settlement reached by E&Y shortly before Plan approval as well as a framework under which BDO and the other Named Third Party Defendants may in the future seek releases under the CCAA, should any Named Third Party Defendants settle the claims advanced against them.

Supplemental Report to the Thirteenth Report of the Monitor, dated December 4, 2012;  
Appellants' Motion Record, Vol. 2, Tab 9.

30. In exchange for being considered a Named Third Party Defendant under the Plan and having the *possibility* of obtaining a future CCAA release, BDO agreed:

- (a) to drop any further attempts to appeal the Equity Claims Order,
- (b) to release any of its claims against Sino-Forest and its directors and officers (beyond claims to insurance proceeds),
- (c) to waive any right to distributions under the Plan, and
- (d) to support the Plan in its entirety.

Endorsement of The Honourable Justice Morawetz, dated December 12, 2012, para. 38-39;  
Appellants' Motion Record, Tab 7, p. 551

31. As with the other aspects of the Plan, Article 11 was the subject of complex negotiations at arm's length amongst numerous parties. The final version of the Plan reflected concessions by everyone involved.

32. BDO accepts the submissions of Sino-Forest as to the importance of these concessions to the approval and overall success of the Plan, which was implemented late last month.

**D. The Sanction Order:**

33. After the Plan received overwhelming approval of the Sino-Forest creditors entitled to vote on it and in the absence of any opposition other than that of the Objecting Parties, Justice Morawetz granted the December 10, 2012 Sanction Order from which leave to appeal is sought.

34. In doing so, Justice Morawetz expressly observed that his approval of the Plan did not include any approval of the settlement reached by E&Y, which would have to be dealt with at a future hearing for that purpose.

35. Implicit in this observation by Justice Morawetz is the fact that future settlements by Named Third Party Defendants will also have to be subject to court approval at a future hearings held for that purpose.

**E. The Objecting Parties have not shown they would even have standing to complain about a future BDO settlement:**

36. The Objecting Parties' proposed appeal deals largely with hypothetical future situations in which BDO and/or one or more of the other third party defendants to the Sino-Forest proceedings settles the claims against them and then seeks court approval of the settlement.

37. Article 11 and the corresponding ss. 40 and 41 of the Sanction Order provide only a framework for the manner in which a future third party settlement may be dealt with under the Plan – all of which is subject to a settlement being reached and court approval of the settlements. As observed by Justice Morawetz in his Endorsement sanctioning the Plan, Article 11 does not itself provide third party releases to BDO, E&Y or any other third party defendants.

Endorsement of The Honourable Justice Morawetz, dated December 12, 2012, paras. 38 - 39;  
Appellants' Motion Record, Tab 7, pp.

Sanction Order, paras. 40 – 41 and the Plan, Article 11, Appellants' Motion Record, Vol. 2,  
Tab 4, pp. 433-434 and 518 - 519

38. Regarding BDO, it is currently unclear whether the Objecting Parties would even have standing to object, should BDO settle the claims against it in the future.

39. As set out above, BDO's last audit report was filed more than 4 years before the alleged corrective disclosure in the June 2, 2011 Muddy Waters Report. BDO's tenure as auditor predated that report by almost as long; it resigned approximately 46 months before the Muddy Waters Report was issued.

40. To hold BDO liable for the damages said to be suffered in relation to alleged misrepresentations corrected in the Muddy Waters Report, a potential claimant will have to show that securities purchased in reliance on BDO's audit reports for 2005 and/or 2006 were somehow still held on June 2, 2011, when the Muddy Waters Report was released and the securities dropped in value.

41. It is fair to assume that a significant portion of the Sino-Forest securities bought early in the Class Period when BDO remained Sino Forest's auditor would have been sold (likely at a profit) long before June 2, 2011 – thereby giving rise to no damages and no claim against BDO.

42. The Objecting Parties have put forward no evidence to particularize what Sino-Forest securities they purchased, what was relied upon when making those purchases, or when such securities were sold. They have not identified any particular offerings under which they bought Sino-Forest shares or notes on the primary market.

43. It is impossible to ascertain whether any of the Objecting Parties purchased Sino-Forest shares on BDO's watch or pursuant to any of the public offerings of shares or notes that used BDO's audit reports. It is equally impossible to ascertain whether any of those securities

purchased in reliance on BDO's audit reports were still held by the Objecting Parties on June 2, 2011, when the Muddy Waters Report came out.

44. On the current record it is impossible to reach a conclusion on whether the Objecting Parties could even have a claim against BDO - or any of the other third party defendants, for that matter.

45. As such, not only are the Objecting Parties seeking to appeal part of the Sanction Order on the basis of hypothetical settlements by third party defendants that might in the future come up for court approval, the Objecting Parties' own ability to potentially claim against such third party defendants and therefore to have standing to challenge such future settlements is unclear.

46. In other words, the Objecting Parties' concerns about third party releases being granted under the Plan are not only premature, it is impossible to divorce those concerns from the specific circumstances of particular future settlements with third party defendants that could be submitted for approval by the CCAA Court.

47. Until such settlements are submitted to the court for approval, the Objecting Parties' concerns are hypothetical.

### **PART III - ISSUES AND LAW**

#### **A. The test for leave to appeal**

48. Under the *Rules* and the CCAA, leave to appeal can be granted where:

- (a) The point on appeal is of significance to the practice;
- (b) The point on appeal is of significance to the underlying action;
- (c) The appeal is *prima facie* meritorious and not frivolous; and
- (d) The appeal will not hinder the progress of the action.

*Stelco Inc. (Re)*, 75 O.R. (3d) 5 (CA), at para. 24; BDO Brief of Authorities, TAB 1

#### **B. The proposed appeal is not of significance to the practice**

49. The proposed appeal does not, as is alleged, deal with the propriety of third party releases.

50. Article 11 of the Plan deals with a framework under which third party releases *may* be sought and granted in the future, should future settlements be reached and submitted to the Court for approval. In other words, it deals with the possibility of third party releases being granted in this case.

51. The possibility that third party releases may in appropriate circumstances be granted in CCAA proceedings has already been well-established by this Court.

*Metcalfe & Mansfield Alternative Investments II Corp. (Re)* (2008) 92 O.R. (3d) (C.A.),  
BDO Brief of Authorities, TAB 2

52. Numerous cases since then have also found that third party releases can be ordered in the context of complex restructurings under the CCAA.

53. It is not of significance to the practice for this Court to pronounce on when third party releases may be granted.

54. That question has already been decided.

**C. The appeal has significance to the underlying action:**

55. Article 11 of the Plan only provides for a framework for future third party releases. It does not itself release anyone.

56. An appeal from this proposed framework will not settle anything – as all settlements will still need to go before the Court for approval.

57. As such, the proposed appeal has no significance to the underlying proceeding.

**D. The proposed appeal is not meritorious:**

58. The provisions of the Sanction Order and Plan that the Objecting Parties seek to challenge deal with the framework under which future third party settlements can come before the court for approval.

59. These provisions were part of a Plan that was extensively negotiated and ultimately approved by an overwhelming majority of the creditors. They cannot be easily severed from the Plan as a whole or from the negotiations leading up to its approval and sanction.

60. What is being sought is effectively the amendment of an existing Plan that will remove the main consideration received by BDO and the other third party defendants that ultimately supported the Plan.

61. It is well-settled that the court should exercise its discretion to amend a Plan “sparingly and in exceptional circumstances only”.

*Sammi Atlas Inc. (Re)*, [1998] O.J. No. 1089 (Gen. Div.) at para. 4; BDO Book of Authorities, TAB 4

62. In considering whether to sanction a Plan, the Court should not second-guess the creditors’ judgment in approving a Plan and in determining whether they derive a benefit from it.

*Re Muscletech Research & Development Inc.*, [2007] O.J. No. 695 at para. 18; BDO Brief of Authorities, TAB 5

63. The Objecting Parties, in their proposed appeal, seek to set aside the decision of the Court below to exercise its discretion not to amend a Plan that had been overwhelmingly approved by the creditors of Sino-Forest.

64. As an exercise of discretion, the decision below would be entitled to deference from this Court on any appeal, should leave be granted.

65. In particular, an exercise of discretion by a supervising judge on a CCAA proceeding may not be overturned absent an error in principle or a palpable or overriding error of fact. The mere fact that this Court might have decided the issue differently is not enough.



*Resurgence Asset Management LLC v. Canadian Airlines Corp.*, [2000] A.J. No. 610 (CA) at para. 35; BDO Brief of Authorities, Tab 6

66. The decision below was correct. It did not opine on, or sanction, the terms of any particular settlement or release in favour of a third party. It merely provided for the future possibility and framework for such releases to be approved.

67. The law is well-settled that such third party releases are possible and may be granted in appropriate circumstances. There was no error in principle in allowing for this to happen on future motions or in approving a basic framework for such releases to be granted.

*Metcalfe & Mansfield Alternative Investments II Corp. (Re)* (2008) 92 O.R. (3d) (C.A.), BDO Brief of Authorities, TAB 3

68. The proposed appeal seeks to challenge the terms of possible future settlements that may or may not happen and may or may not come up for approval under the Plan.

69. On the current record, it cannot even be ascertained whether the Objecting Parties have possible claims against BDO and the other Named Third Party Defendants who might in the future seek approval of releases under the Plan.

70. The Objecting Parties' concerns are entirely hypothetical and premature. The court below was correct in finding that their objections were premature and that the Plan should be sanctioned.

71. As such, the proposed appeal is not meritorious.

**E. The proposed appeal will hinder the restructuring:**

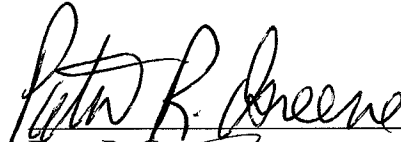
72. The proposed appeal seeks to amend a Plan after it has been implemented by removing an important rationale for BDO's consent to the Plan – the possibility of future releases under Article 11.

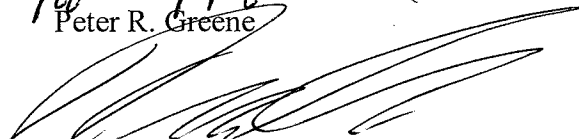
73. This would undermine the integrity of the CCAA process by setting aside a Plan that has been negotiated and agreed upon after it has already been implemented.

**PART IV - RELIEF SOUGHT**

74. BDO asks that the motion for leave to appeal portions of the Sanction Order be dismissed with costs.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 25<sup>th</sup> day of February, 2013.

  
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**SCHEDULE "A"**  
**LIST OF AUTHORITIES**

1. *Stelco Inc. (Re)*, 75 O.R. (3d) 5 (CA)
2. *Metcalf & Mansfield Alternative Investments II Corp. (Re)* (2008) 92 O.R. (3d) (C.A.)
3. *Sammi Atlas Inc. (Re)*, [1998] O.J. No. 1089 (Gen. Div.)
4. *Re Muscletech Research & Development Inc.*, [2007] O.J. No. 695 SCJ)
5. *Resurgence Asset Management LLC v. Canadian Airlines Corp.*, [2000] A.J. No. 610 (CA)

**SCHEDULE "B"**  
**RELEVANT STATUTES**

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

6. (1) If a majority in number representing two thirds in value of the creditors, or the class of creditors, as the case may be — other than, unless the court orders otherwise, a class of creditors having equity claims, — present and voting either in person or by proxy at the meeting or meetings of creditors respectively held under sections 4 and 5, or either of those sections, agree to any compromise or arrangement either as proposed or as altered or modified at the meeting or meetings, the compromise or arrangement may be sanctioned by the court and, if so sanctioned, is binding

(a) on all the creditors or the class of creditors, as the case may be, and on any trustee for that class of creditors, whether secured or unsecured, as the case may be, and on the company; and

(b) in the case of a company that has made an authorized assignment or against which a bankruptcy order has been made under the *Bankruptcy and Insolvency Act* or is in the course of being wound up under the *Winding-up and Restructuring Act*, on the trustee in bankruptcy or liquidator and contributories of the company.

• • • •

19. (1) Subject to subsection (2), the only claims that may be dealt with by a compromise or arrangement in respect of a debtor company are

(a) claims that relate to debts or liabilities, present or future, to which the company is subject on the earlier of

(i) the day on which proceedings commenced under this Act, and

(ii) if the company filed a notice of intention under section 50.4 of the Bankruptcy and Insolvency Act or commenced proceedings under this Act with the consent of inspectors referred to in section 116 of the Bankruptcy and Insolvency Act, the date of the initial bankruptcy event within the meaning of section 2 of that Act; and

(b) claims that relate to debts or liabilities, present or future, to which the company may become subject before the compromise or arrangement is sanctioned by reason of any obligation incurred by the company before the earlier of the days referred to in subparagraphs (a)(i) and (ii).

Exception

(2) A compromise or arrangement in respect of a debtor company may not deal with any claim that relates to any of the following debts or liabilities unless the compromise or arrangement explicitly provides for the claim's compromise and the creditor in relation to that debt has voted for the acceptance of the compromise or arrangement:

(a) any fine, penalty, restitution order or other order similar in nature to a fine, penalty or restitution order, imposed by a court in respect of an offence;

(b) any award of damages by a court in civil proceedings in respect of

(i) bodily harm intentionally inflicted, or sexual assault, or

(ii) wrongful death resulting from an act referred to in subparagraph (i);

(c) any debt or liability arising out of fraud, embezzlement, misappropriation or defalcation while acting in a fiduciary capacity or, in Quebec, as a trustee or an administrator of the property of others;

(d) any debt or liability resulting from obtaining property or services by false pretences or fraudulent misrepresentation, other than a debt or liability of the company that arises from an equity claim; or

(e) any debt for interest owed in relation to an amount referred to in any of paragraphs (a) to (d).

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