

The Ontario Securities Commission

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The Ontario Securities Commission administers the *Securities Act* of Ontario (R.S.O. 1990, c. S.5) and the *Commodity Futures Act* of Ontario (R.S.O. 1990, c. C.20)

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# Chapter 1

## Notices / News Releases

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### 1.3 Notices of Hearing with Related Statements of Allegations

#### 1.3.1 Gregory Deacon – ss. 127, 127.1

**IN THE MATTER OF  
GREGORY DEACON**

**NOTICE OF HEARING  
(Sections 127 and 127.1 of the Securities Act)**

**TAKE NOTICE THAT** the Ontario Securities Commission (the **Commission**) will hold a hearing pursuant to sections 127 and 127.1 of the *Securities Act*, RSO 1990, c S.5, at the offices of the Commission, 20 Queen Street West, 17th Floor, Toronto, Ontario, commencing on July 25, 2017 at 3:30 p.m., or as soon thereafter as the hearing can be held;

**AND TAKE NOTICE** that the purpose of the hearing is for the Commission to consider whether it is in the public interest to approve the Settlement Agreement dated as of July 7, 2017 between Gregory Deacon and Staff of the Commission (**Staff**);

**BY REASON OF** the allegations set out in the Statement of Allegations of Staff dated July 13, 2017;

**AND TAKE FURTHER NOTICE** that any party to the proceeding may be represented by a representative at the hearing;

**AND TAKE FURTHER NOTICE** that upon failure of any party to attend at the time and place aforesaid, the hearing may proceed in the absence of the party and the party is not entitled to any further notice of the proceeding;

**AND TAKE FURTHER NOTICE** that the Notice of Hearing is also available in French on request of a party, participation may be in either French or English and participants must notify the Secretary's Office in writing as soon as possible, and in any event, at least thirty (30) days before a hearing if the participant is requesting a proceeding to be conducted wholly or partly in French;

**ET AVIS EST ÉGALEMENT DONNÉ PAR LA PRÉSENTE** que l'avis d'audience est disponible en français sur demande d'une partie, que la participation à l'audience peut se faire en français ou en anglais et que les participants doivent aviser le Bureau du secrétaire par écrit le plus tôt possible et, dans tous les cas, au moins trente (30) jours avant l'audience si le participant demande qu'une instance soit tenue entièrement ou partiellement en français.

**DATED** at Toronto, Ontario this 13th day of July, 2017.

"Grace Knakowski"  
Secretary to the Commission

**IN THE MATTER OF  
GREGORY DEACON**

**STATEMENT OF ALLEGATIONS OF  
STAFF OF THE ONTARIO SECURITIES COMMISSION**

Staff ("Staff") of the Ontario Securities Commission (the "Commission") make the following allegations:

**A. Overview**

1. Gregory Deacon (the "Respondent") is a licensed insurance agent who sold securities to his clients without the registration, product knowledge, suitability analyses or prospectus disclosure required by Ontario securities law.

**B. The Respondent**

2. The Respondent is a 61-year-old resident of Ontario who has worked in the insurance industry for approximately 40 years. He is licensed with the Financial Services Commission of Ontario ("FSCO") as a Life Insurance and Accident & Sickness Insurance Agent, but has never been registered with the Commission in any capacity.

**C. Details of Conduct**

3. Between June and December 2014 (the "Material Time"), the Respondent sold to 20 individuals, most of whom were his insurance clients, convertible debentures in the aggregate principal amount of \$2,720,000. The convertible debentures were issued by Biosenta Inc. ("Biosenta"), an Ontario corporation in the business of developing, producing and selling mold-elimination products. The convertible debentures provided for a two-year term, a 6% annual interest rate and that, upon conversion, a holder would receive common shares of Biosenta ("Shares"), which are listed on the Canadian Stock Exchange.

4. The Respondent's sales activities included:

- (a) soliciting investors, including meeting with them in their homes to discuss the merits of Biosenta, its products and the convertible debentures and providing them with product samples;
- (b) taking orders for the convertible debentures and communicating them to Biosenta;
- (c) collecting subscription proceeds; and
- (d) delivering to investors executed convertible debentures.

5. In exchange, Biosenta or an authorized representative paid the Respondent \$153,000 in commissions.

6. The Respondent's activities in relation to the convertible debentures constitute the business of trading in securities without an exemption from the registration requirement. Although the Respondent was aware that a license from FSCO is required to sell insurance, he never registered or sought to register with the Commission to sell securities, in breach of the registration requirement of the *Securities Act*, R.S.O. 1990, c. S-5, as amended (the "Act").

7. The Respondent did not comply with the know-your-product and suitability obligations applicable to him as a registrant, being a person required to be registered under the Act. He lacked the education, training and experience that a reasonable person would consider necessary to engage in the business of trading in securities competently. His understanding of the convertible debentures, including their key features and risks, was limited. The Respondent did not evaluate investors' needs in the manner required of registrants and did not ensure that purchases of the convertible debentures were suitable for them.

8. The Respondent's sales of the convertible debentures were in breach of the prospectus requirement of Ontario securities law. As trades in securities that had not been previously issued, the sales were distributions. No preliminary prospectus or prospectus was filed with the Commission in respect of the convertible debentures and no prospectus receipts were issued to qualify their sale.

9. The Respondent did not determine whether any exemptions from the prospectus requirement applied to the distributions. He did not obtain any documents from investors to demonstrate that any exemptions were available. None applied to five of the distributions.

10. Eighteen of the convertible debentures stated on their face that they were issued to the Respondent's insurance company "in trust" for the applicable investor; however, neither the Respondent nor his company acted as trustee for any of these holders. During the Material Time, the Respondent understood that the purpose of the "in trust" language was to reduce

the paperwork regarding investors' financial situations that would otherwise be required. The Respondent advised certain investors that grouping their investments in this manner allowed them to invest in Biosenta when they otherwise would not have been able to do so.

11. None of the convertible debentures sold by the Respondent is outstanding. In 2016, Biosenta completed a court-supervised restructuring, in connection with which investors in convertible debentures could choose to receive cash or Shares in partial satisfaction of their claims. In connection with the restructuring, all of the investors to whom the Respondent sold convertible debentures received Shares.

**D. Breaches of Ontario Securities Law and Conduct Contrary to the Public Interest**

12. The specific allegations advanced by Staff are that, by engaging in the conduct described above:

- (a) the Respondent engaged or held himself out as engaging in the business of trading in securities without being registered to do so and where no exemption from the registration requirement was available, contrary to subsection 25(1) of the Act;
- (b) the Respondent performed an activity which requires registration without having the education, training and experience that a reasonable person would consider necessary to perform the activity competently, and in particular did not have the requisite understanding of the convertible debentures, contrary to subsection 3.4(1) of National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations ("NI 31-103");
- (c) the Respondent did not take reasonable steps to ensure that purchases of the convertible debentures were suitable for investors, contrary to subsection 13.3(1) of NI 31-103;
- (d) the Respondent distributed securities when neither a preliminary prospectus nor a prospectus in respect of the securities had been filed nor receipts issued for them and where no exemption from the prospectus requirement was available, contrary to subsection 53(1) of the Act; and
- (e) as set out in sub-paragraphs (a) through (d) above, the Respondent engaged in conduct contrary to the public interest.

13. Staff reserve the right to make such other allegations as Staff may advise and the Commission may permit.

**DATED** at Toronto, Ontario this 13th day of July, 2017.

1.3.2 Virginia Tan – ss. 127(1), 127(10)

IN THE MATTER OF  
VIRGINIA TAN

NOTICE OF HEARING  
(Subsections 127(1) and 127(10) of the Securities Act)

**TAKE NOTICE THAT** the Ontario Securities Commission (the **Commission**) will hold a hearing pursuant to subsections 127(1) and 127(10) of the *Securities Act*, RSO 1990, c S.5 (the **Act**), at the offices of the Commission, 20 Queen Street West, 17th Floor, commencing on August 3, 2017 at 2:00 p.m., or as soon thereafter as the hearing can be held;

**TO CONSIDER** whether, pursuant to subsection 127(1) and paragraphs 4 and 5 of subsection 127(10) of the Act, it is in the public interest for the Commission to make an order:

1. against Virginia Tan (**Tan**) that:
  - a. trading in any securities or derivatives by Tan cease permanently, pursuant to paragraph 2 of subsection 127(1) of the Act;
  - b. the acquisition of any securities by Tan cease permanently, pursuant to paragraph 2.1 of subsection 127(1) of the Act;
  - c. Tan resign any positions that she holds as a director or officer of any issuer or registrant, pursuant to paragraphs 7 and 8.1 of subsection 127(1) of the Act;
  - d. Tan be prohibited permanently from becoming or acting as a director or officer of any issuer or registrant, pursuant to paragraphs 8 and 8.2 of subsection 127(1) of the Act; and
  - e. Tan be prohibited permanently from becoming or acting as a registrant, investment fund manager or promoter, pursuant to paragraph 8.5 of subsection 127(1) of the Act;
2. or such other order or orders as the Commission considers appropriate.

**BY REASON** of the allegations set out in the Statement of Allegations of Staff of the Commission dated July 17, 2017, and by reason of a Settlement Agreement between Tan and the British Columbia Securities Commission (the “**BCSC**”) dated April 13, 2017 (the “**Settlement Agreement**”), an Order of the BCSC dated April 13, 2017, and such additional allegations as counsel may advise and the Commission may permit;

**AND TAKE FURTHER NOTICE** that any party to the proceeding may be represented by a representative at the hearing;

**AND TAKE FURTHER NOTICE** that upon failure of any party to attend at the time and place aforesaid, the hearing may proceed in the absence of the party and such party is not entitled to any further notice of the proceeding;

**AND TAKE FURTHER NOTICE** that the Notice of Hearing is also available in French on request, participation may be in either French or English and participants must notify the Secretary’s Office in writing as soon as possible, and in any event, at least thirty (30) days before a hearing if the participant is requesting a proceeding to be conducted wholly or partly in French; and

**ET AVIS EST ÉGALEMENT DONNÉ PAR LA PRÉSENTE** que l’avis d’audience est disponible en français sur demande, que la participation à l’audience peut se faire en français ou en anglais et que les participants doivent aviser le Bureau du secrétaire par écrit le plus tôt possible et, dans tous les cas, au moins trente (30) jours avant l’audience si le participant demande qu’une instance soit tenue entièrement ou partiellement en français.

**DATED** at Toronto this 18th day of July, 2017.

“Grace Knakowski”  
Secretary to the Commission



IN THE MATTER OF  
VIRGINIA TAN

STATEMENT OF ALLEGATIONS OF  
STAFF OF THE ONTARIO SECURITIES COMMISSION

Staff of the Ontario Securities Commission ("Staff") allege:

**I. OVERVIEW**

1. On April 13, 2017, Virginia Tan ("Tan" or the "Respondent") entered into a Settlement Agreement (the "Settlement Agreement") with the British Columbia Securities Commission (the "BCSC").
2. Tan is subject to an order made by the BCSC dated April 13, 2017 (the "BCSC Order") that imposes sanctions, conditions, restrictions or requirements upon her.
3. Staff are seeking an inter-jurisdictional enforcement order reciprocating the BCSC Order, pursuant to paragraphs 4 and 5 of subsection 127(10) of the *Ontario Securities Act*, R.S.O. 1990, c. S.5 (the "Act").

**II. THE BCSC PROCEEDINGS**

**Agreed Statement of Facts**

4. In the Settlement Agreement, Tan agreed with the following facts:

*Background*

5. Tan is a resident of British Columbia, and is the sole proprietor of Letan Investments Management ("Letan"). She has never been registered under the British Columbia *Securities Act*, RSBC 1996, c 418 (the "BC Act").
6. For several years prior to 2011 (the "Factoring Period"), Tan operated a business through Letan that involved making short-term, high interest loans to individuals and small businesses that were unable to obtain traditional financing from financial institutions.
7. To finance her business, Tan raised funds from investors and issued promissory notes to them.
8. During the Factoring Period, Tan told investors that:
  - (a) her business of making short-term, high interest loans was called "factoring";
  - (b) she required funds from investors to make the short-term loans; and
  - (c) she would pass on the interest she received on these short-term loans to the investors.
9. By 2011, Tan had discontinued her factoring business. However, she continued to raise funds from investors.

*Misconduct*

10. From 2011 to 2015 (the "Material Period"), Tan raised at least \$30 million from investors. Tan raised these funds mostly from investors who had initially invested with her during the Factoring Period, and agreed to invest additional funds.
11. Tan issued promissory notes to the investors, which provided terms ranging from one month to two years and annualized rates of return of 16% to 21%.
12. Tan raised funds directly from investors. In addition, a few of her early investors acted as her agents in raising funds from other investors. Tan paid ongoing commissions to these agents representing a percentage of the amounts invested by their investors. From time to time, the agents assisted Tan by transferring investors' funds to her and by preparing interest cheques payable to investors. However, Tan signed all the promissory notes and cheques issued to the investors.
13. Many investors renewed their investment with Tan when their promissory notes matured. When investors renewed their investment, Tan issued them a new promissory note even though they did not provide any new funds.

14. Tan gave the investors a cover letter with each promissory note. Although Tan was no longer in the business of making short-term loans, she continued to use wording in her cover letters that was similar to the wording she had used during the Factoring Period. The cover letters did not specify how Tan could use investors' funds, but stated that:
  - (a) the investments were "Re: short-term financing"; and
  - (b) investors' funds would be used "to/for investment purposes" or "to finance short term investments."
15. Tan did not inform the investors that:
  - (a) she had discontinued her factoring business and was no longer in the business of making short term loans; and
  - (b) she was not earning income from any other business.
16. Tan explored other business opportunities, and some investors were aware of this fact. However, none of these opportunities ever came to fruition.
17. During the Material Period, since Tan earned no business income, she made interest and principal payments to investors with funds raised from other investors. Tan also commingled a relatively small amount of her personal funds with investor funds in her bank accounts, and used these accounts to make payments to investors.
18. Tan was ultimately unable to raise sufficient new funds from investors, or to inject enough of her own funds, to continue making the interest payments owing under the promissory notes. By late 2015, Tan was insolvent and she ceased to make further interest payments to investors.
19. During the Material Period, the total amount that Tan raised from investors was approximately equal to the total value of her principal and interest payments to investors. However, many individual investors suffered substantial losses as a result of their investment with Tan.
20. Several investors commenced law suits against Tan. In April 2016, one of the investors petitioned Tan into bankruptcy and she remains an undischarged bankrupt.
21. Tan's assets vested in the court appointed trustee when she was forced into bankruptcy. The trustee is charged with liquidating those assets, and distributing the proceeds to the investors. Tan's only current source of income is her Canada Pension Plan and other old age benefits.

*Fraud*

22. By failing to inform investors that she had no factoring business and was not earning income from any other business, and by using other investors' funds to pay the investors' purported returns, Tan perpetrated a fraud on the investors contrary to section 57(b) of the BC Act.

*Settlement Payment*

23. Pursuant to the Settlement Agreement, Tan agreed to pay \$3 million to the BCSC in settlement of the BCSC proceedings. The BCSC will take steps to collect this sum once Tan has paid the amounts owing to investors.

**The BCSC Order**

24. The BCSC Order imposed the following sanctions, conditions, restrictions or requirements upon Tan under sections 161(1)(b) and 161(1)(d) of the BC Act:
  - (i) Tan cease trading in, and is permanently prohibited from purchasing, any securities or exchange contracts;
  - (ii) Tan resign any positions she holds as, and is permanently prohibited from becoming or acting as, a director or officer of any issuer or registrant;
  - (iii) Tan is permanently prohibited from becoming or acting as a registrant or promoter;
  - (iv) Tan is permanently prohibited from acting in a management or consultative capacity in connection with activities in the securities market; and

- (v) Tan is permanently prohibited from engaging in investor relations activities.

**Consent to Regulatory Orders**

25. Tan consents to a regulatory order made by any provincial or territorial securities regulatory authority in Canada containing any or all of the Orders set out in paragraph 3 of the Settlement Agreement.

**III. JURISDICTION OF THE ONTARIO SECURITIES COMMISSION**

26. The Respondent is subject to an order of the BCSC that imposes sanctions, conditions, restrictions or requirements upon her.
27. Pursuant to paragraphs 4 and 5, respectively, of subsection 127(10) of the Act, an order made by a securities regulatory authority, derivatives regulatory authority or financial regulatory authority, in any jurisdiction, that imposes sanctions, conditions, restrictions or requirements on a person or company, or an agreement with a securities regulatory authority, derivatives regulatory authority or financial regulatory authority, in any jurisdiction, that a person or company is to be made subject to sanctions, conditions, restrictions or requirements may form the basis for an order in the public interest made under subsection 127(1) of the Act.
28. Staff allege that it is in the public interest to make an order against the Respondent.
29. Staff reserve the right to amend these allegations and to make such further and other allegations as Staff deem fit and the Commission may permit.

**DATED** at Toronto, this 17th day of July, 2017.

1.3.3 EagleMark Ventures, LLC et al. – ss. 127(1), 127(10)

**IN THE MATTER OF  
EAGLEMARK VENTURES, LLC,  
FALCON HOLDINGS, LLC,  
RICHARD LIAN  
(also known as RICHARD TERRY RUUSKA) and  
ENNA M. KELLER**

**NOTICE OF HEARING  
(Subsections 127(1) and 127(10) of the Securities Act)**

**TAKE NOTICE THAT** the Ontario Securities Commission (the **Commission**) will hold a hearing pursuant to subsections 127(1) and 127(10) of the *Securities Act*, RSO 1990, c S.5 (the **Act**), at the offices of the Commission, 20 Queen Street West, 17th Floor, commencing on August 3, 2017 at 2:30 p.m., or as soon thereafter as the hearing can be held;

**TO CONSIDER** whether, pursuant to subsection 127(1) and paragraph 4 of subsection 127(10) of the Act, it is in the public interest for the Commission to make an order:

1. against Richard Lian (also known as Richard Terry Ruuska) (**Lian**) that:
  - a. trading in any securities or derivatives by Lian cease permanently, pursuant to paragraph 2 of subsection 127(1) of the Act;
  - b. the acquisition of any securities by Lian cease permanently, pursuant to paragraph 2.1 of subsection 127(1) of the Act;
  - c. any exemptions contained in Ontario securities law do not apply to Lian permanently, pursuant to paragraph 3 of subsection 127(1) of the Act;
  - d. Lian resign any positions that he holds as a director or officer of any issuer or registrant, pursuant to paragraphs 7 and 8.1 of subsection 127(1) of the Act;
  - e. Lian be prohibited permanently from becoming or acting as a director or officer of any issuer or registrant, pursuant to paragraphs 8 and 8.2 of subsection 127(1) of the Act; and
  - f. Lian be prohibited permanently from becoming or acting as a registrant, investment fund manager or promoter, pursuant to paragraph 8.5 of subsection 127(1) of the Act;
2. against Enna M. Keller (**Keller**) that:
  - a. trading in any securities or derivatives by Keller cease permanently, pursuant to paragraph 2 of subsection 127(1) of the Act;
  - b. the acquisition of any securities by Keller cease permanently, pursuant to paragraph 2.1 of subsection 127(1) of the Act;
  - c. any exemptions contained in Ontario securities law do not apply to Keller permanently, pursuant to paragraph 3 of subsection 127(1) of the Act;
  - d. Keller resign any positions that she holds as a director or officer of any issuer or registrant, pursuant to paragraphs 7 and 8.1 of subsection 127(1) of the Act;
  - e. Keller be prohibited permanently from becoming or acting as a director or officer of any issuer or registrant, pursuant to paragraphs 8 and 8.2 of subsection 127(1) of the Act; and
  - f. Keller be prohibited permanently from becoming or acting as a registrant, investment fund manager or promoter, pursuant to paragraph 8.5 of subsection 127(1) of the Act;
3. against EagleMark Ventures, LLC (**EagleMark**) that:
  - a. trading in any securities of EagleMark cease permanently, pursuant to paragraph 2 of subsection 127(1) of the Act;

- b. trading in any securities or derivatives by EagleMark cease permanently, pursuant to paragraph 2 of subsection 127(1) of the Act;
  - c. the acquisition of any securities by EagleMark be prohibited permanently, pursuant to paragraph 2.1 of subsection 127(1) of the Act;
  - d. any exemptions contained in Ontario securities law do not apply to EagleMark permanently, pursuant to paragraph 3 of subsection 127(1) of the Act; and
  - e. EagleMark be prohibited permanently from becoming or acting as a registrant, investment fund manager or promoter, pursuant to paragraph 8.5 of subsection 127(1) of the Act;
4. against Falcon Holdings, LLC (**Falcon**) that:
- a. trading in any securities of Falcon cease permanently, pursuant to paragraph 2 of subsection 127(1) of the Act;
  - b. trading in any securities or derivatives by Falcon cease permanently, pursuant to paragraph 2 of subsection 127(1) of the Act;
  - c. the acquisition of any securities by Falcon be prohibited permanently, pursuant to paragraph 2.1 of subsection 127(1) of the Act;
  - d. any exemptions contained in Ontario securities law do not apply to Falcon permanently, pursuant to paragraph 3 of subsection 127(1) of the Act; and
  - e. Falcon be prohibited permanently from becoming or acting as a registrant, investment fund manager or promoter, pursuant to paragraph 8.5 of subsection 127(1) of the Act;
5. such other order or orders as the Commission considers appropriate.

**BY REASON** of the allegations set out in the Statement of Allegations of Staff of the Commission dated July 17, 2017, and by reason of an order of the British Columbia Securities Commission dated February 14, 2017, and such additional allegations as counsel may advise and the Commission may permit;

**AND TAKE FURTHER NOTICE** that at the hearing on August 3, 2017 at 2:30 p.m., Staff will bring an application to proceed with the matter by written hearing, in accordance with Rule 11 of the Ontario Securities Commission *Rules of Procedure* (2014), 37 OSCB 4168 and section 5.1 of the *Statutory Powers Procedure Act*, RSO 1990, c S.22, and any party to the proceeding may make submissions in respect of the application to proceed by written hearing;

**AND TAKE FURTHER NOTICE** that any party to the proceeding may be represented by a representative at the hearing;

**AND TAKE FURTHER NOTICE** that upon failure of any party to attend at the time and place aforesaid, the hearing may proceed in the absence of the party and such party is not entitled to any further notice of the proceeding;

**AND TAKE FURTHER NOTICE** that the Notice of Hearing is also available in French on request of a party, participation may be in either French or English and participants must notify the Secretary's Office in writing as soon as possible, and in any event, at least thirty (30) days before a hearing if the participant is requesting a proceeding to be conducted wholly or partly in French; and

**ET AVIS EST ÉGALEMENT DONNÉ PAR LA PRÉSENTE** que l'avis d'audience est disponible en français sur demande d'une partie, que la participation à l'audience peut se faire en français ou en anglais et que les participants doivent aviser le Bureau du secrétaire par écrit le plus tôt possible et, dans tous les cas, au moins trente (30) jours avant l'audience si le participant demande qu'une instance soit tenue entièrement ou partiellement en français.

**DATED** at Toronto this 18th day of July, 2017.

"Grace Knakowski"  
Secretary to the Commission

**IN THE MATTER OF  
EAGLEMARK VENTURES, LLC,  
FALCON HOLDINGS, LLC,  
RICHARD LIAN  
(also known as RICHARD TERRY RUUSKA) and  
ENNA M. KELLER**

**STATEMENT OF ALLEGATIONS OF  
STAFF OF THE ONTARIO SECURITIES COMMISSION**

Staff of the Ontario Securities Commission ("Staff") allege:

**I. OVERVIEW**

1. EagleMark Ventures, LLC ("EagleMark"), Falcon Holdings, LLC ("Falcon"), Richard Lian (also known as Richard Terry Ruuska) ("Lian") and Enna M. Keller ("Keller") (collectively, the "Respondents") are subject to an order made by the British Columbia Securities Commission (the "BCSC") dated February 14, 2017 (the "BCSC Order") that imposes sanctions, conditions, restrictions or requirements upon them.
2. In its findings on liability dated August 22, 2016 (the "Findings"), a panel of the BCSC (the "BCSC Panel") found that Lian and Keller perpetrated a fraud, contrary to section 57(b) of the British Columbia *Securities Act*, RSBC 1996, c 418 (the "BC Act"), and that Keller engaged in unregistered trading, contrary to section 34 of the BC Act.
3. The BCSC Panel further found that each of the Respondents contravened a BCSC cease trade order dated October 1, 2009 (the "BCSC CTO"), and contravened a BCSC temporary order dated December 9, 2011 (the "BCSC TO").
4. Staff are seeking an inter-jurisdictional enforcement order, pursuant to paragraph 4 of subsection 127(10) of the Ontario *Securities Act*, R.S.O. 1990, c. S.5 (the "Act").

**II. THE BCSC PROCEEDINGS**

**The BCSC Findings**

5. The conduct for which the Respondents were sanctioned took place between approximately 2008 and 2012 (the "Material Time").
6. As of the date of the Findings, Lian was a United States resident. Lian has never been registered under the BC Act.
7. As of the date of the Findings, Keller was a resident of British Columbia. Keller has never been registered under the BC Act.
8. EagleMark is a Nevada corporation. Falcon is a New Mexico corporation. During the Material Time, Lian was the managing member of both companies and had sole signing authority over their respective bank accounts. The BCSC Panel found Lian effectively treated EagleMark and Falcon as alter egos of himself. EagleMark and Falcon have never been registered under the BC Act.
9. As of the date of the Findings, Lexicon Building Systems Ltd. ("Lexicon"), formerly named American Insulok Inc., was a reporting issuer in British Columbia and was listed on the CNSX. Lexicon was a manufacturing firm engaged in the development of products for the construction industry, in particular a proprietary product known as PolyBlock, a polyurethane block thought to have superior properties in various construction applications.
10. Lian was associated with Lexicon in various capacities from 2008 to at least October 31, 2014. Keller was a director of Lexicon from 1993 to 2007, and was CEO of Lexicon for part of that period until December 2007. Keller was an early shareholder in Lexicon and, during the Material Time, owned a significant number of its shares.
11. On October 1, 2009, the BCSC CTO was issued regarding all trading in Lexicon securities (with an exception the BCSC Panel noted as irrelevant) for failure to file financial statements. The BCSC CTO remained in place at the time of the BCSC proceedings. Following issuance of the BCSC CTO, Lexicon was de-listed, and remained de-listed, during the Material Time, and was prohibited from issuing securities to raise capital to support its operations and the development of the PolyBlock product.
12. During the Material Time, Lexicon underwent a number of acrimonious changes among its board of directors and management. Lexicon was petitioned into involuntary bankruptcy in December 2009, following which its ability to carry

on business was severely constrained. (In 2011, a plan of reorganization was approved by the US Bankruptcy Court, resulting in Lexicon's emergence from bankruptcy.)

13. Between 2008 and 2010, Falcon and EagleMark (and another company associated with Lian) entered into several consulting agreements with Lexicon, whereby Lian was to provide various consulting services to Lexicon, including seeking manufacturers for the PolyBlock; assisting Lexicon in obtaining relief from bankruptcy; and developing marketing and financial plans for Lexicon. Pursuant to the consulting agreements, Lian was permitted to receive compensation in the form of Lexicon shares and warrants, if and when the BCSC CTO was revoked. Lian, through EagleMark and Falcon, billed Lexicon substantial sums for compensation and reimbursement of expenses under the agreements. These sums, would, if fully paid in shares and warrants of Lexicon, have resulted in Lian, through EagleMark and Falcon, owning a very large number of Lexicon shares and warrants.
14. In early 2010, Lian and Keller launched the "Friends and Family Program" ("FFP"). Approximately \$3.2 million was raised under the FFP, from approximately 315 persons, including residents of British Columbia, and other provinces in Canada, the United States and Europe. FFP participants would pay monies to EagleMark, Falcon or Lian to contribute towards the funding of operating costs, debts and liabilities of Lexicon while Lian worked to remove the company from bankruptcy and get the BCSC CTO revoked. FFP participants made payments to one or more bank accounts of EagleMark, Falcon and Lian personally through wire transfers, deposits and cheques.
15. FFP participants were led to believe that their payments would fund Lian's resolving Lexicon's many issues, so that, ultimately, the BCSC CTO would be revoked. Lian and his companies would then receive substantial amounts of Lexicon shares and warrants, and, in turn, the appropriate amounts of shares and warrants would then be transferred to each FFP participant. Further, the revocation of the BCSC CTO would allow for Lexicon securities to be re-listed for trading, Lexicon could finance manufacturing and marketing of the PolyBlock, and the market value of Lexicon shares and warrants would increase.
16. While Lian had some direct contact with FFP participants, Keller was the predominant face of the FFP to both participants and prospective participants. Lian's role included, among other things, providing update emails to Keller. These emails were often misleading in various ways, including alleged progress towards resolving Lexicon's issues; the expected matters on which the FFP funds would be expended; timing for revocation of the BCSC CTO; timing of the transfer of Lexicon shares and warrants to FFP participants; and the potential share prices of Lexicon after relisting. The BCSC Panel found that Lian knew that the update emails would be forwarded by Keller to FFP participants.
17. Keller's role included soliciting prospective FFP investors; enabling FFP participants to make payments into the FFP; maintaining records of monies paid through her assistance; and providing information to FFP participants and prospective participants on, among other things, Lexicon's bankruptcy proceeding. Keller also forwarded the update emails created by Lian to her FFP distribution list.
18. Lexicon was unaware of and did not authorize the FFP. Upon learning of the FFP through a participant in October 2011, Lexicon issued cease and desist directions to Lian and Keller, filed complaints with various securities regulatory authorities and terminated the consulting agreements with Lian's companies. (Following a subsequent change in management, however, Lexicon's new management team reinstated these consulting agreements).
19. On December 9, 2011, the BCSC TO was issued against EagleMark, Lian, and Keller. The BCSC TO required that EagleMark, Lian, and Keller cease trading in any securities or exchange contracts and that all persons cease trading in the FFP securities.
20. The BCSC Panel found that Lian spent approximately US \$600,000, of the US \$3.2 million raised, on Lexicon's debts, expenses and other liabilities (no funds were paid directly to Lexicon), and repaid approximately US \$180,000 to FFP participants who demanded return of their funds. The balance of approximately US \$2.4 million was spent almost entirely by Lian on matters unrelated to Lexicon and of no benefit to the FFP participants. Further, except for the \$180,000 refunded to a few FFP participants, none of the other participants received any repayments, interest, or any shares or warrants of Lexicon.
21. The BCSC Panel found, among other things, that Lian failed to inform FFP participants of the true use of their funds, and knew that the FFP participants' funds had been dissipated with substantial risk that they were lost permanently. The BCSC Panel also found, among other things, that Keller failed to inform FFP participants that Lexicon was unaware of the FFP and had not authorized it, and that Lexicon had ordered that she and Lian "cease and desist" offering the FFP.
22. The BCSC Panel found that Lian, Keller, EagleMark, and Falcon breached the BCSC CTO by trading in securities of Lexicon through the FFP after the BCSC CTO was issued.

23. The BCSC Panel found that Lian, Keller, EagleMark, and Falcon breached the BCSC TO by continuing to raise at least US \$400,000 under the FFP after the BCSC TO was issued.
24. In its Findings, the BCSC Panel concluded that:
  - a. Lian and Keller perpetrated fraud contrary to section 57(b) of the BC Act;
  - b. each of the Respondents contravened the BCSC CTO;
  - c. each of the Respondents contravened the BCSC TO; and
  - d. Keller contravened section 34 of the BC Act by trading in securities without registration and without any available exemptions.

#### The BCSC Order

25. The BCSC Order imposed the following sanctions, conditions, restrictions or requirements:
  - a. upon Lian:
    - i. under sections 161(1)(b), (c) and (d)(i) through (v) of the BC Act, that Lian resign any position he holds as a director or officer of any issuer or registrant and that permanently:
      1. Lian cease trading in, and be prohibited from purchasing, any securities and exchange contracts;
      2. Lian be prohibited from becoming or acting as a director or officer of any issuer or registrant;
      3. all exemptions under the BC Act, the regulations or a decision do not apply to Lian;
      4. Lian be prohibited from becoming or acting as a registrant or promoter;
      5. Lian be prohibited from acting in a management or consultative capacity in connection with activities in the securities market; and
      6. Lian be prohibited from engaging in investor relations activities;
    - ii. under section 161(1)(g) of the BC Act, that Lian pay to the BCSC US\$2.4 million; and
    - iii. under section 162 of the BC Act, that Lian pay to the BCSC an administrative penalty of \$2.42 million;
  - b. upon Keller:
    - i. under sections 161(1)(b), (c) and (d)(i) through (v) of the BC Act, that Keller resign any position she holds as a director or officer of any issuer or registrant and that permanently:
      1. Keller cease trading in, and be prohibited from purchasing, any securities and exchange contracts;
      2. Keller be prohibited from becoming or acting as a director or officer of any issuer or registrant;
      3. all exemptions under the BC Act, the regulations or a decision do not apply to Keller;
      4. Keller be prohibited from becoming or acting as a registrant or promoter;
      5. Keller be prohibited from acting in a management or consultative capacity in connection with activities in the securities market; and
      6. Keller be prohibited from engaging in investor relations activities; and



- ii. under section 162 of the BC Act, that Keller pay to the BCSC an administrative penalty of \$2.42 million;
- c. upon EagleMark and Falcon:
  - i. under sections 161(1)(b), (c) and (d)(iii) and (v) of the BC Act:
    - 1. a permanent market prohibition against any person purchasing or trading in securities of EagleMark or Falcon;
    - 2. a permanent market prohibition against EagleMark and Falcon on purchasing securities or exchange contracts;
    - 3. permanently that exemptions under the BC Act, the regulations or a decision do not apply to EagleMark or Falcon;
    - 4. that EagleMark and Falcon be permanently prohibited from being a registrant, investment manager or promoter; and
    - 5. that EagleMark and Falcon be permanently prohibited from engaging in investor relations; and
  - ii. under section 161(1)(g) of the BC Act, that EagleMark and Falcon pay to the BCSC US\$2.4 million;

*Joint and Several Liability*

- d. Lian, EagleMark and Falcon are jointly and severally liable to pay the amounts in paragraphs 25(a)(ii) and 25(c)(ii) above.

**III. JURISDICTION OF THE ONTARIO SECURITIES COMMISSION**

- 26. The Respondents are subject to an order of the BCSC imposing sanctions, conditions, restrictions or requirements upon them.
- 27. Pursuant to paragraph 4 of subsection 127(10) of the Act, an order made by a securities regulatory authority, derivatives regulatory authority or financial regulatory authority, in any jurisdiction, that imposes sanctions, conditions, restrictions or requirements on a person or company may form the basis for an order in the public interest made under subsection 127(1) of the Act.
- 28. Staff allege that it is in the public interest to make an order against the Respondents.
- 29. Staff reserve the right to amend these allegations and to make such further and other allegations as Staff deem fit and the Commission may permit.
- 30. Staff request that this application be heard by way of a written hearing pursuant to Rules 2.6 and 11 of the Ontario Securities Commission *Rules of Procedure*.

**DATED** at Toronto, this 17th day of July, 2017.

**1.5 Notices from the Office of the Secretary**

**1.5.1 Manulife Securities Incorporated and Manulife Securities Investment Services Inc.**

**FOR IMMEDIATE RELEASE  
July 13, 2017**

**IN THE MATTER OF  
MANULIFE SECURITIES INCORPORATED AND  
MANULIFE SECURITIES INVESTMENT SERVICES INC.**

**TORONTO** – Following a hearing held today, the Commission issued an Order in the above named matter approving the Settlement Agreement reached between Staff of the Commission and Manulife Securities Incorporated and Manulife Securities Investment Services Inc.

A copy of the Order dated July 13, 2017 and Settlement Agreement dated July 10, 2017 are available at [www.osc.gov.on.ca](http://www.osc.gov.on.ca).

OFFICE OF THE SECRETARY  
GRACE KNAKOWSKI  
SECRETARY TO THE COMMISSION

For media inquiries:

[media\\_inquiries@osc.gov.on.ca](mailto:media_inquiries@osc.gov.on.ca)

For investor inquiries:

OSC Contact Centre  
416-593-8314  
1-877-785-1555 (Toll Free)

**1.5.2 Pro-Financial Asset Management Inc. et al.**

**FOR IMMEDIATE RELEASE  
July 13, 2017**

**IN THE MATTER OF  
PRO-FINANCIAL ASSET MANAGEMENT INC.,  
STUART MCKINNON and  
JOHN FARRELL**

**TORONTO** – The Commission issued an Order in the above named matter which provides that:

1. If, as indicated, Mr. McKinnon brings a motion under section 144 of the *Securities Act*, RSO 1990, c S.5, he shall file, on or before August 18, 2017, his motion materials, including the grounds relied upon and any new evidence;
2. A pre-hearing conference is scheduled for August 23, 2017 at 9:30 a.m. for the purpose of dealing with matters with respect to the section 144 motion and scheduling the sanctions and costs hearing; and
3. An oral hearing of the section 144 motion is scheduled for September 28, 2017 at 10:00 a.m., if necessary.

The pre-hearing conference will be held *in camera*.

A copy of the Order dated July 13, 2017 is available at [www.osc.gov.on.ca](http://www.osc.gov.on.ca).

OFFICE OF THE SECRETARY  
GRACE KNAKOWSKI  
SECRETARY TO THE COMMISSION

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1-877-785-1555 (Toll Free)

**1.5.3 Sino-Forest Corporation et al.**

**FOR IMMEDIATE RELEASE**  
July 14, 2017

**IN THE MATTER OF  
SINO-FOREST CORPORATION,  
ALLEN CHAN,  
ALBERT IP,  
ALFRED C.T. HUNG,  
GEORGE HO,  
SIMON YEUNG and  
DAVID HORSLEY**

**TORONTO** – Following the hearing on the merits in the above noted matter, the Commission issued its Reasons and Decision.

A copy of the Reasons and Decision dated July 13, 2017 is available at [www.osc.gov.on.ca](http://www.osc.gov.on.ca).

OFFICE OF THE SECRETARY  
GRACE KNAKOWSKI  
SECRETARY TO THE COMMISSION

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For investor inquiries:

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1-877-785-1555 (Toll Free)

**1.5.4 Gregory Deacon**

**FOR IMMEDIATE RELEASE**  
July 14, 2017

**IN THE MATTER OF  
GREGORY DEACON**

**TORONTO** – The Office of the Secretary issued a Notice of Hearing for a hearing to consider whether it is in the public interest to approve a settlement agreement entered into by Staff of the Commission and Gregory Deacon.

The hearing will be held on July 25, 2017 at 3:30 p.m. on the 17th floor of the Commission's offices located at 20 Queen Street West, Toronto.

A copy of the Notice of Hearing dated July 13, 2017 and Statement of Allegations of Staff of the Ontario Securities Commission dated July 13, 2017 are available at [www.osc.gov.on.ca](http://www.osc.gov.on.ca).

OFFICE OF THE SECRETARY  
GRACE KNAKOWSKI  
SECRETARY TO THE COMMISSION

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For investor inquiries:

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416-593-8314  
1-877-785-1555 (Toll Free)

**1.5.5 Virginia Tan**

**FOR IMMEDIATE RELEASE**  
**July 18, 2017**

**IN THE MATTER OF  
VIRGINIA TAN**

**TORONTO** – The Office of the Secretary issued a Notice of Hearing pursuant to Subsections 127(1) and 127(10) of the *Securities Act* setting the matter down to be heard on August 3, 2017 at 2:00 p.m. or as soon thereafter as the hearing can be held in the above named matter. The hearing will be held at the offices of the Commission at 20 Queen Street West, 17th Floor, Toronto.

A copy of the Notice of Hearing dated July 18, 2017 and Statement of Allegations of Staff of the Ontario Securities Commission dated July 17, 2017 are available at [www.osc.gov.on.ca](http://www.osc.gov.on.ca).

OFFICE OF THE SECRETARY  
GRACE KNAKOWSKI  
SECRETARY TO THE COMMISSION

For media inquiries:

[media\\_inquiries@osc.gov.on.ca](mailto:media_inquiries@osc.gov.on.ca)

For investor inquiries:

OSC Contact Centre  
416-593-8314  
1-877-785-1555 (Toll Free)

**1.5.6 EagleMark Ventures, LLC et al.**

**FOR IMMEDIATE RELEASE**  
**July 18, 2017**

**IN THE MATTER OF  
EAGLEMARK VENTURES, LLC,  
FALCON HOLDINGS, LLC,  
RICHARD LIAN  
(also known as RICHARD TERRY RUUSKA) and  
ENNA M. KELLER**

**TORONTO** – The Office of the Secretary issued a Notice of Hearing pursuant to Subsections 127(1) and 127(10) of the *Securities Act* setting the matter down to be heard on August 3, 2017 at 2:30 p.m. or as soon thereafter as the hearing can be held in the above named matter. The hearing will be held at the offices of the Commission at 20 Queen Street West, 17th Floor, Toronto.

A copy of the Notice of Hearing dated July 18, 2017 and Statement of Allegations of Staff of the Ontario Securities Commission dated July 17, 2017 are available at [www.osc.gov.on.ca](http://www.osc.gov.on.ca).

OFFICE OF THE SECRETARY  
GRACE KNAKOWSKI  
SECRETARY TO THE COMMISSION

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## Chapter 2

# Decisions, Orders and Rulings

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### 2.1 Decisions

#### 2.1.1 1832 Asset Management L.P. et al.

##### Headnote

National Policy 11-203 Process for Exemptive Relief Applications in Multiple Jurisdictions – approval of investment fund mergers – approval required because mergers do not meet the criteria for pre-approved reorganizations and transfers in National Instrument 81-102 Investment Funds – certain terminating funds and continuing funds do not have substantially similar fundamental investment objectives – the mergers will not be a “qualifying exchange” or a tax-deferred transaction under the Income Tax Act – Fund Facts documents not available for certain series of the Continuing Funds– securityholders provided with timely and adequate disclosure regarding the mergers.

##### Applicable Legislative Provisions

National Instrument 81-102 Investment Funds, ss. 5.5(1)(b), 5.7(1)(b), 19.1(2).

June 16, 2017

IN THE MATTER OF  
THE SECURITIES LEGISLATION OF  
ONTARIO  
(the Jurisdiction)

AND

IN THE MATTER OF  
THE PROCESS FOR EXEMPTIVE RELIEF APPLICATIONS  
IN MULTIPLE JURISDICTIONS

AND

IN THE MATTER OF  
1832 ASSET MANAGEMENT L.P.  
(the Manager)

AND

DYNAMIC STRATEGIC BOND FUND,  
DYNAMIC CANADIAN ASSET ALLOCATION CLASS,  
DYNAMIC POWER BALANCED CLASS,  
DYNAMIC AURION TACTICAL BALANCED CLASS,  
DYNAMIC POWER CANADIAN GROWTH CLASS,  
DYNAMIC POWER DIVIDEND GROWTH CLASS,  
DYNAMIC GLOBAL VALUE CLASS,  
DYNAMIC EAFE VALUE CLASS,  
DYNAMIC EMERGING MARKETS CLASS,  
DYNAMIC EMERGING MARKETS FUND,  
DYNAMIC POWER AMERICAN CURRENCY NEUTRAL FUND,  
DYNAMIC RESOURCE FUND,  
DYNAMIC STRATEGIC GROWTH PORTFOLIO  
(each, a Terminating Fund, collectively the Terminating Funds,  
and together with the Manager on behalf of the Terminating Funds, the Filers)

DECISION

**Background**

The principal regulator in the Jurisdiction has received an application (the **Application**) from the Filers, for a decision under the securities legislation of the jurisdiction of the principal regulator (the **Legislation**) approving the proposed reorganization of each of the Terminating Funds with applicable Continuing Funds (each as defined below) (the **Mergers**), pursuant to subsection 5.5(1)(b) of National Instrument 81-102 – *Investment Funds (NI 81-102)* (the **Requested Relief**).

Under the Process for Exemptive Relief Applications in Multiple Jurisdictions (for a passport application):

- (a) the Ontario Securities Commission is the principal regulator for this application; and
- (b) the Filers have provided notice that section 4.7(1) of Multilateral Instrument 11-102 *Passport System (MI 11-102)* is intended to be relied upon in each of the other provinces and territories in Canada (the Other Jurisdictions and collectively with Ontario, the **Jurisdictions**).

**Interpretation**

Terms defined in NI 81-102, National Instrument 14-101 – *Definitions*, and MI 11-102 have the same meaning if used in this decision, unless otherwise defined.

**Circular** means the management information circular dated May 1, 2017 and provided by the Manager in connection with the Mergers.

**Closed Mergers** means the following Mergers involving the existing series of the Continuing Funds specified below which are not currently offered for purchase and are not currently qualified for distribution under a prospectus:

Closed Mergers			
Terminating Fund		Continuing Fund	
Fund Name	Series	Fund Name	Series
Dynamic Power Balanced Class	Series E	Dynamic Power Balanced Fund	Series E
Dynamic Aurion Tactical Balanced Class	Series E	Dynamic Power Balanced Fund	Series E
Dynamic Power Canadian Growth Class	Series IP	Dynamic Power Canadian Growth Fund	Series IP
Dynamic Power Dividend Growth Class	Series I	Dynamic Power Canadian Growth Fund	Series IP

**Continuing Funds** means, collectively, Dynamic Canadian Bond Fund, Dynamic Canadian Dividend Fund, Dynamic Power Balanced Fund, Dynamic Power Canadian Growth Fund, Dynamic Global Value Fund, Dynamic Power American Growth Fund, Dynamic Strategic Resource Class and DynamicEdge Balanced Growth Portfolio and each individually, a Continuing Fund.

**Exempt Mergers** means the following Merger, where Series UN of the Continuing Fund will be offered only on an exempt distribution basis:

Exempt Mergers			
Terminating Fund		Continuing Fund	
Fund Name	Series	Fund Name	Series
Dynamic Power American Currency Neutral Fund	Series U	Dynamic Power American Growth Fund	Series UN

**Funds** means collectively, the Terminating Funds and the Continuing Funds.

**Grandfathering Mergers** means the following Mergers, where the following series of securities of the Continuing Funds are being created solely to facilitate the Mergers, will not be qualified for distribution under a prospectus and will not be available for purchase subsequent to the Mergers:

Grandfathering Mergers			
Terminating Fund		Continuing Fund	
Fund Name	Series	Fund Name	Series
Dynamic Strategic Bond Fund	Series H	Dynamic Canadian Bond Fund	Series H
Dynamic Canadian Asset Allocation Class	Series A Series T	Dynamic Canadian Dividend Fund	Series A1
	Series E		Series E
Dynamic Power Dividend Growth Class	Series A Series T	Dynamic Power Canadian Growth Fund	Series A1
	Series F		Series F1
Dynamic Emerging Markets Class	Series IP	Dynamic Global Value Fund	Series IP
Dynamic Resource Fund	Series A	Dynamic Strategic Resource Class	Series A1
	Series G		Series G1
	Series E		Series E
	Series F		Series F1
	Series FI		Series FI
Dynamic Power American Currency Neutral Fund	Series I	Dynamic Power American Growth Fund	Series IN

**Select Mergers** means the following Mergers, where Series N and Series FN of Dynamic Power American Growth Fund as well as Series O of Dynamic Strategic Resource Class are being created to facilitate the Mergers, will be qualified for distribution under a prospectus and will be available for purchase subsequent to the Mergers:

Select Mergers			
Terminating Fund		Continuing Fund	
Fund Name	Series	Fund Name	Series
Dynamic Power American Currency Neutral Fund	Series A	Dynamic Power American Growth Fund	Series N
	Series F		Series FN
Dynamic Resource Fund	Series O	Dynamic Strategic Resource Class	Series O

**Tax Act** means the *Income Tax Act* (Canada).

**Representations**

**The Manager**

- The Manager is an Ontario limited partnership, which is wholly-owned indirectly by The Bank of Nova Scotia. The general partner of the Manager (the **General Partner**) is 1832 Asset Management G.P. Inc., an Ontario corporation wholly-owned directly by The Bank of Nova Scotia, with its head office in Toronto, Ontario.

2. The Manager is the manager of the Funds and is registered as: (i) a portfolio manager in all of the provinces of Canada and in the Northwest Territories and the Yukon; (ii) an exempt market dealer in all of the provinces of Canada (except Prince Edward Island and Saskatchewan); (iii) an investment fund manager in Ontario, Québec, Newfoundland and Labrador and the Northwest Territories; and (iv) a commodity trading manager in Ontario.

**The Funds**

3. Each of the Funds is either a mutual fund trust or a class of a mutual fund corporation established or incorporated under the laws of Ontario or the laws of Canada and is a reporting issuer under the applicable securities legislation of each Jurisdiction.
4. Neither the Manger nor any Fund is in default of securities legislation in any Jurisdiction.
5. Other than circumstances in which the securities regulatory authority of a Jurisdiction has expressly exempted a Fund therefrom, each of the Funds follows the standard investment restrictions established under NI 81-102.
6. The securities of each Fund (other than Series A, Series G, Series IP and Series OP securities of certain Funds and securities to be received by the securityholders of the Terminating Funds in connection with the Grandfathering Mergers, the Closed Mergers and the Exempt Mergers) are or will be qualified for distribution in the Jurisdictions pursuant to a simplified prospectus and annual information form prepared and filed in accordance with the securities legislation of the Jurisdictions.
7. Series U and Series UN securities of certain Funds are or will be offered only on an exempt distribution basis. Series A, Series C, Series E, Series FC, Series FI, Series G, Series I, Series IP and Series OP securities of certain Funds are no longer available for purchase. Finally, Series A1, Series E, Series F1, Series FI, Series G1, Series H, Series IN and Series IP of certain Funds are being created with the sole purpose of facilitating the Mergers and are not or will not be qualified for distributions or available for sale following the completion of the Mergers.
8. The net asset value for each series of securities of the Funds is calculated on a daily basis in accordance with the Funds' valuation policy and as described in the simplified prospectus and annual information form for the Funds.

**Reasons for the Requested Relief**

9. Approval of the Mergers is required because:
- (a) in respect of certain Mergers, the fundamental investment objectives of certain Continuing Funds are not, or may be considered not to be, "substantially similar" to the fundamental investment objectives of their corresponding Terminating Funds;
  - (b) the Mergers will not be completed as a "qualifying exchange" or a tax-deferred transaction under the Tax Act; and
  - (c) in respect of certain Mergers, the materials to be sent to certain securityholders of the Terminating Funds will not include the most recently filed Fund Facts documents for the series of the Continuing Funds into which the applicable series of the Terminating Funds are merging because:
    - (A) the applicable series of the Continuing Funds are being created solely to facilitate the Mergers, will not be qualified for distribution under a prospectus and will not be available for sale subsequent to the Mergers (the **Grandfathering Mergers**);
    - (B) the applicable series of the Continuing Funds are being newly created to facilitate the Mergers and Fund Facts documents were not available prior to the mailing date of the Meeting Materials (the **Select Mergers**);
    - (C) the applicable series of the Continuing Funds are no longer offered for sale and are no longer qualified for distribution under a prospectus (the **Closed Mergers**); and
    - (D) the applicable series of the Continuing Funds are or will be offered only on an exempt distribution basis, as is the case with the series of the Terminating Funds merging into these series (the **Exempt Mergers**).
10. Pursuant to the Mergers, securityholders of each of the Terminating Funds would become securityholders of the applicable Continuing Fund, as follows:



TERMINATING FUND	CONTINUING FUND
Dynamic Strategic Bond Fund	Dynamic Canadian Bond Fund
Dynamic Canadian Asset Allocation Class	Dynamic Canadian Dividend Fund
Dynamic Power Balanced Class	Dynamic Power Balanced Fund
Dynamic Aurion Tactical Balanced Class	
Dynamic Power Canadian Growth Class	Dynamic Power Canadian Growth Fund
Dynamic Power Dividend Growth Class	
Dynamic Global Value Class	Dynamic Global Value Fund
Dynamic EAFE Value Class	
Dynamic Emerging Markets Class	
Dynamic Emerging Markets Fund	
Dynamic Power American Currency Neutral Fund	Dynamic Power American Growth Fund
Dynamic Resource Fund	Dynamic Strategic Resource Class
Dynamic Strategic Growth Portfolio	DynamicEdge Balanced Growth Portfolio

11. Except as noted above, the Mergers will otherwise comply with all other criteria for pre-approved reorganizations and transfers set out in section 5.6 of NI 81-102.
12. Other than in the case of Dynamic Strategic Resource Class, the Mergers do not require approval of securityholders of the Continuing Funds as the Manager has determined that none of those Mergers will result in a material change to the corresponding Continuing Funds.
13. The Manager has determined that the Merger of Dynamic Resource Fund into Dynamic Strategic Resource Class will constitute a material change for Dynamic Strategic Resource Class as the assets under management of Dynamic Resource Fund were larger than those of Dynamic Strategic Resource Class as at March 31, 2017. As a result, the Manager will be seeking the prior approval of the securityholders of Dynamic Strategic Resource Class to the Merger of Dynamic Resource Fund into Dynamic Strategic Resource Class.
14. As required by National Instrument 81-107 – *Independent Review Committee for Investment Funds*, the Independent Review Committee (**IRC**) has been appointed for the Funds. The Manager presented the terms of the Mergers to the IRC for a recommendation. The IRC reviewed the Mergers and provided a positive recommendation for each of the Mergers on March 29, 2017, having determined that the Mergers, if implemented, would achieve a fair and reasonable result for each of the Funds and their respective securityholders.
15. In accordance with National Instrument 81-106 – *Continuous Disclosure*, a press release describing the Mergers was issued and filed on SEDAR on March 30, 2017. An associated material change report with respect to the Terminating Funds and Dynamic Strategic Resource Class was filed on SEDAR on April 5, 2017. Amendments to the simplified prospectus, annual information form and Fund Facts documents of the Terminating Funds and Dynamic Strategic Resource Class were filed with the Principal Regulator on April 7, 2017.
16. In reliance on notice-and-access exemptive relief issued on November 4, 2016 (“**Notice-and-Access Relief**”), the Manager received an exemption from the requirement to deliver an information circular to each registered holder of securities of a Fund whose proxy is solicited if, instead, the Manager delivered a “notice-and-access document” using the “notice-and-access procedure” (each as defined in the Notice-and-Access Relief). Therefore, pursuant to the Notice-and-Access Relief, the Manager made available a copy of the Circular and mailed a notice-and-access document, proxy and Fund Facts documents, where applicable, of the applicable series of the Continuing Funds (collectively, **Meeting Materials**) to securityholders of the Terminating Funds and Dynamic Strategic Resource Class on May 4, 2017.
17. The Meeting Materials outline the material facts concerning the Mergers relevant to each securityholder, including the differences between fundamental investment objectives, fee structure and valuation procedures of the Terminating

Funds and the Continuing Funds, the IRC's recommendation of the Mergers, and income tax considerations so that securityholders of the Terminating Funds may consider this information before voting on the Mergers. The Meeting Materials also describe the various ways in which securityholders can obtain a copy of the simplified prospectus and annual information form of the Continuing Funds, as well as the most recent interim and annual financial statements and management reports of fund performance for the Continuing Funds, at no cost.

18. Fund Facts documents relating to the applicable series of each Continuing Fund will be mailed to securityholders of the corresponding series of each Terminating Fund in all instances other than in respect of the Grandfathering Mergers, the Select Mergers, the Closed Mergers and the Exempt Mergers.
19. In respect of the Grandfathering Mergers, the Closed Mergers and the Exempt Mergers, because a current simplified prospectus and Fund Facts documents are not available for the applicable series of the Continuing Funds, securityholders of each of the corresponding series of the Terminating Funds will be sent Fund Facts documents relating to Series A securities of the applicable Continuing Fund, or, where appropriate, another series of securities of the applicable Continuing Fund.
20. In respect of the Select Mergers, because the simplified prospectus and Fund Facts documents were not available as of the mailing date of the Meeting Materials for the securities of the Continuing Funds to be distributed in connection with the Select Mergers:
  - a) securityholders of Series A and Series F of Dynamic Power American Currency Neutral Fund were sent Fund Fact documents relating to Series A and Series F, respectively, of Dynamic Power American Growth Fund; and
  - b) securityholders of Series O of Dynamic Resource Fund were sent Fund Facts documents relating to Series I of Dynamic Strategic Resource Class.

For Fund Facts delivery purposes, Series A and Series F of Dynamic Power American Growth Fund (for the Mergers in paragraph 20(a)) and Series I of Dynamic Strategic Resource Class (for the Mergers in paragraph 20(b)) were selected since these series have a fee structure that most closely compares to the fee structure of the applicable series of the Continuing Fund.

21. In order to affect the Select Mergers, the relevant series of the Continuing Funds were qualified for distribution and the relevant amendment to the simplified prospectus, annual information form and Fund Fact documents of those Continuing Funds were receipted on June 2, 2017.
22. The Manager will pay for the costs of the Mergers. These costs consist mainly of brokerage charges associated with the trades that occur both before and after the date of the Mergers and legal, proxy solicitation, printing, mailing and regulatory fees. There are no charges payable by securityholders of the Terminating Funds who acquire securities of the corresponding Continuing Funds as a result of the Mergers.
23. Securityholders of each of the Terminating Funds and Dynamic Strategic Resource Class approved the Mergers associated with those Funds at special meetings of securityholders held on June 9, 2017 (the **Securityholders' Meetings**), with the Mergers to be implemented on or before June 30, 2017.
24. The Mergers will be affected on a taxable basis to the Terminating Funds, which the Manager has determined will be in the overall best interests of the investors of the Terminating Funds and the Continuing Funds. Affecting the Mergers on a taxable basis will preserve, where applicable, any unused tax losses of the Continuing Fund, which would otherwise expire upon implementation of the Merger on a tax deferred basis and therefore would not be available to shelter income and capital gains realized by the Continuing Fund in future years. Where a Continuing Fund does not have any unused tax losses, the Manager has determined that it is in the best interest of these Funds to affect the Mergers on a taxable basis because (i) a non-taxable merger would result in a deemed tax year-end for corresponding Continuing Funds; (ii) a deemed tax year-end for a Continuing Fund will also cause a deemed disposition by the Continuing Fund of all of its investment at the lower of cost or fair market value (**FMV**) and reacquire those investments at the same amount. The result of which will cause any accrued losses on investments in the Continuing Fund's investment portfolio to be realized on the Merger such that it cannot be carried forward to offset capital gains realized in tax years following the Merger; and (iii) under a non-taxable merger the Terminating Fund will defer any accrued and unrealized capital gains on investments in its investment portfolio. Such accrued and unrealized capital gains will be transferred to the corresponding Continuing Fund which, if the investments are disposed of in the year following the Merger, will be distributed to all securityholders of the Continuing Fund, including the original securityholders of the Continuing Fund.
25. Following the Mergers, all operational services (such as systematic withdrawal plan and pre-authorized contribution plans, other than in the case of the Grandfathering Mergers and the Closed Mergers) will continue to be available to

investors who will be automatically enrolled in comparable plans with respect to the securities of the corresponding Continuing Funds unless investors request otherwise. However, series of a Continuing Fund issued in connection with a Grandfathering Merger or Closed Merger will not be in distribution following the Mergers and, therefore, no new pre-authorized contribution plan will be made available.

26. Following the Mergers, investors in any Continuing Fund may change or cancel any systematic plan at any time.

***Procedure for the Mergers***

27. The Manager will carry out the following steps to complete the Mergers:
- (i) Prior to affecting the Mergers, each Terminating Fund may sell any investment that is not consistent with the investment objective and investment strategies of the applicable Continuing Fund or acceptable to the portfolio manager of the applicable Continuing Fund. As a result, some of the Terminating Funds may temporarily hold cash or money market instruments and may not be fully invested in accordance with their investment objectives for a brief period of time prior to the Merger being effected.
  - (ii) The value of each Terminating Fund's portfolio and other assets will be determined at the close of business on the effective date of each respective Merger in accordance with the constating documents of the applicable Terminating Fund.
  - (iii) Each Continuing Fund will acquire the investment portfolio and other assets of the corresponding Terminating Fund in exchange for securities of the Continuing Fund. The securities of the Continuing Fund received by the Terminating Fund will (a) have an aggregate net asset value equal to the value of the net assets transferred by the corresponding Terminating Fund and (b) be issued at the net asset value per security of the Continuing Fund as of the close of business on the effective date of the applicable Merger.
  - (iv) Each Terminating Fund will subsequently redeem its outstanding securities and distribute the corresponding securities of the Continuing Fund to the securityholders of the Terminating Fund on a dollar-for-dollar basis.
  - (v) In each case, the investors in the Terminating Funds will receive either the same series of securities of the Continuing Funds as such investors hold in the Terminating Funds or an equivalent series of securities with attributes similar to those of the series of securities held by such investors in the Terminating Funds.
  - (vi) The Continuing Funds will not assume any liabilities of the corresponding Terminating Funds and the Terminating Funds will retain sufficient assets to satisfy their respective estimated liabilities, if any, as of the effective date of the respective Merger.
  - (vii) The Terminating Funds will distribute a sufficient amount of their net income and net realized capital gains, if any, to securityholders to ensure that the Terminating Funds will not be subject to tax for their current tax year.
  - (viii) Each Terminating Fund will be wound up as soon as reasonably possible following the completion of the applicable Merger.
28. Securityholders of the Terminating Funds will have the right to redeem their securities prior to the Mergers should they wish to do so up to the close of business on the last business day before the effective date of the Merger.
29. Following the Securityholders' Meetings, a press release announcing the results of such meetings in respect of the Mergers will be issued and filed.
30. Following the implementation of the Mergers, the Continuing Funds will continue as publicly offered open-ended mutual funds offering securities in the Jurisdictions or as classes of a mutual fund corporation.
31. No commission or other fee will be charged to investors in connection with the Mergers on the exchange of securities of the Terminating Funds for the securities of the corresponding Continuing Fund.

***Merger Benefits***

32. The Manager believes that the Mergers are beneficial to securityholders of the Terminating Funds and corresponding Continuing Funds for the following reasons:
- (i) **Economies of scale:** The Mergers will provide economies of scale by eliminating duplicative administrative and regulatory costs of operating the Terminating Funds and the corresponding Continuing Funds as separate

mutual funds. The Mergers will also allow the Manager to make its product offering smaller and simpler, and therefore easier for investors to navigate.

- (ii) **Flexible mandate of the Continuing Fund:** In certain cases, the Continuing Funds provide a substantially similar yet broader or more flexible mandate with consistency of management that the Manager believes provides those Continuing Funds with broader investment opportunities that may lead to increased return potential.
- (iii) **Increased diversification:** In certain cases, the assets of the Terminating Funds have decreased to such a point where it has become inefficient to manage a Terminating Fund as a standalone fund and provide proper diversification. Following the Mergers, the Continuing Funds will have more assets allowing for increased portfolio diversification opportunities and a smaller proportion of assets set aside to fund redemptions.
- (iv) **Similar or lower fees:** Terminating Fund investors will receive securities of the Continuing Fund that have a management fee and a fixed administration fee that is substantially similar and/or lower than the management fee charged in respect of the securities of the Terminating Fund that they currently hold.

### Decision

The Principal Regulator is satisfied that the decision meets the test set out in the Legislation for the Principal Regulator to make the decision.

The decision of the Principal Regulator under the Legislation is that the Requested Relief is granted.

“Vera Nunes”  
Manager  
Investment Funds and Structured Products Branch  
Ontario Securities Commission

2.1.2 Wells Fargo Securities, LLC

Headnote

U.S. registered broker-dealer exempted from dealer registration under paragraph 25(1) of the Act in respect of certain trades in debt securities with permitted clients, as defined under NI 31-103, where the debt securities are i) debt securities of Canadian issuers and are denominated in a currency other than the Canadian dollar; or ii) debt securities of any issuer, including a Canadian issuer, and were originally offered primarily in a foreign jurisdiction outside Canada and a prospectus was not filed with a Canadian securities regulatory authority for the distribution – relief is subject to sunset clause – relief as contemplated by CSA Staff Notice 31-346 Guidance as to the Scope of the International Dealer Exemption in relation to Foreign-Currency Fixed Income Offerings by Canadian Issuers.

Applicable Legislative Provisions

Statutes Cited

Securities Act, R.S.O. 1990, c. S.5, as am., ss. 25(1), 74(1).

Instruments Cited

Multilateral Instrument 11-102 Passport System, s. 4.7.  
National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations, s. 8.18.

July 11, 2017

IN THE MATTER OF  
THE SECURITIES LEGISLATION OF  
ONTARIO  
(the Jurisdiction)

AND

IN THE MATTER OF  
THE PROCESS FOR EXEMPTIVE RELIEF  
APPLICATIONS  
IN MULTIPLE JURISDICTIONS

AND

IN THE MATTER OF  
WELLS FARGO SECURITIES, LLC (the Filer)

DECISION

Background

The principal regulator in the Jurisdiction has received an application from the Filer (the **Application**) for a decision under the securities legislation of the Jurisdiction (the **Legislation**) exempting the Filer from the dealer registration requirement under the Legislation in respect of trades in debt securities, other than during the distribution of such securities, with permitted clients, as defined under

National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (**NI 31-103**), where the debt securities are

- (a) debt securities of Canadian issuers and are denominated in a currency other than the Canadian dollar; or
- (b) debt securities of any issuer, including a Canadian issuer, and were originally offered primarily in a foreign jurisdiction outside Canada and a prospectus was not filed with a Canadian securities regulatory authority for the distribution (the **Exemption Sought**).

Under the Process for Exemptive Relief Applications in Multiple Jurisdictions (for a passport application):

- (a) the Ontario Securities Commission (**OSC**) is the principal regulator for this application, and
- (b) the Filer has provided notice that subsection 4.7(1) of Multilateral Instrument 11-102 *Passport System* (**MI 11-102**) is intended to be relied upon in each of the other provinces and territories of Canada (the **Passport Jurisdictions** and together with the Jurisdiction, the **Jurisdictions**).

Interpretation

Terms defined in National Instrument 14-101 *Definitions* and MI 11-102 have the same meaning if used in this decision unless otherwise defined.

Representations

This Decision is based on the following facts represented by the Filer:

1. The Filer is a limited liability company organized under the laws of the state of Delaware with its head office located at 550 South Tryon Street, Charlotte, North Carolina 28202, United States of America. The Filer is a wholly owned indirect subsidiary of Wells Fargo & Company.
2. The Filer is registered as a broker-dealer with the U.S. Securities and Exchange Commission (**SEC**) and a member of the Financial Industry Regulatory Authority (**FINRA**), a self-regulatory organization. This registration subjects the Filer to requirements over regulatory capital, lending of money, extension of credit and provision of margin, financial reporting to the SEC and FINRA, and segregation and custody of assets which provide protections that are substantially similar to the protections provided by the rules to which dealer-members of the Investment Industry Regu-

- latory Organization of Canada (**IIROC**) are subject.
3. The Filer is a member of a number of major U.S. securities exchanges, including the New York Stock Exchange and NASDAQ.
  4. The Filer provides a variety of capital raising, investment banking, market making, brokerage, and advisory services, including fixed income and equity sales and research, commodities trading, foreign exchange sales, emerging markets activities, securities lending and derivatives dealing for governments, corporate and financial institutions.
  5. Wells Fargo Securities Canada, Ltd. (**WFS Canada**) is an affiliate of the Filer. WFS Canada is registered as an investment dealer in Alberta, British Columbia, Manitoba, New Brunswick, Nova Scotia, Ontario, Quebec and Saskatchewan, as a derivatives dealer in Quebec, and is a dealer member of IIROC.
  6. The Filer is currently relying on the international dealer registration exemption under section 8.18 of NI 31-103 (the **international dealer exemption**) in each of the Jurisdictions.
  7. The Filer is in compliance in all material respects with U.S. securities laws. The Filer is not in default of Canadian securities laws.
  8. The Filer wishes to trade in debt securities of Canadian issuers with permitted clients other than during such securities' distribution.
  9. Paragraph 8.18(2)(b) of NI 31-103 provides that, subject to subsections 8.18(3) and 8.18(4), the dealer registration requirement does not apply in respect of a trade in a debt security with a permitted client during the security's distribution, if the debt security is offered primarily in a foreign jurisdiction and a prospectus has not been filed with a Canadian securities regulatory authority for the distribution. Paragraph 8.18(2)(c) of NI 31-103 provides that, subject to subsections 8.18(3) and 8.18(4), the dealer registration requirement does not apply in respect of a trade in a debt security that is a foreign security with a permitted client, other than during the security's distribution.
  10. The permitted activities under subsection 8.18(2) of NI 31-103 do not include a trade in a debt security of a Canadian issuer with a permitted client, other than during the security's distribution in the limited circumstances described above.
  11. On September 1, 2016, the Staff of the Canadian Securities Administrators (**CSA Staff**) published CSA Staff Notice 31-346 *Guidance as to the Scope of the International Dealer Exemption in relation to Foreign-Currency Fixed Income Offerings by Canadian Issuers* (the **Staff Notice**).
  12. CSA Staff stated in the Staff Notice that they did not believe there was a policy reason to limit the exemption in subsection 8.18(2) of NI 31-103 to trades that occur during the initial period of the securities' distribution or to conclude that an international dealer should be permitted to sell a debt security to a Canadian institutional investor but not be permitted to act for the institutional investor in connection with the resale of the security. CSA Staff further stated that they were prepared to recommend exemptive relief to permit international dealers to deal with institutional investors to facilitate resales of debt securities, subject to conditions the CSA consider appropriate.
  13. Accordingly, the Filer is seeking exemptive relief as contemplated by the Staff Notice to permit the Filer to deal with Canadian permitted clients in connection with resales of debt securities that may be distributed to the permitted clients in reliance on the international dealer exemption in section 8.18 of NI 31-103.
  14. It may be difficult at the time of a resale of a debt security to determine whether the debt security was originally offered as part of an offering that was made primarily in a foreign jurisdiction or whether a prospectus was filed in Canada in connection with such offering. However, the Filer believes, based on its experience with foreign-currency-denominated fixed income offerings by Canadian issuers (**Canadian foreign-currency fixed income offerings**), that such offerings are generally made primarily outside of Canada. Accordingly, the Filer believes that the denomination of an offering of debt securities in a foreign currency will be a reasonable proxy for determining whether the offering was originally made primarily outside of Canada.
  15. Similarly, the Filer believes, based on its experience with Canadian foreign-currency fixed income offerings, that, to the extent that debt securities that are the subject of such offerings are listed on a stock exchange, they will typically not be listed on a stock exchange situated in Canada. To the extent that foreign-currency-denominated debt securities of a Canadian issuer are listed on a stock exchange situated in Canada, investors will be required to trade such debt securities through an IIROC registered dealer.
  16. The Filer is a "market participant" as defined under subsection 1(1) of the OSA. As a market participant, among other requirements, the Filer is required to comply with the record keeping and provision of information provisions under section 19 of the OSA, which include the requirement to keep such books, records and other documents

(a) as are necessary for the proper recording of business transactions and financial affairs, and the transactions executed on behalf of others, (b) as may otherwise be required under Ontario securities law, and (c) as may reasonably be required to demonstrate compliance with Ontario securities laws, and to deliver such records to the OSC if required.

**Decision**

The principal regulator is satisfied that the decision meets the test set out in the Legislation for the principal regulator to make the decision.

The decision of the principal regulator under the Legislation is that the Exemption Sought is granted provided that the Filer complies with the terms and conditions described in section 8.18 of NI 31-103 as if the Filer had made the trades in reliance on an exemption contained in section 8.18.

It is further the decision of the principal regulator that the Exemption Sought shall expire on the date that is the earlier of:

- (a) the date on which amendments to the international dealer exemption in section 8.18 of NI 31-103 come into force that address the ability of international dealers to trade debt securities of Canadian issuers; and
- (b) five years after the date of this decision.

“Grant Vingoe”  
Vice-Chair  
Ontario Securities Commission

“Tim Moseley”  
Commissioner  
Ontario Securities Commission

**2.2 Orders**

**2.2.1 Pro-Financial Asset Management Inc. et al.**

**IN THE MATTER OF  
PRO-FINANCIAL ASSET MANAGEMENT INC.,  
STUART MCKINNON and  
JOHN FARRELL**

Timothy Moseley, Commissioner

July 13, 2017

**ORDER**

**WHEREAS** on July 13, 2017, the Ontario Securities Commission (the **Commission**) held a pre-hearing conference at the offices of the Commission, located at 20 Queen Street West, 17th Floor, Toronto, Ontario with respect to scheduling;

**ON HEARING** and considering the submissions of Staff of the Commission, Stuart McKinnon (appearing in person) and counsel for Mr. McKinnon and Pro-Financial Asset Management;

**IT IS HEREBY ORDERED** that:

1. If, as indicated, Mr. McKinnon brings a motion under section 144 of the *Securities Act*, RSO 1990, c S.5, he shall file, on or before August 18, 2017, his motion materials, including the grounds relied upon and any new evidence;
2. A pre-hearing conference is scheduled for August 23, 2017 at 9:30 a.m. for the purpose of dealing with matters with respect to the section 144 motion and scheduling the sanctions and costs hearing; and
3. An oral hearing of the section 144 motion is scheduled for September 28, 2017 at 10:00 a.m., if necessary.

“Timothy Moseley”

## 2.2.2 Nesscap Energy Inc.

### Headnote

National Policy 11-203 Process for Exemptive Relief Applications in Multiple Jurisdictions – National Policy 11-206 Process for Cease to be a Reporting Issuer Applications – issuer deemed to no longer be a reporting issuer under applicable securities legislation – issuer is in the process of winding up – issuer will distribute to its shareholders all of its remaining assets, including shares of another entity that it holds – issuer has ceased all commercial activity and will be dissolved after the liquidation process is complete – shareholders voted to approve the liquidation resolution and the application to cease reporting – issuer has more than 50 securityholders worldwide and more than 15 securityholders in Canada.

### Applicable Legislative Provisions

Securities Act, R.S.O. 1990, c. S.5, as am., s. 1(10)(a)(ii).

July 14, 2017

**IN THE MATTER OF  
THE SECURITIES LEGISLATION OF  
ONTARIO  
(the Jurisdiction)**

**AND**

**IN THE MATTER OF  
THE PROCESS FOR CEASE TO BE  
A REPORTING ISSUER APPLICATIONS**

**AND**

**IN THE MATTER OF  
NESSCAP ENERGY INC.  
(the Filer)**

**ORDER**

### Background

The principal regulator in the Jurisdiction has received an application from the Filer for an order under the securities legislation of the Jurisdiction of the principal regulator (the Legislation) that the Filer has ceased to be a reporting issuer in all jurisdictions of Canada in which it is a reporting issuer (the Order Sought).

Under the Process for Cease to be a Reporting Issuer Applications (for a passport application):

- (a) the Ontario Securities Commission is the principal regulator for this application, and
- (b) the Filer has provided notice that subsection 4C.5(1) of Multilateral Instrument 11-102 *Passport System* (MI 11-102) is intended to be relied upon in British Columbia and Alberta (collectively with Ontario, the Jurisdictions).

### Interpretation

Terms defined in National Instrument 14-101 *Definitions* and MI 11-102 have the same meaning if used in this order, unless otherwise defined.

### Representations

This order is based on the following facts represented by the Filer:

1. The Filer is a corporation governed by the *Business Corporations Act* (Ontario) (the OBCA) with its registered and head office located at 40 King Street West, Suite 5800, Toronto, Ontario, M5H 3S1;
2. The Filer is a reporting issuer in the Provinces of Ontario, British Columbia and Alberta;



## Decisions, Orders and Rulings

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3. The authorized capital of the Filer consists of an unlimited number of common shares (the Shares) and 18,304,341 Series 1 Preferred Shares of which 574,666,542 Shares and no Series 1 Preferred Shares are issued and outstanding;
4. The Shares are held by approximately 132 beneficial holders (shareholders) and 18 registered shareholders, including approximately 117 Canadian shareholders holding approximately 1% of the Shares outstanding and approximately 33 non-Canadian beneficial shareholders holding approximately 99% of the Shares outstanding;
5. Two non-Canadian shareholders, I2BF Holdings Ltd. and Arbat Capital Group Ltd., own or control approximately 80% of the Shares;
6. On April 28, 2017, the Filer completed the sale of substantially all of its assets to Maxwell Technologies, Inc. (Maxwell), a US based NASDAQ issuer, by way of plan of arrangement under the provisions of the OBCA (the Asset Sale);
7. In exchange for the Filer's assets Maxwell has issued to the Filer shares in the capital of Maxwell with a value of US\$23,175,000 (the Consideration Shares);
8. The Filer has no active business or commercial operations and its assets consist of cash and the Consideration Shares;
9. At a special meeting of shareholders of the Filer held on April 24, 2017 (the Meeting), holders of 100% of the Shares represented at the Meeting, representing 92.95% of all issued and outstanding Shares, voted in favour of resolutions to (i) approve the Asset Sale, (ii) delist the Shares from the TSX Venture Exchange and (iii) voluntarily dissolve the Filer and distribute all remaining assets to the shareholders at times and in amounts at the discretion of the Board of directors of the Filer;
10. The Filer obtained a final order for the Asset Sale from the Ontario Superior Court of Justice (Commercial List) on April 27, 2017;
11. Effective at the close of trading on May 2, 2017, the Shares were delisted from trading on the TSX Venture Exchange; no securities of the Filer, including debt securities, are traded in Canada or another country on a marketplace as defined in National Instrument 21-101 *Marketplace Operation* or any other facility for bringing together buyers and sellers of securities where trading data is publicly reported, and the Filer does not intend to have any of its securities listed, traded or quoted on such marketplace in Canada or any other jurisdiction;
12. The Filer must secure a clearance certificate from the Canada Revenue Agency before it can dissolve, and anticipates obtaining this certificate by August 31, 2017;
13. The Filer will satisfy all of its liabilities and distribute all of its assets to its shareholders at times and in amounts at the discretion of the Board of directors of the Filer, and will dissolve in accordance with the terms for a voluntary dissolution under the OBCA;
14. The management information circular of the Filer dated March 24, 2017 provided to shareholders of the Filer in connection with the Meeting included disclosure of the Filer's intention to submit an application to applicable securities regulatory authorities in Canada for an order deeming the Filer to no longer be a reporting issuer for the purposes of applicable securities legislation;
15. The Filer has no intention to seek public financing by way of offering of securities;
16. All issued and outstanding securities of the Filer will be cancelled upon the dissolution of the Filer;
17. The Filer has issued a news release on April 28, 2017 advising shareholders:
  - (a) that it has applied to cease to be a reporting issuer; and
  - (b) of the anticipated timeframe of its dissolution and final distribution to shareholders;
18. The Filer has provided an undertaking to the securities regulatory authority or regulator in each of the Jurisdictions that:
  - (a) as soon as practicable following the decision that the Filer is no longer a reporting issuer, it will issue a news release advising shareholders:
    - (i) that it has ceased to be a reporting issuer; and

- (ii) of the anticipated date of its dissolution and final distribution to shareholders;
  - (b) if the Filer has not dissolved on or before December 31, 2017, it will, on or about that date, issue a news release regarding the status of its liquidation and anticipated timing of its dissolution;
  - (c) if the Filer has not dissolved by March 31, 2018, on or about that date and thereafter on a quarterly basis until it dissolves, issue a news release on the status of its liquidation and anticipated timing of its dissolution;
  - (d) the Filer will notify the Jurisdictions at any time before its dissolution if it:
    - (i) commences an active business or any commercial operations;
    - (ii) proposes to undertake a public or private offering of securities in any jurisdiction; or
    - (iii) files an application to revive the Filer under the *Business Corporations Act* (Ontario);
  - (e) as soon as practicable after the time of dissolution, the Filer will issue a news release confirming the dissolution;
19. At the Filer's request CDS Clearing and Depository Services Inc. (CDS) has placed restrictions on the Shares so that no transfers among participants may occur;
20. The Filer is not eligible to use the simplified procedure in National Policy 11-206 *Process for Cease to be a Reporting Issuer Applications* (NP 11-206) or BC Instrument 11-502 *Voluntary Surrender of Reporting Issuer Status* as it has more than 51 security holders worldwide;
21. The Filer will not be a reporting issuer or the equivalent in any jurisdiction immediately following the granting of the Order Sought; and
22. The Filer is not in default of securities legislation in any jurisdiction.

**Order**

The principal regulator is satisfied that the order meets the test set out in the Legislation for the principal regulator to make the order.

The decision of the principal regulator under the Legislation is that the Order Sought is granted.

"Grant Vingoe"  
Ontario Securities Commission

"Frances Kordyback"  
Ontario Securities Commission

### 2.2.3 Nesscap Energy Inc. – s. 1(6) of the OBCA

#### Headnote

Applicant deemed to have ceased to be offering its securities to the public under the Business Corporations Act (Ontario).

#### Applicable Legislative Provisions

Business Corporations Act, R.S.O. 1990, c. B.16, as am., s. 1(6).

**IN THE MATTER OF  
THE BUSINESS CORPORATIONS ACT (ONTARIO),  
R.S.O. 1990, C. B.16, AS AMENDED  
(the OBCA)**

**AND**

**IN THE MATTER OF  
NESSCAP ENERGY INC.  
(the APPLICANT)**

**ORDER  
(Subsection 1(6) of the OBCA)**

**UPON** the application of the Applicant to the Ontario Securities Commission (the Commission) for an order pursuant to subsection 1(6) of the OBCA to be deemed to have ceased to be offering its securities to the public;

**AND UPON** the Applicant representing to the Commission that:

1. The Applicant is an “offering corporation” as defined in the OBCA, with its registered and head office located at 40 King Street West, Suite 5800, Toronto, Ontario, M5H 3S1;
2. The authorized capital of the Applicant consists of an unlimited number of common shares (the Shares) and 18,304,341 Series 1 Preferred Shares of which 574,666,542 Shares and no Series 1 Preferred Shares are issued and outstanding;
3. The Applicant has no debt securities outstanding;
4. The Shares are held by approximately 132 beneficial holders (shareholders) and 18 registered shareholders, including approximately 117 Canadian shareholders holding approximately 1% of the Shares outstanding and approximately 33 non-Canadian beneficial shareholders holding approximately 99% of the Shares outstanding;
5. Two non-Canadian shareholders, I2BF Holdings Ltd. and Arbat Capital Group Ltd., own or control approximately 80% of the Shares;
6. On April 28, 2017, the Applicant completed the sale of substantially all of its assets to Maxwell Technologies, Inc. (Maxwell), a US based NASDAQ issuer, by way of plan of arrangement under the provisions of the OBCA (the Asset Sale);
7. In exchange for the Applicant’s assets Maxwell has issued to the Applicant shares in the capital of Maxwell with a value of US\$23,175,000 (the Consideration Shares);
8. The Applicant has no active business or commercial operations and its assets consist of cash and the Consideration Shares;
9. At a special meeting of shareholders of the Applicant held on April 24, 2017 (the Meeting), holders of 100% of the Shares represented at the Meeting, representing 92.95% of all issued and outstanding Shares, voted in favour of resolutions to (i) approve the Asset Sale, (ii) delist the Shares from the TSX Venture Exchange and (iii) voluntarily dissolve the Applicant and distribute all remaining assets to the shareholders at times and in amounts at the discretion of the Board of directors of the Applicant;
10. The Applicant obtained a final order for the Asset Sale from the Ontario Superior Court of Justice (Commercial List) on April 27, 2017;

## Decisions, Orders and Rulings

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11. Effective at the close of trading on May 2, 2017, the Shares were delisted from trading on the TSX Venture Exchange;
12. The Applicant must secure a clearance certificate from the Canada Revenue Agency before it can dissolve, and anticipates obtaining this certificate by August 31, 2017;
13. The Applicant will satisfy all of its liabilities and distribute all of its assets to its shareholders at times and in amounts at the discretion of the Board of directors of the Applicant, and will dissolve in accordance with the terms for a voluntary dissolution under the OBCA;
14. The Applicant has no intention to seek public financing by way of offering of securities;
15. All issued and outstanding securities of the Applicant will be cancelled upon the dissolution of the Applicant;
16. On July 14, 2017, the Applicant was granted an order that it is not a reporting issuer in Ontario pursuant to subclause 1(10)(a)(ii) of the *Securities Act* (Ontario), and is not a reporting issuer or the equivalent in any other jurisdiction of Canada in accordance with the procedures set out in National Policy 11-206 *Process for Cease to be a Reporting Issuer Applications*; and
17. In connection with the order that the Applicant is not a reporting issuer, the Applicant provided an undertaking to the securities regulatory authority or regulator in each of Ontario, British Columbia and Alberta (the Jurisdictions) that:
  - (a) as soon as practicable following the decision that the Applicant is no longer a reporting issuer, it will issue a news release advising shareholders:
    - (i) that it has ceased to be a reporting issuer; and
    - (ii) of the anticipated date of its dissolution and final distribution to shareholders;
  - (b) if the Applicant has not dissolved on or before December 31, 2017, it will, on or about that date, issue a news release regarding the status of its liquidation and anticipated timing of its dissolution;
  - (c) if the Applicant has not dissolved by March 31, 2018, on or about that date and thereafter on a quarterly basis until it dissolves, issue a news release on the status of its liquidation and anticipated timing of its dissolution;
  - (d) the Applicant will notify the Jurisdictions at any time before its dissolution if it:
    - (i) commences an active business or any commercial operations;
    - (ii) proposes to undertake a public or private offering of securities in any jurisdiction; or
    - (iii) files an application to revive the Applicant under the Business Corporations Act (Ontario);
  - (e) as soon as practicable after the time of dissolution, the Applicant will issue a news release confirming the dissolution.

**AND UPON** the Commission being satisfied to do so would not be prejudicial to the public interest;

**IT IS HEREBY ORDERED** by the Commission pursuant to subsection 1(6) of the OBCA that the Applicant be deemed to have ceased to be offering its securities to the public for the purpose of the OBCA.

**DATED** at Toronto on this 14th day of July, 2017.

“Mark Sandler”  
Ontario Securities Commission

“Frances Kordyback”  
Ontario Securities Commission

## 2.2.4 International Road Dynamics Inc.

### Headnote

National Policy 11-206 Process for Cease to be a Reporting Issuer Applications – The issuer ceased to be a reporting issuer under securities legislation.

### Applicable Legislative Provisions

Securities Act, R.S.O. 1990, c. S.5, as am., s. 1(10)(a)(ii).

July 17, 2017

**IN THE MATTER OF  
THE SECURITIES LEGISLATION OF  
SASKATCHEWAN AND ONTARIO  
(the Jurisdictions)**

**AND**

**IN THE MATTER OF  
THE PROCESS FOR CEASE TO BE  
A REPORTING ISSUER APPLICATIONS**

**AND**

**IN THE MATTER OF  
INTERNATIONAL ROAD DYNAMICS INC.  
(the Filer)**

**ORDER**

### Background

The securities regulatory authority or regulator in each of the Jurisdictions (**Decision Maker**) has received an application from the Filer for an order under the securities legislation of the Jurisdictions (the **Legislation**) that the Filer has ceased to be a reporting issuer in all jurisdictions of Canada in which it is a reporting issuer (the **Order Sought**).

Under the Process for Cease to be a Reporting Issuer Applications (for a dual application):

- (a) the Financial and Consumer Affairs Authority of Saskatchewan is the principal regulator for this application,
- (b) the Filer has provided notice that subsection 4C.5(1) of Multilateral Instrument 11-102 *Passport System (MI 11-102)* is intended to be relied upon in Ontario, Alberta and British Columbia, and
- (c) this order is the order of the principal regulator and evidences the decision of the securities regulatory authority or regulator in Ontario.

### Interpretation

Terms defined in National Instrument 14-101 *Definitions* and MI 11-102 have the same meaning if used in this order, unless otherwise defined.

### Representations

This order is based on the following facts represented by the Filer:

1. the Filer is not an OTC reporting issuer under Multilateral Instrument 51-105 *Issuers Quoted in the U.S. Over the Counter Markets*;
2. the outstanding securities of the Filer, including debt securities, are beneficially owned, directly or indirectly, by fewer than 15 securityholders in each of the jurisdictions of Canada and fewer than 51 securityholders in total worldwide;

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3. no securities of the Filer, including debt securities, are traded in Canada or another country on a marketplace as defined in National Instrument 21-101 *Marketplace Operation* or any other facility for bringing together buyers and sellers of securities where trading data is publicly reported;
4. the Filer is applying for an order that the Filer has ceased to be a reporting issuer in all of the jurisdictions of Canada in which it is a reporting issuer; and
5. the Filer is not in default of securities legislation in any jurisdiction.

### Order

Each of the Decision Makers is satisfied that the order meets the test set out in the Legislation for the Decision Maker to make the order.

The decision of the Decision Makers under the Legislation is that the Order Sought is granted.

“Dean Murrison”  
Director, Securities Division  
Financial and Consumer Affairs  
Authority of Saskatchewan

2.3 Orders with Related Settlement Agreements

2.3.1 Manulife Securities Incorporated and Manulife Securities Investment Services Inc.

**IN THE MATTER OF  
MANULIFE SECURITIES INCORPORATED AND  
MANULIFE SECURITIES INVESTMENT SERVICES INC.**

D. Grant Vingoe, Vice-Chair and Chair of the Panel  
William J. Furlong, Commissioner

July 13, 2017

**ORDER  
(Subsections 127(1) and 127(2) of the Securities Act, RSO 1990, c S.5)**

**THIS APPLICATION**, made jointly by Staff of the Commission and Manulife Securities Incorporated and Manulife Securities Investment Services Inc. (the **Manulife Dealers**) for approval of a settlement agreement dated July 10, 2017 (the **Settlement Agreement**), was heard on July 13, 2017 at the offices of the Commission, located at 20 Queen Street West, 17th Floor, Toronto, Ontario;

**ON READING** the Statement of Allegations dated July 10, 2017, the Joint Application Record for a Settlement Hearing dated July 10, 2017, including the Settlement Agreement, and on hearing the submissions of counsel for the Manulife Dealers and Staff;

**IT IS ORDERED THAT:**

1. pursuant to subsection 127(1) of the Act, the Settlement Agreement is approved;
2. pursuant to subsection 127(2) of the Act, the approval of the Settlement Agreement is subject to the following terms and conditions:
  - a. in respect of inadequacies in the Manulife Dealers' systems of controls and supervision which formed part of their compliance systems (the **Control and Supervision Inadequacies**), within 90 days of receiving comments from Staff regarding the procedures, controls and supervisory and monitoring systems designed to prevent the re-occurrence of the Control and Supervision Inadequacies in the future (the **Enhanced Control and Supervision Procedures**), the Manulife Dealers shall provide to a manager or deputy director in the Compliance and Registrant Regulation Branch (the **OSC Manager**), revised written policies and procedures (the **Revised Policies and Procedures**) that, to the satisfaction of the OSC Manager, are responsive to any remaining issues raised by Staff with regard to the Manulife Dealers' policies and procedures to establish the Enhanced Control and Supervision Procedures (the **Remaining Issues**);
  - b. thereafter, the Manulife Dealers shall make such further modifications to their Revised Policies and Procedures as are required to ensure that the Revised Policies and Procedures address any Remaining Issues to the satisfaction of the OSC Manager;
  - c. within eight months of receiving confirmation from the OSC Manager that the Revised Policies and Procedures satisfy the Remaining Issues raised by Staff (the **Confirmation Date**), the Manulife Dealers shall submit a letter (the **Attestation Letter**), signed by the Ultimate Designated Person and the Chief Compliance Officer for each of the Manulife Dealers, to the OSC Manager, expressing their opinion on whether the Enhanced Control and Supervision Procedures were adequately followed, administered and enforced by the Manulife Dealer for the six month period commencing from the Confirmation Date;
  - d. the Attestation Letter shall be accompanied by a report which provides a description of the testing performed to support the conclusions contained in the Attestation Letter;
  - e. the Manulife Dealers shall submit such additional reports as may be requested by the OSC Manager for the purpose of satisfying the OSC Manager that the opinion expressed in the Attestation Letter described in subparagraph 2(c) above is valid;
  - f. any of the Manulife Dealers or Staff may apply to the Commission for directions in respect of any issues that may arise with regard to the implementation of subparagraphs 2(a) to (e) above;

- g. the Manulife Dealers shall comply with their undertaking in the Settlement Agreement to:
  - i. pay appropriate compensation to eligible clients and former clients who were harmed by the Control and Supervision Inadequacies in accordance with a plan submitted by the Manulife Dealers to Staff (the **Compensation Plan**) and to report to the OSC Manager in accordance with the Compensation Plan;
  - ii. make voluntary payment of \$25,000 to reimburse the Commission for costs incurred or to be incurred by it, in accordance with subsection 3.4(2)(a) of the Act; and
  - iii. make a further voluntary payment of \$495,000 to be designated for allocation or use by the Commission in accordance with paragraphs (b)(i) or (ii) of subsection 3.4(2) of the Act; and
- h. the voluntary payment referred to at subparagraph 2(g)(iii) above is designated for allocation or use by the Commission in accordance with paragraphs (b)(i) or (ii) of subsection 3.4(2) of the Act.

“D. Grant Vingoe”

“William J. Furlong”



**IN THE MATTER OF  
THE SECURITIES ACT,  
R.S.O. 1990, c. S.5, AS AMENDED**

**AND**

**IN THE MATTER OF  
MANULIFE SECURITIES INCORPORATED AND  
MANULIFE SECURITIES INVESTMENT SERVICES INC.**

**SETTLEMENT AGREEMENT BETWEEN  
STAFF OF THE COMMISSION and  
MANULIFE SECURITIES INCORPORATED and  
MANULIFE SECURITIES INVESTMENT SERVICES INC.**

**PART I – INTRODUCTION**

1. The Ontario Securities Commission (the “Commission”) will issue a Notice of Hearing to announce that it will hold a hearing to consider whether, pursuant to subsections 127(1) and 127(2) of the *Securities Act*, R.S.O. 1990, c. S.5, as amended (the “Act”), it is in the public interest for the Commission to make certain orders in respect of Manulife Securities Incorporated (“MSI”) and Manulife Securities Investment Services Inc. (“MSISI”) (together, the “Manulife Dealers”).
2. MSI is a corporation incorporated pursuant to the laws of Ontario. MSI is a member of the Investment Industry Regulatory Organization of Canada (“IIROC”) and is registered with the Commission as an investment dealer.
3. MSISI is a corporation incorporated pursuant to the laws of Canada. MSISI is a member of the Mutual Fund Dealers Association of Canada (“MFDA”) and is registered with the Commission as a mutual fund dealer and an exempt market dealer. Each of the Manulife Dealers is a subsidiary of Manulife Financial Corporation.
4. Commencing in June 2015, the Manulife Dealers self-reported to Staff of the Commission (“Commission Staff”) the matters described in Part III below. During Commission Staff’s investigation of these matters, the Manulife Dealers provided prompt, detailed and candid co-operation to Commission Staff.
5. As summarized at paragraph 11 below and more fully described in Part III below, it is Commission Staff’s position that there were inadequacies in the Manulife Dealers’ systems of controls and supervision which formed part of their compliance systems (the “Control and Supervision Inadequacies”) which resulted in certain clients paying, directly or indirectly, excess fees that were not detected or corrected by the Manulife Dealers in a timely manner.

**PART II – JOINT SETTLEMENT RECOMMENDATION**

6. Commission Staff and the Manulife Dealers have agreed to a settlement of the proceeding initiated in respect of the Manulife Dealers by Notice of Hearing dated July 10, 2017 (the “Proceeding”) on the basis of the terms and conditions set out in this settlement agreement (the “Settlement Agreement”). Commission Staff have consulted with IIROC Staff and MFDA Staff in relation to the underlying facts which are the subject matter of this Settlement Agreement.
7. Pursuant to this Settlement Agreement, Commission Staff agree to recommend to the Commission that the Proceeding be resolved and disposed of in accordance with the terms and conditions contained herein.
8. It is Commission Staff’s position that:
  - a. the statement of facts set out by Commission Staff in Part III below, which is based on an investigation carried out by Commission Staff following the self-reporting by the Manulife Dealers, is supported by the evidence reviewed by Commission Staff and the conclusions contained in Part III are reasonable; and
  - b. it is in the public interest for the Commission to approve this Settlement Agreement, having regard to the following considerations:
    - (i) Commission Staff’s allegations are that the Manulife Dealers failed to establish, maintain and apply procedures to establish controls and supervision:

- A. sufficient to provide reasonable assurance that the Manulife Dealers, and each individual acting on behalf of the Manulife Dealers, complied with securities legislation, including the requirement to deal fairly with clients with regard to fees; and
- B. that were reasonably likely to identify the non-compliance described in A. above at an early stage and that would have allowed the Manulife Dealers to correct the non-compliant conduct in a timely manner;
- (ii) Commission Staff do not allege, and have found no evidence of dishonest conduct by the Manulife Dealers;
- (iii) the Manulife Dealers discovered and promptly self-reported the Control and Supervision Inadequacies to Commission Staff;
- (iv) during the investigation of the Control and Supervision Inadequacies following the self-reporting by the Manulife Dealers, the Manulife Dealers provided prompt, detailed and candid cooperation to Commission Staff;
- (v) the Manulife Dealers had formulated an intention to pay appropriate compensation to clients and former clients when they self-reported the Control and Supervision Inadequacies to Commission Staff and, thereafter, the Manulife Dealers co-operated with Commission Staff with a view to providing appropriate compensation to clients and former clients who were harmed by any of the matters in Part III below, including the Control and Supervision Inadequacies (the "Affected Clients");
- (vi) as part of this Settlement Agreement, the Manulife Dealers have agreed to pay appropriate compensation to the Affected Clients, in accordance with a plan submitted by the Manulife Dealers to Commission Staff and presented to the Commission (the "Compensation Plan"). As at the date of this Settlement Agreement, the Manulife Dealers anticipate paying compensation to Affected Clients of approximately \$11,700,000 in the aggregate in respect of the Control and Supervision Inadequacies;
- (vii) the Compensation Plan prescribes, among other things:
  - A. the detailed methodology to be used for determining the compensation to be paid to the Affected Clients, including an amount representing the time value of money in respect of any monies owed by the Manulife Dealers to the Affected Clients;
  - B. the approach to be taken with regard to contacting and making payments to the Affected Clients;
  - C. the timing to complete the various steps included in the Compensation Plan;
  - D. a \$25 *de minimis* exception (the aggregate of such *de minimis* amounts as at the date of this Settlement Agreement is approximately \$8,300 as compared to \$11,700,000 in compensation to be paid) which aggregate *de minimis* amount will be donated to United Way Financial Literacy Programs;
  - E. the approach to be taken to any remaining funds that are not paid out to Affected Clients after the steps included in the Compensation Plan have been fully implemented. In that regard, the Compensation Plan provides that if the Manulife Dealers are not able to contact any former Affected Clients, notwithstanding the steps described in the Compensation Plan, each Manulife Dealer will use reasonable efforts to locate any Affected Clients who are entitled to payment of \$200 or more including directory searches, internet searches, and the employment of third parties to assist in the search. If the Manulife Dealer determines that a client is deceased but does not know the identity of the personal representative of the client's estate, and the estate is entitled to more than \$400, the Manulife Dealer shall make reasonable efforts to identify the personal representative of the deceased client. Subject to any applicable unclaimed property legislation, any amounts remaining undistributed to non-located clients by June 30, 2019 will be donated to United Way Financial Literacy Programs;
  - F. the resolution of client inquiries through an escalation process; and
  - G. regular reporting to a manager or deputy director in the Compliance and Registrant Regulation Branch of the Commission ("OSC Manager") detailing the Manulife Dealers'

progress with respect to the implementation of the Compensation Plan, including with regard to the resolution of client inquiries;

- (viii) at the request of Commission Staff, each of the Manulife Dealers conducted an extensive review of its other businesses operated in Canada to identify whether there were any other instances of inadequacies in their systems of controls and supervision leading to clients directly paying excess fees or indirectly paying excess fees on mutual funds managed by Manulife Asset Management Limited (“MAML”), an affiliate of the Manulife Dealers. Based on this review, the Manulife Dealers have advised Commission Staff that there are no other instances other than those instances of Control and Supervision Inadequacies described herein;
  - (ix) the Manulife Dealers have taken corrective action including implementing additional controls and supervision to address the Control and Supervision Inadequacies including establishing procedures and implementing controls, supervisory and monitoring systems designed to prevent the re-occurrence of the Control and Supervision Inadequacies in the future (the “Enhanced Control and Supervision Procedures”) and, as part of this Settlement Agreement, the Manulife Dealers are required to report to the OSC Manager on the development and implementation of the Enhanced Control and Supervision Procedures;
  - (x) the Manulife Dealers have agreed to make a voluntary payment of \$495,000 to the Commission to be designated for allocation or use by the Commission in accordance with paragraphs (b)(i) or (ii) of subsection 3.4(2) of the Act;
  - (xi) the Manulife Dealers have agreed to make a further voluntary payment of \$25,000 to reimburse the Commission for costs incurred or to be incurred;
  - (xii) the total agreed voluntary payment of \$520,000 will be paid by wire transfer before the commencement of the hearing before the Commission to approve this Settlement Agreement, which payment is conditional upon approval of this Settlement Agreement by the Commission; and
  - (xiii) the terms of this Settlement Agreement are appropriate in all the circumstances, including mitigating factors and the principles of general and specific deterrence. Commission Staff are of the view that the voluntary payments referred to above in addition to the amounts to be paid as compensation to Affected Clients by the Manulife Dealers will emphasize to the marketplace that Commission Staff expect registrants to have compliance systems with appropriate controls and supervision in place which:
    - A. provide reasonable assurance that registrants, and each individual acting on behalf of registrants, are complying with securities legislation, including the requirement to deal fairly with clients including, without limitation, with regard to fees; and
    - B. are reasonably likely to allow registrants to identify and correct non-compliance with securities legislation in a timely manner.
9. The Manulife Dealers neither admit nor deny the accuracy of the facts or the conclusions of Commission Staff as set out in Part III of this Settlement Agreement.
10. The Manulife Dealers agree to this Settlement Agreement and to the making of an order in the form attached as Schedule “A”.

### **PART III – COMMISSION STAFF’S STATEMENT OF FACTS AND CONCLUSIONS**

#### **A. Overview**

11. Commencing in June 2015, the Manulife Dealers self-reported the Control and Supervision Inadequacies to Commission Staff. The Control and Supervision Inadequacies are summarized as follows:
- a. Certain investment products with embedded advisor fees held in fee-based accounts with the Manulife Dealers were incorrectly included in account fee calculations, thereby resulting in some clients paying excess fees during the period June 30, 2005 to September 23, 2016; and
  - b. Beginning in 2007, some clients of the Manulife Dealers were not advised that they qualified for a lower Management Expense Ratio (“MER”) series of a MAML managed mutual fund, the Elite Series, and indirectly

paid excess fees when they invested in the higher MER series of the same mutual fund (the “MER Differential Issue”).

12. In each instance, the Control and Supervision Inadequacies continued undetected for an extended period of time. The Manulife Dealers discovered the Control and Supervision Inadequacies following inquiries made and/or reviews conducted by the relevant Manulife Dealers.
13. As set out in greater detail below in the section entitled Mitigating Factors, the Manulife Dealers have taken several remedial steps in order to correct the Control and Supervision Inadequacies.
14. The Manulife Dealers engaged an independent third party to validate the identification of Trailer Paying Products (defined below) in connection with the Control and Supervision Inadequacy described in B(a) below, and with developing the compensation calculation methodology and performing the compensation calculations in connection with the Control and Supervision Inadequacy described in B(b) below.

**B. The Control and Supervision Inadequacies**

15. The Control and Supervision Inadequacies are described below.

**(a) Excess Account Fees Paid on Certain Trailer Paying Products**

16. Some clients of the Manulife Dealers have fee-based accounts and are charged a fee for investment management services received in respect of assets held in the account (the “Fee-Based Accounts”). The investment management fee is based on the market value of the client’s assets under management (the “Account Fee”).
17. For some clients of the Manulife Dealers with Fee-Based Accounts, assets held in a Fee-Based Accounts included certain investment products with embedded advisor fees, including certain non-exchange traded mutual funds, exchange traded funds, structured notes and closed end funds (“Trailer-Paying Products”). As part of its review relating to this matter, the Manulife Dealers identified that the market value of certain Trailer-Paying Products had been incorrectly included in the calculation of the Account Fee in some Fee-Based Accounts during the period June 30, 2005 to September 23, 2016, and, as a result, some clients of the Manulife Dealers were charged excess Account Fees. Specifically,
  - a. it was determined that the Manulife Dealers did not have adequate systems of internal controls and supervision in place to ensure that all Trailer-Paying Products were consistently excluded from the calculation of the Account Fee;
  - b. it was determined that the Manulife Dealers’ internal controls failed to detect this Control and Supervision Inadequacy in a timely manner; and
  - c. the Manulife Dealers took immediate steps to ensure that Trailer-Paying Products were consistently excluded from the calculation of the Account Fee on a going forward basis.
18. Upon identification of the issue described above, the Manulife Dealers took steps to determine the extent of the problem and how to compensate Affected Clients who paid excess Account Fees. The Manulife Dealers identified all Trailer Paying Products that had been incorrectly included in the calculation of Account Fees, and engaged an independent third party to validate the results. Thereafter, the Manulife Dealers calculated the amounts to be paid to Affected Clients as compensation for the excess Account Fees paid by the them. The Manulife Dealers self-reported this Control and Supervision Inadequacy to Commission Staff in June 2015.
19. The Manulife Dealers have determined that, as a result of this Control and Supervision Inadequacy, approximately 5,483 client accounts were charged excess Account Fees during the period June 2005 to September 2016.
20. The Manulife Dealers have agreed to compensate the Affected Clients who were subject to excess Account Fees as described above during the relevant period in accordance with the Compensation Plan, which requires that the Manulife Dealers pay to the Affected Clients:
  - a. the excess Account Fee;
  - b. an amount representing the applicable sales taxes charged on the excess Account Fee; and

- c. an amount representing the time value of money in respect of the excess Account Fee from the time the excess Account Fee was charged to June 30, 2017, based on a simple interest rate of 5% per annum calculated monthly (the "Account Fee Foregone Investment Opportunity Cost").
21. As at the date of this Settlement Agreement, the Manulife Dealers have determined that the total amount to be paid as compensation to these Affected Clients pursuant to the Compensation Plan, inclusive of the Account Fee Foregone Investment Opportunity Cost, is approximately \$6,000,000.
- b) Excess Indirect Fees paid by some clients of the Manulife Dealers who invested in the MER Differential Funds**
22. MAML, an affiliate of the Manulife Dealers, manages a number of mutual funds that are available in different series. For certain of these mutual funds, there were two series (Advisor and Elite) of the same mutual fund which differed solely in that the MER of the Advisor series, which has a lower minimum investment threshold, contains a pre-determined service fee whereas the MER of the Elite Series, which has a higher minimum investment threshold, contains a lower service fee negotiated between the client and the Manulife advisor (the "MER Differential Funds").
23. The threshold for the Elite Series was an investment of \$100,000 or greater. The Elite Series were launched between 2007 and 2015.
24. On October 1, 2016, MAML introduced tiered pricing for all of its funds to replace the single minimum investment threshold described above. Tiered pricing offers standardized MER reductions at the product level to securityholders who meet certain eligibility requirements, such as reaching certain asset levels in their combined household holdings.
25. The Manulife Dealers conducted a review of the MER Differential Funds to cover the period from July 2007 to October 1, 2016 and determined that certain client accounts invested in an MER Differential Fund that appeared to qualify for the Elite Series were not invested in that series, and therefore the holders of those client accounts did not benefit from the Elite Series' lower MER. Specifically,
- a. the Manulife Dealers determined that they did not have adequate systems of internal controls and supervision in place to ensure that when a purchase or transfer-in of an investment in an MER Differential Fund, alone or combined with existing holdings of the same MER Differential Fund, exceeded the minimum investment threshold required to qualify for the Elite Series, the client was consistently advised that the Elite Series of the same MER Differential Fund was available; and
- b. the Manulife Dealers determined that their internal controls failed to identify this Control and Supervision Inadequacy in a timely manner.
26. The Manulife Dealers engaged an independent third party to develop the compensation calculation methodology, and to perform the calculations of the appropriate compensation to be paid to clients.
27. The Manulife Dealers self-reported this Control and Supervision Inadequacy to Commission Staff in June 2015.
28. The Manulife Dealers have determined that there are approximately 3,937 client accounts that from July 2007 to October 2016 ought to have been invested in the Elite Series of an MER Differential Fund but were not.
29. In accordance with the Compensation Plan, in respect of those client accounts, the Manulife Dealers have agreed to pay to each Affected Client:
- a. an amount representing the difference in the return that the Affected Client would have received on any unit held by the client of an MER Differential Fund had the client been invested in the Elite Series of that mutual fund in a timely manner upon becoming eligible to invest in the Elite Series held in that mutual fund for the entire period in which the Affected Client qualified for the Elite Series units of that mutual fund (the "Difference in Return"). For the purpose of this calculation, a deemed service fee for each category of mutual fund (i.e. equity and balanced funds, fixed income/bond funds or money market/cash funds) of the Elite Series was calculated as follows:
- (i) in the case of funds other than money market/cash funds, by taking the simple average negotiated service fee for the category of mutual fund as at May 31, 2015, which was determined to be a globally favourable methodology to Affected Clients; and

- (ii) in the case of money market/cash funds (which were held in 72 accounts), no data on negotiated service fees were available so the deemed service fee employed was 25 basis points, representing one half of the difference in MAML's fee as between the Advisor Series and the Elite Series; and
  - b. an amount representing the time value of money in respect of the Difference in Return from the date of sale, conversion, transfer or disposition of any Advisor Series units of an MER Differential Fund for any periods up to June 30, 2017, based on a simple interest rate of 5% per annum calculated monthly (the "MER Foregone Investment Opportunity Cost").
30. On this basis, the Manulife Dealers have determined that the total compensation to be paid to Affected Clients as a result of this Control and Supervision Inadequacy is approximately \$5,700,000, inclusive of the MER Foregone Investment Opportunity Cost, where applicable.

**C. Breaches of Ontario Securities Law**

31. In both instances of Control and Supervision Inadequacies, the Manulife Dealers failed to establish, maintain and apply procedures to establish controls and supervision:
- a. sufficient to provide reasonable assurance that the Manulife Dealers, and each individual acting on behalf of the Manulife Dealers, complied with securities legislation, including the requirement to deal fairly with clients with regard to fees; and
  - b. that were reasonably likely to identify the non-compliance described in a. above at an early stage and that would have allowed the Manulife Dealers to correct the non-compliant conduct in a timely manner.
32. As a result, both of the Control and Supervision Inadequacies constituted a breach of section 11.1 of National Instrument 31-103 – *Registration Requirements, Exemptions and Ongoing Registrant Obligations* ("NI 31-103"). In addition, the failures in the Manulife Dealers' systems of controls and supervision associated with the Control and Supervision Inadequacies were contrary to the public interest.

**D. Mitigating Factors**

33. Commission Staff do not allege, and have found no evidence of dishonest conduct by the Manulife Dealers.
34. The Manulife Dealers discovered and promptly self-reported the Control and Supervision Inadequacies to Commission Staff.
35. During the investigation of the Control and Supervision Inadequacies following the self-reporting by the Manulife Dealers, the Manulife Dealers provided prompt, detailed and candid cooperation to Commission Staff.
36. The Manulife Dealers had formulated an intention to pay appropriate compensation to clients and former clients in connection with their self-reporting of the Control and Supervision Inadequacies to Commission Staff and, thereafter, the Manulife Dealers co-operated with Commission Staff with a view to providing appropriate compensation to the Affected Clients that were harmed by any of the Control and Supervision Inadequacies.
37. As part of this Settlement Agreement, the Manulife Dealers have agreed to pay appropriate compensation to the Affected Clients, in accordance with the Compensation Plan. As at the date of this Settlement Agreement, the Manulife Dealers anticipate paying compensation to Affected Clients of approximately \$11,700,000 in the aggregate in respect of the Control and Supervision Inadequacies.
38. The Compensation Plan prescribes, among other things:
- a. the detailed methodology to be used for determining the compensation to be paid to the Affected Clients, including the time value of money owed by the Manulife Dealers to the Affected Clients;
  - b. the approach to be taken with regard to contacting and making payments to the Affected Clients;
  - c. the timing to complete the various steps included in the Compensation Plan and the person(s) responsible for implementation of these steps;
  - d. a \$25 *de minimis* exception (the aggregate of such *de minimis* amounts as at the date of this Settlement Agreement is approximately \$8,300 as compared to \$11,700,000 in compensation to be paid), which aggregate *de minimis* amount will be donated to United Way Financial Literacy Programs;

- e. the approach to be taken to any remaining funds that are not paid out to Affected Clients after the steps included in the Compensation Plan have been fully implemented. In that regard, the Compensation Plan provides that if the Manulife Dealers are not able to contact any former Affected Clients, notwithstanding the steps described in the Compensation Plan, each Manulife Dealer will use reasonable efforts to locate any Affected Clients who are entitled to payment of \$200 or more including directory searches, internet searches, and the employment of third parties to assist in the search. If the Manulife Dealer determines that a client is deceased but does not know the identity of the personal representative of the client's estate, and the estate is entitled to more than \$400, the Manulife Dealer shall make reasonable efforts to identify the personal representative of the deceased client. Subject to any applicable unclaimed property legislation, any amounts remaining undistributed to non-located clients on June 30, 2019 will be donated to United Way Financial Literacy Programs;
  - f. the resolution of client inquiries through an escalation process; and
  - g. regular reporting to the OSC Manager detailing the Manulife Dealers' progress with respect to the implementation of the Compensation Plan, including with regard to the resolution of client inquiries.
39. At the request of Commission Staff, the Manulife Dealers conducted an extensive review of their other businesses operating in Canada to identify whether there were any other instances of inadequacies in their systems of controls and supervision leading to clients directly paying excess fees or indirectly paying excess fees on mutual funds managed by MAML. Based on this review, the Manulife Dealers have advised Commission Staff that there are no other instances other than the two instances of Control and Supervision Inadequacies described herein.
40. The Manulife Dealers have taken corrective action including implementing the Enhanced Control and Supervision Procedures and, as part of this Settlement Agreement, the Manulife Dealers are required to report to the OSC Manager on the development and implementation of the Enhanced Control and Supervision Procedures.
41. The Manulife Dealers have agreed to make voluntary payments totalling \$520,000 as described in paragraphs 8(b)(x) and (xi) above.
42. The Manulife Dealers will pay the total agreed voluntary payment amount of \$520,000 by wire transfer before the commencement of the hearing before the Commission to approve this Settlement Agreement, which payment is conditional upon approval of this Settlement Agreement by the Commission.
43. The terms of settlement are appropriate in all the circumstances, including mitigating factors and the principles of general and specific deterrence. Commission Staff are of the view that the voluntary payments referred to above in addition to the amounts to be paid as compensation to Affected Clients by the Manulife Dealers will emphasize to the marketplace that Commission Staff expect registrants to have compliance systems with appropriate controls and supervision in place which:
- a. provide reasonable assurance that registrants, and each individual acting on behalf of registrants, are complying with securities legislation, including the requirement to deal fairly with clients including, without limitation, with regard to fees; and
  - b. are reasonably likely to allow registrants to identify and correct non-compliance with securities legislation in a timely manner.

**E. The Manulife Dealers' Undertaking**

44. By signing this Settlement Agreement, the Manulife Dealers undertake to:
- a. pay compensation to the Affected Clients in accordance with the Compensation Plan and to report to the OSC Manager in accordance with the Compensation Plan; and
  - b. make the voluntary payments referred to in paragraphs 8(b)(x) and (xi) above
- (the "Undertaking").

**PART IV – TERMS OF SETTLEMENT**

45. The Manulife Dealers agree to the terms of settlement listed below and consent to the Order in substantially the form attached hereto, that provides that:

- a. pursuant to subsection 127(1) of the Act, the Settlement Agreement is approved;
  - b. pursuant to subsection 127(2) of the Act, the approval of the Settlement Agreement is subject to the following terms and conditions:
    - i. within 90 days of receiving comments from Commission Staff regarding the Enhanced Control and Supervision Procedures, the Manulife Dealers shall provide to the OSC Manager, revised written policies and procedures (the "Revised Policies and Procedures") that, to the satisfaction of the OSC Manager, are responsive to any remaining issues raised by Commission Staff with regard to the Manulife Dealers' policies and procedures to establish the Enhanced Control and Supervision Procedures (the "Remaining Issues");
    - ii. thereafter, the Manulife Dealers shall make such further modifications to their Revised Policies and Procedures as are required to ensure that the Revised Policies and Procedures address any Remaining Issues to the satisfaction of the OSC Manager;
    - iii. within eight months of receiving confirmation from the OSC Manager that the Revised Policies and Procedures satisfy the remaining issues raised by Commission Staff (the "Confirmation Date"), the Manulife Dealers shall submit a letter (the "Attestation Letter"), signed by the Ultimate Designated Person and the Chief Compliance Officer for each of the Manulife Dealers, to the OSC Manager, expressing their opinion on whether the Enhanced Control and Supervision Procedures were adequately followed, administered and enforced by the Manulife Dealer for the six month period commencing from the Confirmation Date;
    - iv. the Attestation Letter shall be accompanied by a report which provides a description of the testing performed to support the conclusions contained in the Attestation Letter;
    - v. the Manulife Dealers shall submit such additional reports as may be requested by the OSC Manager for the purpose of satisfying the OSC Manager that the opinion expressed in the Attestation Letter described in subparagraph (b)(iii) above is valid;
    - vi. any of the Manulife Dealers or Commission Staff may apply to the Commission for directions in respect of any issues that may arise with regard to the implementation of subparagraphs (b)(i) to (v) above; and
    - vii. the Manulife Dealers shall comply with the Undertaking.
46. The Manulife Dealers agree to make the voluntary payments described in subparagraph 44(b) by wire transfer before the commencement of the hearing before the Commission to approve this Settlement Agreement.

#### **PART V – COMMISSION STAFF COMMITMENT**

47. If the Commission approves this Settlement Agreement, Commission Staff will not commence any proceeding under Ontario securities law in relation to the Commission Staff's Statement of Facts and Conclusions set out in Part III of this Settlement Agreement, subject to the provisions of paragraph 48 below and except with respect to paragraph 39 above, and nothing in this Settlement Agreement shall be interpreted as limiting Commission Staff's ability to commence proceedings against the Manulife Dealers in relation to any control and supervision inadequacies leading to clients paying excess fees other than the two Control and Supervision Inadequacies described herein.
48. If the Commission approves this Settlement Agreement and either of the Manulife Dealers fails to comply with any of the terms of this Settlement Agreement, Commission Staff may bring proceedings under Ontario securities law against the Manulife Dealers. These proceedings may be based on, but are not limited to, the Commission Staff's Statement of Facts and Conclusions set out in Part III of this Settlement Agreement as well as the breach of this Settlement Agreement.

#### **PART VI – PROCEDURE FOR APPROVAL OF SETTLEMENT**

49. The parties will seek approval of this Settlement Agreement at a public hearing before the Commission scheduled for July 13, 2017, or on another date agreed to by Commission Staff and the Manulife Dealers, according to the procedures set out in this Settlement Agreement and the Commission's Rules of Procedure.



## Decisions, Orders and Rulings

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50. Commission Staff and the Manulife Dealers agree that this Settlement Agreement will form all of the evidence that will be submitted at the settlement hearing on the Manulife Dealers' conduct, unless the parties agree that additional evidence should be submitted at the settlement hearing.
51. If the Commission approves this Settlement Agreement, the Manulife Dealers agree to waive all rights to a full hearing, judicial review or appeal of this matter under the Act.
52. If the Commission approves this Settlement Agreement, the Manulife Dealers will not make any public statement that is inconsistent with this Settlement Agreement or with any additional evidence submitted at the settlement hearing. In addition, the Manulife Dealers agree that they will not make any public statement that there is no factual basis for this Settlement Agreement. Nothing in this paragraph affects the Manulife Dealers' testimonial obligations or the right to take legal or factual positions in other investigations or legal proceedings in which the Commission and/or Commission Staff is not a party or in which any provincial or territorial securities regulatory authority in Canada and/or its staff is not a party ("Other Proceedings") or to make public statements in connection with Other Proceedings.
53. The Manulife Dealers will not use, in any proceeding, this Settlement Agreement or the negotiation or process of approval of this Settlement Agreement as the basis for any attack on the Commission's jurisdiction, alleged bias, alleged unfairness, or any other remedies or challenges that may otherwise be available.

### PART VII – DISCLOSURE OF SETTLEMENT AGREEMENT

54. If the Commission does not approve this Settlement Agreement or does not make the order attached as Schedule "A" to this Settlement Agreement:
  - a. this Settlement Agreement and all discussions and negotiations between Commission Staff and the Manulife Dealers before the settlement hearing takes place will be without prejudice to Commission Staff and the Manulife Dealers; and
  - b. Commission Staff and the Manulife Dealers will each be entitled to all available proceedings, remedies and challenges, including proceeding to a hearing of the allegations contained in the Statement of Allegations. Any proceedings, remedies and challenges will not be affected by this Settlement Agreement, or by any discussions or negotiations relating to this Settlement Agreement.
55. The parties will keep the terms of this Settlement Agreement confidential until the commencement of the public hearing to obtain approval of this Settlement Agreement by the Commission. Any obligations of confidentiality shall terminate upon the commencement of the public settlement hearing. If, for whatever reason, the Commission does not approve this Settlement Agreement, the terms of this Settlement Agreement remain confidential indefinitely, unless Commission Staff and the Manulife Dealers otherwise agree or if otherwise required by law.

### PART VIII – EXECUTION OF SETTLEMENT AGREEMENT

56. This agreement may be signed in one or more counterparts which, together, constitute a binding agreement.
57. A facsimile copy or other electronic copy of any signature will be as effective as an original signature.

Dated this 10th day of July, 2017

#### Manulife Securities Incorporated

"Rick Annaert"

Per: Rick Annaert

#### Manulife Securities Investment Services Inc.

"Rick Annaert"

Per: Rick Annaert

#### Commission Staff

"Jeff Kehoe"

Jeff Kehoe  
Director, Enforcement Branch  
Ontario Securities Commission

**SCHEDULE "A"**

**IN THE MATTER OF  
THE SECURITIES ACT,  
R.S.O. 1990, c. S.5, AS AMENDED**

**AND**

**IN THE MATTER OF  
MANULIFE SECURITIES INCORPORATED and  
MANULIFE SECURITIES INVESTMENT SERVICES INC.**

**ORDER  
(Subsections 127(1) and 127(2))**

**THIS APPLICATION**, made jointly by Staff of the Commission and Manulife Securities Incorporated and Manulife Securities Investment Services Inc. (the **Manulife Dealers**) for approval of a settlement agreement dated July 10, 2017 (the **Settlement Agreement**), was heard on July 13, 2017 at the offices of the Commission, located at 20 Queen Street West, 17th Floor, Toronto, Ontario;

**ON READING** the Statement of Allegations dated July 10, 2017, the Joint Application Record for a Settlement Hearing dated July 10, 2017, including the Settlement Agreement, and on hearing the submissions of counsel for the Manulife Dealers and Staff;

**IT IS HEREBY ORDERED THAT:**

- (a) pursuant to subsection 127(1) of the Act, the Settlement Agreement is approved;
- (b) pursuant to subsection 127(2) of the Act, the approval of the Settlement Agreement is subject to the following terms and conditions:
  - (i) in respect of inadequacies in the Manulife Dealers' systems of controls and supervision which formed part of their compliance systems (the **Control and Supervision Inadequacies**), within 90 days of receiving comments from Staff regarding the procedures, controls and supervisory and monitoring systems designed to prevent the re-occurrence of the Control and Supervision Inadequacies in the future (the **Enhanced Control and Supervision Procedures**), the Manulife Dealers shall provide to a manager or deputy director in the Compliance and Registrant Regulation Branch (the **OSC Manager**), revised written policies and procedures (the **Revised Policies and Procedures**) that, to the satisfaction of the OSC Manager, are responsive to any remaining issues raised by Staff with regard to the Manulife Dealers' policies and procedures to establish the Enhanced Control and Supervision Procedures (the **Remaining Issues**);
  - (ii) thereafter, the Manulife Dealers shall make such further modifications to their Revised Policies and Procedures as are required to ensure that the Revised Policies and Procedures address any Remaining Issues to the satisfaction of the OSC Manager;
  - (iii) within eight months of receiving confirmation from the OSC Manager that the Revised Policies and Procedures satisfy the Remaining Issues raised by Staff (the **Confirmation Date**), the Manulife Dealers shall submit a letter (the **Attestation Letter**), signed by the Ultimate Designated Person and the Chief Compliance Officer for each of the Manulife Dealers, to the OSC Manager, expressing their opinion on whether the Enhanced Control and Supervision Procedures were adequately followed, administered and enforced by the Manulife Dealer for the six month period commencing from the Confirmation Date;
  - (iv) the Attestation Letter shall be accompanied by a report which provides a description of the testing performed to support the conclusions contained in the Attestation Letter;
  - (v) the Manulife Dealers shall submit such additional reports as may be requested by the OSC Manager for the purpose of satisfying the OSC Manager that the opinion expressed in the Attestation Letter described in subparagraph (b)(iii) above is valid;
  - (vi) any of the Manulife Dealers or Staff may apply to the Commission for directions in respect of any issues that may arise with regard to the implementation of subparagraphs (b)(i) to (v) above;

- (vii) the Manulife Dealers shall comply with their undertaking in the Settlement Agreement to:
  - a. pay appropriate compensation to eligible clients and former clients who were harmed by the Control and Supervision Inadequacies in accordance with a plan submitted by the Manulife Dealers to Staff (the **Compensation Plan**) and to report to the OSC Manager in accordance with the Compensation Plan;
  - b. make voluntary payment of \$25,000 to reimburse the Commission for costs incurred or to be incurred by it, in accordance with subsection 3.4(2)(a) of the Act; and
  - c. make a further voluntary payment of \$495,000 to be designated for allocation or use by the Commission in accordance with paragraphs (b)(i) or (ii) of subsection 3.4(2) of the Act; and
- (viii) the voluntary payment referred to at paragraph (vii)(c) above is designated for allocation or use by the Commission in accordance with paragraphs (b)(i) or (ii) of subsection 3.4(2) of the Act.

**DATED** at Toronto, Ontario this \_\_\_\_ day of July, 2017

  

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## Chapter 3

# Reasons: Decisions, Orders and Rulings

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### 3.1 OSC Decisions

#### 3.1.1 Sino-Forest Corporation et al.

IN THE MATTER OF  
SINO-FOREST CORPORATION,  
ALLEN CHAN,  
ALBERT IP,  
ALFRED C.T. HUNG,  
GEORGE HO,  
SIMON YEUNG and  
DAVID HORSLEY

#### REASONS AND DECISION

**Citation:** *Sino-Forest Corporation (Re)*, 2017 ONSEC 27

**Date:** 2017-07-13

**Hearing:** September 2, 3, 4, 5, 8, 10, 11, 12, 16, 17, 18, 19, 22, 24 and 30, 2014  
October 1, 2, 3, 6, 8, 9, 10, 14, 15, 16, 17, 28, 29, 30 and 31, 2014  
November 3, 5, 6, 7, 10, 12, 13, 14, 17, 19, 20, 21, 24, 25, 26, 27 and 28, 2014  
December 1, 3, 4, 5, 9, 10, 11, 12, 15, 16, 17 and 18, 2014  
January 6, 7, 8, 9 and 12, 2015  
March 16, 17, 18, 20, 23, 25, 26, 27 and 31, 2015  
April 1, 2, 8, 9, 10, 15, 16, 17, 20, 22, 23, 24, 28, 29 and 30, 2015  
May 1, 4, 6, 7, 8, 12, 13, 14, 15, 20, 21, 22, 25, 27, 28 and 29, 2015  
June 3, 4, 5, 9, 10, 11, 12, 17, 18, 19, 22, 23, 24 and 26, 2015  
September 1, 2, 3, 4, 9, 10, 11, 14, 15, 21, 23, 24, 25, 28, 29 and 30, 2015  
October 1, 5, 6, 7, 13, 14, 15, 16, 19, 21, 22, 23, 26, 27, 28 and 29, 2015  
November 2, 4, 6, 9, 11, 12, 13, 16, 18, 19, 20, 23, 25 and 30, 2015  
December 2, 3, 4, 7, 8, 9, 10, 14 and 16, 2015  
April 18, 20, 21, 22, 25, 26, 27 and 28, 2016  
May 2, 4, 5, 6, 9, 11 and 12, 2016

**Reasons and Decision:** July 13, 2017

**Panel:** James D. Carnwath, Q.C. – Commissioner and Chair of the Panel  
Edward P. Kerwin – Commissioner  
Deborah Leckman – Commissioner

**Appearances:** Hugh Craig – For Staff of the Commission  
Carlo Rossi  
Malinda Alvaro  
  
Emily Cole – For Allen Chan  
Rohit Kumar  
Caleb Edwards  
  
Markus Koehnen – For Albert Ip, Alfred C.T. Hung, George Ho and Simon Yeung  
Stephen Wortley  
Jeffrey Levine  
Adam Chisholm  
  
No one appeared on behalf of Sino-Forest Corporation

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  - 2. Was Chan's non-disclosure of his interest in the Greenheart Transactions a dishonest act?
  - 3. Were Sino-Forest Investors put at risk as a result of Chan's non-disclosure of his beneficial interest in the Greenheart Transactions to the Sino-Forest Board?
  - 4. Did Chan have the requisite *mens rea* for the offence?
    - (a) Chan had subjective knowledge of the prohibited act
    - (b) Chan had subjective knowledge that the dishonest conduct could result in deprivation to another
- D. Did Sino-Forest and Chan make materially misleading statements by failing to disclose Chan's interest in the Greenheart Transactions in Sino-Forest's public disclosure?
  - 1. Were the statements misleading in a material respect?
  - 2. Did Sino-Forest breach Ontario securities law pursuant to subsection 122(1)(b) of the *Securities Act*?
  - 3. Did Chan authorize, permit or acquiesce, pursuant to section 122(3) of the *Securities Act*, in Sino-Forest's breach of Ontario securities law?

IX. ANALYSIS OF THE ALLEGATIONS OF MISLEADING STAFF

- A. The Law – Misleading the Commission
- B. Allegations against Chan
  - 1. Submissions of the Parties
    - (a) Staff's Submissions
    - (b) Chan's Submissions
  - 2. Analysis
- C. Allegations against Ip
  - 1. Submissions of the Parties
    - (a) Staff's Submissions
    - (b) Ip's Submissions
  - 2. Analysis
- D. Allegations against Hung
  - 1. Submissions of the Parties
    - (a) Staff's Submissions
    - (b) Hung's Submissions
  - 2. Analysis
- E. Allegations against Ho
  - 1. Submissions of the Parties
    - (a) Staff's Submissions
    - (b) Ho's Submissions
  - 2. Analysis
- F. Allegations against Yeung
  - 1. Submissions of the Parties
    - (a) Staff's Submissions
    - (b) Yeung's Submissions
  - 2. Analysis

X. CONCLUSIONS

APPENDIX A – GLOSSARY OF TERMS

## REASONS AND DECISION

### I. BACKGROUND

#### A. Introduction

[1] These are our reasons and decision on the merits of allegations made by Staff of the Ontario Securities Commission (**Staff** and the **Commission**, respectively) concerning the conduct of Sino-Forest Corporation (**Sino-Forest**) and five members of its senior management, Allen Chan, Albert Ip, Alfred C.T. Hung, George Ho and Simon Yeung (collectively, the **Respondents**<sup>1</sup>).

[2] Staff submits the Respondents perpetrated one of the largest corporate frauds in Canadian history.

[3] In its Statement of Allegations, Staff makes four sets of allegations against the Respondents regarding their conduct from June 30, 2006 to January 11, 2012 (the **Material Time**). First, Staff alleges the Respondents engaged in deceitful and dishonest courses of conduct that ultimately caused the assets and revenue derived from the purchase and sale of standing timber, Sino-Forest's main business, to be fraudulently overstated, putting the pecuniary interests of investors in securities issued by Sino-Forest at risk contrary to Ontario securities law and contrary to the public interest. Second, Staff alleges the Respondents made materially misleading statements in Sino-Forest's public disclosure record related to its standing timber business. Third, Staff alleges that Chan committed fraud in relation to Sino-Forest's purchase of a controlling interest in another forestry company and that by concealing Chan's substantial interest in this transaction, Sino-Forest and Chan made materially misleading statements in Sino-Forest's public disclosure. Finally, Staff alleges that each of Chan, Ip, Hung, Ho and Yeung materially misled Staff during the investigation of this matter. In light of these allegations, the Panel must answer the following questions:

- a. Did the Respondents engage in dishonest courses of conduct that ultimately caused the assets and revenue derived from the purchase and sale of standing timber to be fraudulently overstated, contrary to subsection 126.1(b) of the Ontario *Securities Act*, RSO 1990 c S.5 (the **Securities Act**) (the **Standing Timber Fraud Allegations**)?
  - i. Specifically, did the Respondents engage in what Staff has alleged are the three elements of the Standing Timber Fraud Allegations? Specifically,
    - A. did the Respondents dishonestly conceal Sino-Forest's control over its suppliers, authorized intermediaries (**AIs**) and other nominee companies, leading to the misstatement of the true economic substance of Sino-Forest's business in its financial statements?
    - B. did the Respondents falsify evidence of Sino-Forest's ownership of the vast majority of its timber holdings by engaging in a deceitful documentation process, including the fraudulent creation of deceitful purchase and sales contracts, which were then relied on to evidence the purported purchase, ownership and sale of standing timber?
    - C. did the Respondents deceitfully conceal Sino-Forest's internal control weaknesses, obscuring the true nature of transactions and preventing detection of the deceitful documentation process (referred to in B. above)?
  - ii. Did the Respondents engage in significant fraudulent transactions related to Sino-Forest's purchase and sale of standing timber that had the effect of overstating Sino-Forest's assets and revenue during the Material Time? Specifically, in these four examples, did they fraudulently engage in:
    - A. transactions involving a Sino-Forest supplier, Guangxi Dacheng Timber Co., Ltd. (the **Dacheng Transactions**)?
    - B. transactions involving the purchase and sale of approximately 450,000 m<sup>3</sup> of standing timber (the **450 Transactions**)?
    - C. the purported purchase and sale of a plantation in Gengma County, Yunnan Province (the **Gengma #1 Transactions**)?

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<sup>1</sup> Where we refer to the Respondents' submissions in these Reasons, they do not include the submissions of Sino-Forest, which did not participate in this hearing.

- D. the purported purchase and sale of a second plantation in Gengma County, Yunnan Province (the **Gengma #2 Transactions**)?
- iii. Did Chan, Ip, Hung, Ho or Yeung, as officers of Sino-Forest, authorize, permit or acquiesce in conduct of Sino-Forest that was contrary to Ontario securities law, pursuant to subsection 129.2 of the *Securities Act*?
- b. Did the Respondents engage in conduct that resulted in Sino-Forest's disclosure during the Material Time in respect of its standing timber business being misleading in a material respect, contrary to subsection 122(1)(b) of the *Securities Act*?
  - i. Specifically, was Sino-Forest's disclosure misleading in a material respect with respect to:
    - A. Sino-Forest's ownership of assets and revenue recognition?
    - B. the effect of the Dacheng Transactions, the 450 Transactions, the Gengma #1 Transactions and the Gengma #2 Transactions on the reported revenue of Sino-Forest?
    - C. the material weaknesses in Sino-Forest's internal controls?
  - ii. Did Chan, Ip, Hung or Ho, as officers of Sino-Forest, authorize, permit or acquiesce in the making of statements by Sino-Forest that were misleading in a material respect, pursuant to subsection 122(3) of the *Securities Act*?
- c. Did Chan fraudulently conceal his interest in a series of transactions through which Sino-Forest purchased a controlling interest in Greenheart Group Limited, a public company listed on the Hong Kong Stock Exchange (**HKSE**), (the **Greenheart Transactions**)? As a result,
  - i. Did Chan engage in deceitful or dishonest conduct in relation to the Greenheart Transactions that was contrary to subsection 126.1(b) of the *Securities Act*?
  - ii. Did Chan and Sino-Forest engage in conduct that resulted in Sino-Forest's disclosure that was misleading in a material respect, contrary to subsection 122(1)(b) of the *Securities Act*?
  - iii. Did Chan, as Chairman of the Board and Chief Executive Officer (**CEO**) of Sino-Forest, authorize, permit or acquiesce in Sino-Forest's disclosure in respect of the Greenheart Transactions that was misleading in a material respect, pursuant to subsection 122(3) of the *Securities Act*?
- d. Did each of Chan, Ip, Hung, Ho and Yeung make misleading statements in the course of their interviews with Staff during its investigation, contrary to subsection 122(1)(a) of the *Securities Act*?

[4] Our Reasons are structured as follows. They begin with general background information, as well as discussions of additional background issues that are relevant to our analysis of Staff's allegations:

- I. Background
- II. Evidence
- III. Sino-Forest's Timber Business in Mainland China
- IV. Sino-Forest's Business Models: The BVI Model and the WFOE Model
- V. Allen Chan's Role at Sino-Forest

Following this background is our analysis of the Standing Timber Fraud Allegations, which includes a consideration of the three elements of the alleged fraud, and the four examples of allegedly fraudulent transactions:

- VI. Analysis of the Standing Timber Fraud Allegations

We then consider Staff's allegations of misleading statements in Sino-Forest's disclosure relating to three categories of disclosure related to the Standing Timber Fraud Allegations:

- VII. Analysis of the Standing Timber Materially Misleading Statements Allegations

Next, we consider Staff's allegations of fraud and materially misleading statements in connection with the Greenheart Transactions:

VIII. Analysis of the Greenheart Allegations

Finally, we consider whether Chan, Ip, Hung, Ho and Yeung made materially misleading statements to Staff during Staff's investigation of this matter:

IX. Analysis of the Allegations of Misleading Staff

To assist the reader, we have also included a glossary of terms, companies and people referred to in these Reasons as an appendix:

APPENDIX A – GLOSSARY

[5] The hearing in this matter has been exceptionally long. The merits hearing started on September 2, 2014. The Panel sat for 188 days over 2014, 2015 and 2016, and the hearing ended on May 12, 2016. Chan, Ip, Hung, Ho and Yeung were represented by counsel throughout the hearing. Sino-Forest indicated it did not intend to participate in this matter and no one appeared on its behalf during the hearing.

**B. Sino-Forest**

[6] Sino-Forest described itself as a leading commercial forest plantation operator in the People's Republic of China (**China**, or **Mainland China** when referring to the country exclusive of Hong Kong). Sino-Forest's principal businesses were described as the ownership and management of tree plantations, the sale of standing timber and wood logs, and the complementary manufacturing of downstream engineered-wood products. The majority of Sino-Forest's business was in standing timber. Allen Chan described Sino-Forest as operating two business models for its plantation operations in Mainland China. In the first model, Sino-Forest would buy standing timber (*i.e.* forests of trees that were still growing in the ground), hold the standing timber for two to three years and then sell the standing timber without logging it. In the second model described by Chan, Sino-Forest would plant trees on bare land, log the trees once they matured and sell them as logs.

[7] Sino-Forest's executive office was in Hong Kong, its head office was in Mississauga, Ontario and it maintained additional offices throughout Mainland China. Most Sino-Forest executives, including Chan, Ip, Hung and Ho worked out of the company's offices in Hong Kong and/or neighbouring Guangzhou, Mainland China. Sino-Forest's Chief Financial Officer (**CFO**) was Canadian and worked mainly out of the Mississauga, Ontario office, worked in Hong Kong for about two weeks each quarter and was seldom in Mainland China. Sino-Forest's operations offices throughout Mainland China were often in remote rural locations. Many members of the Board of Directors were located in Canada and meetings of the Board and the Audit Committee were often conducted by teleconference.

[8] Sino-Forest became a reporting issuer in Ontario in 1995 when it listed its shares on the Toronto Stock Exchange (**TSX**) through a reverse take-over transaction.

[9] In its 2010 Annual Information Form (**AIF**) dated March 31, 2011, Sino-Forest described its corporate vision as follows:

Our vision is to sustainably manage a geographically diversified portfolio of fast-growing, high-yielding plantations that profitably produces a steady stream of quality fibre and increases China's wood supply independence. We aim to become the leading commercial forest plantation operator and the preferred supplier of wood fibre to downstream consumers in the wood panel, furniture, construction, interior decoration and pulp and paper industries in the PRC. We intend to create value by effectively buying, selling and processing fibre, as well as enhancing the growth of our trees using advanced research and development and plantation management practices.

[10] Between February 2003 and October 2010, Sino-Forest raised approximately US \$3.0 billion from investors (the **Investors**) by issuing debt and equity securities. From the start of the Material Time to March 31, 2011, Sino-Forest's share price rose 340% from CA \$5.75 to CA \$25.30. By March 31, 2011, Sino-Forest's market capitalization was over CA \$6 billion.

[11] On June 1, 2011, trading in Sino-Forest's shares on the TSX closed at CA \$18.21.

**C. The Muddy Waters Report and the Events that Followed**

- [12] On June 2, 2011, Muddy Waters, LLC, headed by an analyst and short-seller with a short position in Sino-Forest shares, released a report that alleged Sino-Forest was a “near total fraud” and a “Ponzi scheme” (the **Muddy Waters Report**).<sup>2</sup>
- [13] On the same day, the Board of Directors of Sino-Forest appointed a committee of independent directors to examine and review the serious and wide-ranging allegations made in the Muddy Waters Report and report back to the Board of Directors (the **Independent Committee**).
- [14] Following the release of the Muddy Waters Report, Sino-Forest shares plummeted. On June 2, 2011, trading in Sino-Forest shares on the TSX closed at CA \$14.46, and by June 21, 2014, Sino-Forest shares traded at CA \$1.99.
- [15] The Commission publicly announced on June 8, 2011 that it had commenced an investigation into Sino-Forest and on August 26, 2011, the Commission issued a temporary order that all trading in Sino-Forest shares cease.<sup>3</sup>
- [16] Sino-Forest failed to file its interim financial results for the third quarter of 2011 and never filed its 2011 audited financial statements. Sino-Forest’s auditors, Ernst & Young LLP (**E&Y**), resigned on April 4, 2012.
- [17] On May 9, 2012, the TSX delisted Sino-Forest’s shares.
- [18] On May 22, 2012, Staff issued its Statement of Allegations against the Respondents and David Horsley, Sino-Forest’s former CFO. Horsley settled with the Commission prior to the start of the merits hearing.
- [19] On January 30, 2013, Sino-Forest entered into a Plan of Compromise and Reorganization that resulted in Sino-Forest’s former bondholders receiving substantially all of its remaining assets.

**D. The Individual Respondents**

- [20] Allen Chan was a co-founder of Sino-Forest in 1992 and Chairman of the Board and CEO during the Material Time until his resignation on August 28, 2011. Chan remained as Chairman Emeritus of Sino-Forest following his resignation. Staff submits Chan was the architect of the alleged standing timber fraud, assisted by Ip, Hung, Ho and Yeung.
- [21] Albert Ip was the Senior Vice-President, Development and Operations North-East and South-West China for Sino-Forest and reported directly to Chan. Ip was in charge of operations of Sino-Panel (Asia) Inc. (**Sino-Panel**)<sup>4</sup> and its approximately 48 subsidiary companies (the **Sino-Panel Group** of companies). In this capacity, he supervised over 1,000 employees with operations distributed over nine provinces across Mainland China. Within Sino-Forest’s BVI Model (discussed in more detail throughout these Reasons), Ip was responsible for forest purchases, including standing timber. He worked at Sino-Forest from 1997 until March 30, 2012. Ip studied in Canada and obtained an engineering degree from the University of Ottawa in 1984.
- [22] Alfred Hung was Vice-President, Corporate Planning and Banking for Sino-Forest for much of the Material Time. Hung joined Sino-Forest in 1999 and held a number of positions at Sino-Forest during his tenure with the company, including executive assistant to Chan. He continued to report to Chan throughout the Material Time. Hung was responsible for developing financial models for existing and potential new businesses and front-line banking relationship management. Hung oversaw the preparation of cheques for a large number of Sino-Forest subsidiaries within the Sino-Wood group of companies. Within the BVI Model, Hung also oversaw the drafting of purchase and sales contracts and the netting of accounts receivable and accounts payable. He was also a member of Sino-Forest’s Disclosure Committee. Hung worked at Sino-Forest from 1999 until he was put on administrative leave in August 2011. Hung has a Masters of Finance and an MBA, is a Chartered Financial Analyst (**CFA**), and has a Financial Risk Manager designation.
- [23] George Ho was Vice-President Finance for Sino-Forest and was CFO and Vice-President Finance of Sino-Panel. He had ultimate oversight of the accounting personnel in the Sino-Panel subsidiaries and reported directly to Chan and Horsley. Ho worked at Sino-Forest from 2007 until he was put on administrative leave in August 2011. Ho obtained a Bachelor of Commerce in accounting from Simon Fraser University in 1987 and prior to joining Sino-Forest, he worked

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<sup>2</sup> The Muddy Waters Report itself was not in evidence. However, the Panel did receive in evidence the reports of the Independent Committee and various Sino-Forest press releases that refer to allegations made in the Muddy Waters Report.

<sup>3</sup> The temporary cease trade order, as varied from time to time, remains in place.

<sup>4</sup> The vast majority of Sino-Forest’s subsidiaries were held through two holding companies, (i) Sino-Panel, a British Virgin Islands incorporated subsidiary of Sino-Forest, (ii) Sino-Wood Partners, Limited (**Sino-Wood**), a Hong Kong incorporated subsidiary of Sino-Forest. Ip oversaw the operations of the Sino-Panel Group and another individual, Albert Zhao, was responsible for operations of Sino-Wood and its subsidiaries.

at business and accounting firms in Canada and Hong Kong, most recently in the Hong Kong branch of BDO McCabe Lo Limited (**BDO**), Sino-Forest's auditors at the time.

[24] Simon Yeung was Vice-President, Operations of Sino-Panel beginning in August 2009. Prior to that, he held various roles within Sino-Panel since joining the company in 2002 as Assistant Project Manager. As Vice-President, Operations, Yeung reported to Ip and oversaw operations of the company and its subsidiaries. Yeung described his role as "a first line trouble shooter to deal with operational issues" within the Sino-Panel Group (Affidavit of Simon Yeung, affirmed August 23, 2015). Yeung was put on administrative leave from his duties in August 2011. Yeung obtained a degree in economics in 1982 and a mechanical engineering diploma in 1993.

## II. EVIDENCE

### A. Witnesses

[25] Twenty two witnesses testified during the hearing.

[26] Staff called the following 12 witnesses:

- a. Two Staff witnesses, Anthony Long and Maggie Shao, both Senior Forensic Accountants in the Enforcement Branch of the Commission. Mr. Long testified over 27 days at the outset of the hearing and Ms. Shao testified over 19 days nearer to the end of Staff's case. Both testified about their work in Staff's investigation into Sino-Forest.
- b. Five former officers or directors of Sino-Forest:
  - i. David Horsley was the Senior Vice-President and CFO of Sino-Forest from October 2005 and was a respondent to this proceeding. Prior to the start of the merits hearing, the Commission approved a settlement agreement between Mr. Horsley and Staff.
  - ii. Thomas Maradin initially joined Sino-Forest as a consultant and became Vice-President, Risk Management. Mr. Maradin reported to Mr. Horsley and testified primarily about his role in assisting Sino-Forest to comply with the requirements of National Instrument 52-109 – *Certification of Disclosure in Issuers' Annual and Interim Filings (NI 52-109)*.
  - iii. James Hyde was a member of the Sino-Forest Board of Directors from 2004 and throughout the Material Time. He was Chair of the Audit Committee and the Corporate Governance Committee and was a member of the Compensation and Nominating Committee. Following the Muddy Waters Report, Mr. Hyde was appointed a member of the Independent Committee.
  - iv. William Ardell was a member of the Sino-Forest Board of Directors from January 2010 until Sino-Forest was dissolved in 2012. He was a member of the Audit Committee, the Corporate Governance Committee and the Compensation and Nominating Committee, and from June 2010 was Lead Director. He was also appointed Chair of the Independent Committee, following the release of the Muddy Waters Report.
  - v. W. Judson Martin was a member of the Sino-Forest Board of Directors from 2006 to 2010. Mr. Martin was a member of the Audit Committee, the Compensation and Nominating Committee (of which he was Chair) and the Corporate Governance Committee and was Lead Director from 2007 until 2010. In June 2010, in the course of Sino-Forest's acquisition of a majority interest in Greenheart, Mr. Martin became Vice-Chairman and an Executive Director of Sino-Forest, responsible for its acquisition of a majority interest in Greenheart, as well as CEO and Chairman of Greenheart. Following Allen Chan's resignation on August 26, 2011, Mr. Martin was appointed CEO of Sino-Forest. Mr. Martin testified by videoconference from Hong Kong.
- c. Yosanda Chiang was Allen Chan's Executive Assistant at Sino-Forest, and continued to work for him following his departure as CEO of Sino-Forest. Ms. Chiang testified by videoconference from Hong Kong. She testified in Cantonese with the assistance of an interpreter.
- d. Two members of the E&Y audit team that audited Sino-Forest's financial statements for 2007 to 2010:
  - i. Josephine Man is a Chartered Accountant and was a Senior Audit Manager and Audit Planner at E&Y. Prior to joining the Vancouver office of E&Y in 2006, Ms. Man worked in its Hong Kong office from 1996 to 2003. Her native language is Cantonese, she is fluent in English and speaks and

understands Mandarin. Ms. Man began working on the Sino-Forest audit in 2007, at which time E&Y was preparing work regarding Sino-Forest's third quarter financial statements and 2007 audit planning.

- ii. Fred Clifford is a Chartered Accountant and managed E&Y's client acceptance process with Sino-Forest. In 2007, he was the coordinating partner responsible for Sino-Forest in terms of the relationship, the execution and the overall transition into the firm. In 2008 and 2009, Clifford was the independent review partner and in 2010, Clifford became one of the engagement partners for the Sino-Forest audits.
- e. Two witnesses from PricewaterhouseCoopers (**PwC**), which acted as one of the advisors to the Independent Committee:
- i. Steven Henderson is a Chartered Professional Accountant with a designation in Investigative Forensic Accounting, as well as a Certified Fraud Examiner. He was involved in creating the work plan for the Independent Committee advisors and led the Canadian PwC team involved in the Independent Committee advisory process.
  - ii. James Pomeroy is a Chartered Accountant and Certified Fraud Examiner and is a Vice President of PwC in the forensic services group. As part of PwC's work advising the Independent Committee, Mr. Pomeroy travelled to and worked out of Hong Kong.

[27] Chan did not testify on his own behalf and called two witnesses:

- a. Dr. Randall Peerenboom has a Ph.D. in philosophy, with a focus on Chinese philosophy in the classical period and has a J.D. from Columbia University. He was born and educated in the United States, but has lived in Beijing for most of the past 20 years, where he continues to reside with his family. Dr. Peerenboom has legal experience in the United Kingdom and China and has worked as a professor and in academia. Dr. Peerenboom testified as an expert in the field of Chinese law and cultural practices in China within a comparative global and Asia context.
- b. Lei Guangyu was a friend of Chan and a Chinese businessman. His companies were involved in the export/import business, real estate, environmental protection and financial investments. He testified predominantly about his involvement with the Greenheart Transactions by videoconference from Shenzhen, China in Mandarin with the assistance of interpreters. Mr. Lei testified in April 2015, but did not complete his cross-examination by Staff. Between April 2015 and the conclusion of the evidence in this hearing in December 2015, efforts to arrange for the completion of Mr. Lei's testimony were unsuccessful. As a result, we are left with testimony from Mr. Lei that is incomplete, as Staff did not have the opportunity to fully test his evidence through cross-examination. The parties were in agreement that Mr. Lei's evidence should remain part of the record that the Panel can consider in its determination of the merits.

[28] Ip, Hung, Ho and Yeung each testified on their own behalf. With Staff's consent, they chose to testify by videoconference from outside Ontario. They testified from Hong Kong, and in the case of Ip, from both Hong Kong and the Dominican Republic. Ip, Hung and Yeung testified, wholly or in part, in Cantonese with interpretation assistance. We granted the request of Ho, Hung and Yeung to provide their evidence in chief by written affidavit, on which Staff and counsel for Chan were permitted to cross examine them (*Re Sino-Forest Corporation* (2015), 38 OSCB 6205).

[29] Ip, Hung, Ho and Yeung called the following four expert witnesses:

- a. Michael Murphy works with AlixPartners in Hong Kong as the Managing Director, Asia Pacific Practice. He specializes in consulting engagements on behalf of investors and boards of directors, as well as debtors and creditors involved in operational and financial turnarounds and loan workouts. He has worked in China for over 20 years. Mr. Murphy was qualified and testified as an expert in Chinese business practices and how they relate to business regulations in China, including business practices arising out of the concept of *guanxi*, foreign exchange regulation, tax regulation, business structures and email usage.
- b. Gavin Hao is a Forestry Consultant with the pulp and forestry consulting firm RISI. He lives in Shanghai and his educational and work experience has been in Chinese forestry. Mr. Hao was qualified and testified as an expert in the Chinese forestry industry. He testified in Mandarin with interpretation assistance.
- c. Jinrong Liu is the managing partner of Global Law Office in Beijing, China and is licensed to practice law in China. Mr. Liu was qualified and testified as an expert in Chinese law, regulation and government practices as they relate to:



- i. the enforceability of oral contracts in China;
- ii. the ability of corporations to lend money;
- iii. whether an entity incorporated in the British Virgin Islands (**BVI**) may hold a Plantation Rights Certificate;
- iv. the investigatory powers of the Chinese State Administration of Foreign Exchange (**SAFE**);
- v. the concept of “retreating from the front line” as a succession planning mechanism by Chinese government organizations; and
- vi. the meaning of legal terms and, in particular, those that have been translated in this proceeding as a right of first refusal as contrasted with an option and the term “Project Preparatory Office”.

Mr. Liu testified by videoconference from his offices in Beijing, China in Mandarin through the assistance of an interpreter.

- d. Dr. Robin Hui Huang is a professor in the Faculty of Law at the Chinese University of Hong Kong, with a research focus that includes corporate law and securities regulation. Dr. Huang was qualified and testified as an expert in translation of the term “*wai wei gong si*” from Chinese characters into English. Dr. Huang testified by videoconference from Hong Kong.

#### **B. Challenges for Witnesses in the Hearing**

- [30] Some of the challenges in receiving evidence in this case included witnesses testifying by videoconference from different locations, including Hong Kong, Beijing, Shenzhen and the Dominican Republic, in time zones that were as much as a 13 hours difference from the time zone in which the hearing was being held. Witnesses testified entirely or in part in another language with the assistance of an interpreter. Some witnesses’ testimony continued in these circumstances for many days. The Panel is mindful of the difficulties created by these circumstances.
- [31] As one might expect, video conferencing is less satisfactory than direct evidence in a hearing room. While the Panel can see an on-screen image of the witness, his or her manner and demeanor are less reliable as a test of credibility. Clarity of the witness’ speech is impaired by the less than perfect sound transmission.
- [32] Some witnesses testified in Cantonese or Mandarin with the assistance of an interpreter. Despite some difficulties with interpretation, overall, the Panel finds the quality of the interpretation and the seeing and hearing of the witness’ testimony was sufficient to permit the Panel to understand the witnesses and to make findings, including findings of credibility.
- [33] The Panel has kept the challenges of testifying under these conditions uppermost in their minds in assessing witness credibility.
- [34] We consider the credibility of any oral evidence in the context of all the evidence before us. We believe it important to highlight the at times difficult circumstances under which witnesses were giving evidence and to note that we have tried at all times to consider the credibility of witness statements in light of such circumstances.

#### **C. The Independent Committee Investigation**

- [35] A major source of documentary evidence in this case was the Independent Committee investigation and its reports. Both Staff and the Respondents refer to the Independent Committee reports in their submissions. We also heard testimony from two members of the Independent Committee (Messrs. Ardell and Hyde) and two members of PwC, an advisor to the Independent Committee (Messrs. Pomeroy and Henderson).
- [36] Following the release of the Muddy Waters Report on June 2, 2011, the Board of Directors established the Independent Committee. The Independent Committee’s mandate was to independently examine and review the serious and wide-ranging allegations made in the Muddy Waters Report, and report back to and, if appropriate, make recommendations to the Sino-Forest Board. The Independent Committee was initially composed of William Ardell (Chair), James Bowland and James Hyde. At the invitation of the Independent Committee, another independent director of Sino-Forest, Gary West, attended virtually all meetings of the Committee and participated in its process. The Independent Committee advisors were: Osler, Hoskin & Harcourt LLP, Canadian counsel who assisted the Independent Committee in developing the appropriate response and identifying and conducting the mandate; PwC, who were engaged as forensic accountants; Mallesons Stephen Jaques, as Hong Kong legal counsel; and Jun He Law

Offices (**Jun He**), as Mainland China legal counsel. Mr. Bowland resigned as director and from the Independent Committee on November 3, 2011.

- [37] The Independent Committee released three reports in the course of its investigation. The *First Interim Report* was released on August 10, 2011. The *Second Interim Report of the Independent Committee of the Board of Directors of the Sino-Forest Corporation* (the **Second IC Report**) was released on November 13, 2011. Along with testimony from members of the Independent Committee and its advisors, the Second IC Report and its appendices form the primary basis for our understanding of the Independent Committee's investigation. A *Final Report of the Independent Committee of the Board of Directors of Sino-Forest Corporation* was issued on January 31, 2012.
- [38] The Independent Committee's advisors had issued their own *Report on Process to Date* on November 13, 2011. When Mr. Henderson of PwC was asked why the advisors issued their own, separate report, he testified that the advisors believed it "important to identify in our own report the limitations and qualifications of the investigation, including recommendations, and the IC considered that information and interpreted it accordingly in writing their own report" (Hearing Transcript, December 5, 2014 at 111:5-9).

### 1. Scope

- [39] The scope of the Independent Committee review was to investigate the ownership structure of the forestry assets on Sino-Forest's balance sheet, the ownership of trees in Yunnan Province (the geographic focus of the Muddy Waters Report), the existence and value of those trees, Sino-Forest's revenue recognition process, and the relationship between Sino-Forest and its suppliers and customers in the BVI Model. The scope became broader than the allegations which were initially raised in the Muddy Waters Report. The Independent Committee needed to respond quickly as well to questions raised by the Commission. According to Mr. Pomeroy of PwC, the investigation was a massive organization of people and resources, with 100 individuals or more working on a variety of issues, against tight deadlines
- [40] The Independent Committee focused its investigation on the years 2006 and following. Its process was limited to the examination and review of three core areas: (i) timber asset verification; (ii) timber asset value; and (iii) revenue recognition. Intertwined with these areas of investigation were issues raised in the Muddy Waters Report regarding related party transactions and relationships.

### 2. Management

- [41] At the outset, management's role was as a resource to the Independent Committee and its advisors. Management was also tasked with drafting their own response to the Muddy Waters' allegations in order to possibly refute any allegations immediately. The Independent Committee dealt principally with Chan, Horsley and Mr. Maradin. As the review progressed, the Independent Committee advisors communicated to the Independent Committee that there was a lack of full cooperation and openness from Chan, Ip, Ho and Hung, among others in management, during examinations and failure to provide significant amounts of material information as requested.
- [42] Mr. Ardell, the Chair of the Independent Committee, testified feedback from PwC and Mallesons to the Independent Committee indicated that Chan, in some instances, was not forthcoming with respect to full disclosure regarding AI and supplier backgrounds.
- [43] He also testified that another example of lack of cooperation was Ho's initial refusal to comply with a request from the advisors for human resources data. Ho expressed concern regarding employee privacy but he did ultimately hand over the data. However, there were discrepancies between the data provided by Ho when compared with human resources data found on other employees' laptops.
- [44] Mr. Martin testified that, as a result of inconsistencies in certain emails and interviews regarding related parties, Chan was asked to resign as CEO in August 2011. Hung, Ho and Yeung were put on administrative leave in late August. Ip's duties were limited and under the direction of Mr. Martin, who became CEO.

### 3. The Investigation

- [45] The advisors began with identifying and confirming the cash in Mainland China, Hong Kong and Canada and fact gathering: understanding the business model and what all the Sino-Forest subsidiaries, customers and other corporate entities were; identifying who all the parties were with whom the company dealt; capturing all Sino-Forest's electronic data, and gathering all the purchase and sale documentation and other timber data.

**(a) Data Capture**

- [46] Electronic data gathering was initially delayed “in view of the potential cultural and other sensitivities of Management,” according to the Independent Committee advisors November 13, 2011 *Report on Process to Date*, and did not begin until more than nine days after the Muddy Waters Report. Management was not informed of legal hold notices over data until June 12, 2011 and all employees were sent legal hold notices on June 14, 2011. The advisors discovered that the extent of historical electronic data in Sino-Forest’s Guangzhou office was “almost nonexistent” (*Report on Process to Date* of the Independent Committee advisors at 13). For example, for two senior management individuals, the earliest email retrieval was June 10, 2011, post Muddy Waters Report.
- [47] When the advisors were electronically capturing data they discovered that certain Sino-Forest employees were using personal devices and non-corporate email addresses to conduct Sino-Forest business. Further complicating the data collection exercise, certain individuals were changing their emails addresses periodically and using different email addresses outside the corporate email structure.

**(b) Forestry Bureaus**

- [48] One of the steps in the review was visiting the local offices of the Chinese state forestry authority, referred to as **Forestry Bureaus**, in an attempt to verify Sino-Forest’s rights to standing timber. In order to maintain the independence of the process, the advisors asked management to provide them the contact details to directly arrange the Forestry Bureau visits. Management declined to do so, maintained control over the arrangements, and attended all visits.

**(c) Suppliers and AIs**

- [49] Another step in the Independent Committee review was to examine Sino-Forest’s relationship with its AIs and suppliers to determine if such relationships were arm’s length and to obtain independent verification of the cash flows underlying the set-off transactions. Mr. Hyde described the results of the interviews with AIs and suppliers as “mediocre at best”, which will be discussed elsewhere in these Reasons in our analysis of the allegations of undisclosed control of third parties.

**(d) Challenges**

- [50] The Independent Committee advisors encountered significant challenges in gathering the information required to address the Muddy Waters’ allegations and the other matters outlined in the scope of the review. Among the challenges outlined by Mr. Hyde were the following:
- Evidence, such as a plantation registration system and documents, were not readily available, and access to Forestry Bureau officials, suppliers and customers was delayed or denied.
  - While there were national policies regarding the issuance of Plantation Rights Certificates (**PRCs**) (official government documents confirming title) that were to be rolled down to the territorial (county) level, in practice, the advisors found that many county Forestry Bureaus had not yet started this process – many would not admit this and others simply denied the advisors access.

As well, the Independent Committee advisors found some corporate registry offices refused to conduct searches of corporate registrations.

- [51] There were geographic challenges. Yunnan, the centre of many of the allegations, is a remote province and visiting Forestry Bureaus in Yunnan involved many days driving on very rough roads where the advisors were worried that “something was going to happen to them, so dangerous getting in,” as described by Mr. Hyde (Hearing Transcript, November 5, 2014 at 161:19-20).
- [52] Culturally, locals were not used to having people arrive and ask for things in a North American fashion. These parties were not compellable so a “little bit of a dating ritual dance” was necessary before discussing business, according to Mr. Hyde (Hearing Transcript, November 5, 2016 at 162:3-4).
- [53] One of the tasks the advisors undertook was to try to establish the standing timber chain of title whereby the advisors were attempting to go back to the very first person who had been granted rights to the land that held the timber. In doing so, the advisors wanted to see if there was a flow of documents that passed title from one to another, which ultimately ended up with Sino-Forest. Hyde testified they found this could not be done – the information was not there.

[54] During the review, the Independent Committee learned the attachments that were referenced in the purchase contracts were not attached. They discovered the PRCs had never been issued. They then tried to look to the resolutions of the original villager owners to support title, which the Independent Committee learned were not attached as well. The Independent Committee was told by Chan that these were reviewed but not retained. This is discussed in more detail in our analysis of the deceitful documentation allegations.

[55] On September 29, 2011, without warning or explanation, Sino-Forest requested the advisors vacate the Sino-Forest offices in Hong Kong. On September 30, 2011 all access cards were returned.

#### 4. The Final Report

[56] The Final Report of the Independent Committee was issued on January 31, 2012. There was little additional information beyond what was set forth in the November 2011 *Second IC Report*. The advisors issued a disclaimer stating: "This Final Report, while based on the work of such advisors, is the report of the IC and not the report of the IC Advisors".

[57] Further references to the Independent Committee's reports are found within these Reasons.

### III. SINO-FOREST'S TIMBER BUSINESS IN MAINLAND CHINA

[58] Our analysis of the Standing Timber Fraud Allegations set forth below in these Reasons also requires some background on how sales of forestry ownership rights were transacted in Mainland China during the Material Time, and, more specifically, the ways in which Sino-Forest conducted its forestry business.

#### A. Forestry Ownership in Mainland China

[59] Gavin Hao, an expert in the Chinese forestry industry, testified that regulation of forestry ownership in China is in a process of reform. The most recent period of reform is a continuation of previous reforms that began with China's general "opening up" after 1978, which initiated the move away from the collective ownership of forestry land that existed in China during the earlier part of the second half of the 20th century. Following the promulgation of China's *Forestry Act* in 1998, the Chinese forestry industry has moved towards implementation of a new forestry rights regime, which includes the systematic issuance of Plantation Rights Certificates, or PRCs, and confirmation of ownership of forestry rights. PRCs are official Chinese government documents that indicate the owners of each of the four categories of forestry rights and the location of the plantation with reference to its general location, the plantation boundaries at each of the four cardinal directions, the Forestry Bureau compartment and sub-compartment classification numbers and a map.

[60] Under China's *Forestry Act*, there are four aspects of forestry ownership in Mainland China. These four rights are separate and can generally be held by different owners. The four types of forestry rights are:

- a. Land ownership: This is ownership of the land itself. Only the state or village collectives can hold land ownership rights. These rights cannot be transferred and cannot be owned by individuals. As a result, these rights were never the subject of Sino-Forest's forestry transactions and are generally not relevant for the purposes of our analysis.
- b. Land use rights: This is the right to use the forestry land, such as a lease interest registered on the land. These rights can be held by individuals and used for forestry purposes for a limited time period, and include the ability to plant or replant timber on the land. Sino-Forest's WFOE (wholly foreign-owned enterprises) subsidiaries, as Chinese entities, were able to own land use rights, but its BVI subsidiaries, as foreign entities, were not.
- c. Timber ownership: This is the ownership of the trees, or standing timber, growing on the land, which includes the right to use, protect and harvest the timber. We heard expert evidence that these rights would, in most circumstances, go hand-in-hand with land use rights, but could be held by separate parties. Both WFOE and BVI subsidiaries were able to hold timber ownership rights, often referred to throughout these Reasons as standing timber rights.
- d. Timber use rights: This is the ownership of the produce, or fruit, of the trees. In the PRCs we have reviewed, this ownership right has always accompanied timber ownership and is not specifically relevant to our consideration of the allegations.

[61] The two rights that are most important for the purposes of these Reasons are therefore (b) land use rights, and (c) timber ownership.

[62] Proof of ownership of forestry rights in Mainland China is generally provided by the issuance of PRCs by Forestry Bureaus. PRCs are official government documents that include the following information:

- Excerpts from the “Constitution of The People’s Republic of China” and the “Forest Law of The People’s Republic of China”;
- The seal of the Forestry Bureau office that issued the PRC (in the case of Sino-Forest PRCs, usually the county-level Forestry Bureau);
- Confirmation to the party requesting the PRC that the ownership or use rights for the forest, timber and forestland have been registered and that the legal rights and interests are protected by law;
- A Registration Form of the Situation of Forest, Timber and Forestland for each parcel of land covered by the PRC. These Registration Forms were standardized, with space for the Forestry Bureau to input the following information:
  - the owner of each of the four ownership rights;
  - a description of the general location area;
  - geographic boundaries to each of the four cardinal directions;
  - the Forestry Bureau compartment and sub-compartment numbers assigned to the parcel of land;
  - the colloquial name for the land;
  - the area in mu;
  - the main tree species for the parcel of land;
  - the forest type (e.g. timber forest);
  - the forestland use period (i.e. the duration of the rights); and
  - Forestry Bureau seal, name of the “responsible person” at the Forestry Bureau and the date of issuance.
- A Registration of Change certificate, which confirmed that, based on the signed contract that transfers forest rights, the plantation ownership had been changed to be under the name of the purchasing party;
- A Map of the Boundaries of the Forest, Timber and Forestland to the Four Cardinal Directions, with the parcels of land covered by the PRC identified; and
- A Notice which included statements that:
  - the PRC “is the legal proof of ownership or use rights for forest, timber and forestland and is valid when sealed by the People’s Government at county level and above or the Forestry Administration Department of the State Council”;
  - the PRC was to be kept by the proprietor of the forest rights;
  - “when there is a legal change to the forest rights, this certificate must be presented on time at the original registration and certificate issuing authority for processing the change in registration”; and
  - “this certificate should be presented when the various levels of People’s government and their forest rights management department or judicial authority are investigating and making enquiries on matters related to the forest rights”.

[63] Mr. Hao explained the process for transfer of forestry rights requires both the seller and purchaser to attend at the local Forestry Bureau to register the change. For a transfer from a village collective, two-thirds of the villagers (or their proxies) are required to attend. This process involves land boundary confirmations by the Forestry Bureau, a two-week public notice period and other registration procedures, all of which generally takes about one month.

[64] Mr. Hao testified the timelines for the implementation of the new forestry rights rules and regulations has varied from province to province and different provinces have achieved varying degrees of progress in the issuance of PRCs. He testified there are several challenges that have delayed forestry reform, which include:

- the complexity of confirming land boundaries, which involves participation from forestry authorities, village collectives or farmers and surveyors;
- historical disputes over land ownership between villagers in the same villages, family clans in the same village collective or neighbouring village collectives that can make confirming ownership challenging or may cause additional disputes with forestry companies which have acquired the land; and
- questions about the proper distribution of land rights to family units, or households – there is ambiguity about how the term “household” should be interpreted and differences of opinion about how rights should be distributed to households where not all births are registered because they were not compliant with China’s one-child policy.

Hao further explained there are substantial variations in the way PRCs are administered. Some are initially issued to the village collective and held by the village chief, while others are issued to households or groups of households that jointly own the forestry rights.

[65] In addition to initial PRC registration challenges, Hao testified about the complexities of the forestry rights transfer process in Mainland China. In negotiations to purchase rights to a particular area from villages or households, a forestry company would likely deal with many individuals with ownership interests, in rural areas of Mainland China where education levels are relatively low and villagers often leave to work as migrant workers in other parts of the country for most of the year. The difficulty villagers may have in understanding or being able to read a contract, and the complicating factor of conducting negotiations in the absence of some villagers, means transacting the transfer of forest rights can be complicated and any subsequent challenges to the validity of the contract may be successful.

## **B. Sino-Forest’s Plantation Ownership in Mainland China**

### **1. Evidence of Transfer of Forestry Rights**

#### **(a) Purchase Transactions**

[66] One of the issues of contention in this hearing is the adequacy of the evidence of Sino-Forest’s ownership of its forestry assets. Although Sino-Forest obtained PRCs for some of its forestry assets, it was unable to do so for most of its assets, notably those acquired using the BVI Model. As we discuss in greater detail later in these Reasons, Sino-Forest employed two business models in its timber operations. The **BVI Model** involved the purchase and sale of standing timber by subsidiaries incorporated in the British Virgin Islands. The **WFOE Model** involved the purchase and sale of timber rights by subsidiaries incorporated in Mainland China. Government restrictions on foreign companies operating in Mainland China resulted in greater constraints on business conducted through the BVI Model.

[67] Sino-Forest noted some of the difficulties in obtaining PRCs in its public disclosure. Its 2010 AIF states that Sino-Forest was required to obtain PRCs in respect of its land use rights and timber ownership. Sino-Forest disclosed that, for its Planted Plantations,<sup>5</sup> it was obligated to apply to Forestry Bureaus at the county level or above, which are responsible for issuing PRCs, but noted the following with respect to its Purchased Plantations:

#### **Plantation Rights Certificates for Our Purchased Plantations<sup>6</sup>**

For our purchased plantations, we have applied for the corresponding Plantation Rights Certificates with the relevant forestry bureaus. As the relevant locations where we purchased our purchased plantations have not fully implemented the new form of Plantation Rights Certificate, we are not able to obtain all the corresponding Plantation Rights Certificates for our purchased plantations. Instead, we obtained confirmation of our ownership of our purchased plantations from the relevant forestry bureaus. Based on the relevant purchase contracts and the approvals issued by the relevant forestry bureaus, we legally own our purchased plantations.

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<sup>5</sup> As explained further below, Sino-Forest used the term “Planted Plantations” in its disclosure to refer to its process of increasing the yield of trees on land that it leased for 30 to 50 years to ensure long-term sustainable harvesting. All Planted Plantations were held in Sino-Forest’s WFOE Model.

<sup>6</sup> Sino-Forest used the term “Purchased Plantations” in its disclosure to refer to its process of purchasing young trees at attractive prices, capturing the fibre growth during ownership and then selling the standing timber to customers. Purchased Plantations could be owned in both Sino-Forest’s BVI Model and WFOE Model.

[68] As discussed elsewhere in these Reasons, Sino-Forest's BVI subsidiaries did not obtain PRCs. Ip testified BVIs, as foreign companies, could not own land use rights. Mr. Hao testified that whether foreign-owned enterprises are eligible to obtain PRCs depends on the different implementation measures of the different provinces and it is not clear whether they are eligible to obtain PRCs pursuant to the *Forestry Act*. BVIs, as foreign companies, could own standing timber rights, but not land use rights. Mr. Hao and others testified PRCs were generally not issued for standing timber ownership alone. We saw evidence of one PRC from Gengma County, Yunnan Province that registered a Sino-Forest WFOE's ownership of standing timber, but not land use rights for two parcels of land. Mr. Hao testified that although certain Forestry Bureaus refuse to register separate ownership of these rights because they are accustomed to these rights being owned together, he had experience with a company that was able to obtain PRCs for timber ownership alone. We did not hear how many PRCs for standing timber alone were obtained by this company, which did business in Guizhou and Sichuan Provinces.

**(b) Sales Transactions**

[69] Sino-Forest similarly had to provide proof to its auditors of its revenue from sales transactions. As discussed elsewhere in these Reasons, sales conducted in the BVI Model were not settled by direct payments to Sino-Forest's subsidiaries, but rather were dealt with through a set-off process, whereby Sino-Forest directed its customers to transfer funds to its suppliers, defined below as the AR/AP Set-Off Process.

[70] Since there was no flow of funds in or out of the bank accounts of the BVI subsidiaries that could be audited, Sino-Forest's auditors were provided with other documents, including sales confirmations and documents detailing the AR/AP Set-Off Process, which were provided to show that assets had been sold.

[71] For sales of plantations held in the WFOE Model, Sino-Forest customers signed **Harvesting/Sales Confirmations**. These were documents prepared by Sino-Forest, which indicated that the sale was complete and that harvesting had taken place. Sales in the BVI Model were evidenced by **Confirmations of Sales Situation** documents. These documents were also prepared by Sino-Forest and confirmed sales had taken place. Both were one-page documents included at the end of some sales contracts. These documents confirmed the volume of timber actually provided to the customer by Sino-Forest pursuant to a specific sales contract, and the total sale price for that contract, based on the volume of timber actually sold. They were addressed to the Sino-Forest subsidiary and chopped by the customer. However, as discussed elsewhere in these Reasons, no actual harvesting took place in the BVI Model.

[72] In addition, for the BVI Model, Sino-Forest's auditors were provided with a set of documentation that enabled them to audit the AR/AP Set-Off Process. The standard documentation provided to E&Y as evidence of the settlement of accounts payable and receivable in the BVI Model was the following:

- a. A letter from a Sino-Forest subsidiary to a Sino-Forest supplier, asking that the supplier accept a specified amount from a Sino-Forest AI/customer as partial or full payment for a purchase contract. This letter would be dated and chopped with the seal of the Sino-Forest subsidiary.
- b. A second letter from the Sino-Forest subsidiary to the AI/customer, asking it to remit part or all of the accounts receivable due to Sino-Forest directly to the Sino-Forest supplier addressed in the first letter. This would also be dated and chopped with the seal of the Sino-Forest subsidiary.
- c. A third letter from the AI/customer to the Sino-Forest subsidiary, confirming the customer has remitted the required amount to the Sino-Forest supplier in payment of the accounts receivable. This letter was undated and chopped by the AI/customer.
- d. A fourth letter entitled Confirmation of Receipt of Funds Notification from the supplier to whom the first letter was sent. This letter confirmed receipt of the specified amount from the AI/customer, was dated and was chopped by the supplier.

[73] Ms. Man testified these documents indicated the Sino-Forest supplier had received the specified amount from the Sino-Forest AI/customer on the date indicated in the fourth letter, in accordance with the AR/AP Set-Off Process. She confirmed E&Y reviewed 100% of the sets of these four settlement documents for the four years that E&Y was auditor for Sino-Forest, all of which would have had similar content. These were supposedly independent confirmations, but, as will be discussed elsewhere, they were actually orchestrated by Sino-Forest and not independent or audit-worthy.

[74] Ms. Man was not aware of any collection issues in the BVI Model and did not recall that Sino-Forest ever had to write down any BVI accounts receivable prior to the Muddy Waters Report.

## 2. Annual Valuation of Sino-Forest's Forestry Assets by Pöyry

[75] Sino-Forest retained the forestry consulting company Pöyry Forest Industry (**Pöyry**) each year during the Material Time to prepare a valuation of its timber holdings.

[76] For its valuation of Sino-Forest's assets, Pöyry used a discounted cash flow approach. It estimated the net present market value of Sino-Forest's timber assets based on the expected cash flow from the harvesting of existing tree crops. Staff submits that Pöyry's valuation approach was materially different from Sino-Forest's business model. Staff cites the following testimony from Ms. Man, formerly of E&Y:

... Sino-Forest model is to sell the trees within three to five years. Poyry's model is to look at a cash flow for a typical forestry company which usually the cycle is more than 10 years because growing trees usually involve a longer period of time.

So how Poyry did the valuation model, according to a discussion with Poyry, was that they look at the trees that Sino-Forest owned as of every year-end, they put in those data into the model, but ignore the sales cycle of Sino-Forest, but put that as – into their model assuming that those trees will be sold in 10 years instead of three to five years.

(Hearing Transcript, November 13, 2014 at 34:19-35:5)

When questioned by the Panel if she knew why Pöyry used a 10-year model rather than the three- to five-year model that Sino-Forest actually employed, Ms. Man responded:

We had a lot of discussion with Poyry at that time. They – my recollection was they mentioned that their model cannot be changed to fit in Sino-Forest's business model and – or Sino-Forest, the business model of Sino-Forest was really unique, and the other clients that they have is a typical, you know, forestry company that involve a longer period of time in terms of the cycle. So they just can't do it the way that Sino-Forest – like they can't align the model to Sino-Forest business model, put it this way.

(Hearing Transcript, November 13, 2014 at 36:1-11)

[77] James Hyde, who was the Chair of Sino-Forest's Audit Committee, described Pöyry's valuations as “what if calculations” and “not considered to be a financial number... not a true valuation in any way, sense or form” (Hearing Transcript, November 3, 2014 at 168 and 169).

[78] Unlike the work of the Independent Committee, or a question we are being asked to address in these Reasons, Pöyry's work did not include confirmation of ownership of assets. Rather, Pöyry's assumption was that title to forest assets was as provided in the data from Sino-Forest.

[79] Hung was the contact person for Pöyry at Sino-Forest and was responsible for providing Pöyry with the information it needed, arranging for site visits and reviewing Pöyry's draft valuations. The annual valuation process began with Hung, or his subordinate, Kenny Wong (whose title was Executive Project Administration), providing Pöyry with an Excel spreadsheet containing information on Sino-Forest's purchased and planted plantation holdings. This spreadsheet contained details of Sino-Forest's total planted and purchased plantation assets by location (province, city and county), with additional information on tree species and year of planting, all of which was derived from the purchase contracts.

[80] For site visits, Pöyry would select a location they wanted to visit (at the county- or city-level). Sino-Forest would provide Pöyry with maps when it arrived for the site visit in Mainland China.

[81] Pöyry sampled a small percentage of Sino-Forest's plantation assets in the course of conducting its annual valuation. Ms. Man guessed Pöyry would have visited around 1% or 2% of the area that covered Sino-Forest's assets in any year.

[82] Based on Pöyry's valuation reports for 2007, 2008 and 2009, Pöyry visited no more than 0.5% of Sino-Forest's timber holdings in each year. Their reports do not distinguish between BVI and WFOE holdings. Pöyry cautioned in the 2007 report that the sample “is not large enough to cover the full range of natural variability across the Yunnan forest resource. However, there is currently no information that allows Pöyry to attribute any greater veracity to existing stand records”. There is no similar reference in the 2008 Report. In the 2009 Report, Pöyry stated, “in comparison with most other forests, the large Sino-Forest estate is significantly under-sampled for growth and yield estimation purposes”.



[83] To locate plantations to use in its annual valuations, Pöyry relied on maps provided by Sino-Forest. Hung testified Pöyry selected plantations at random and was able to rely on the precise maps that Sino-Forest provided, having satisfied itself about the maps and the presence of standing timber. He noted the 2008 Pöyry valuation report refers to cluster maps of 150 plantation compartments with precise geographic coordinates. In cross-examination, he testified Sino-Forest would have provided Pöyry with the data on location, tree species, area in hectares, planted year and the status as planted or purchased plantations.

[84] As discussed in our analysis of allegations of deceitful documentation, Pöyry's annual valuations do not assist us.

## C. Forestry Asset Terminology in Sino-Forest's Disclosure

### 1. Description of Assets

[85] Although the meaning of the terms trees, timber and logs may seem obvious, it is important to note the different terminology used by Sino-Forest in its financial statements to refer to the various forestry assets it owned and sold.

[86] Plantations of trees growing in the ground (*i.e.* in forests, yet to be harvested) were referred to as **standing timber**. Sino-Forest transacted most frequently in the purchase and sale of standing timber and this accounted for the vast majority of its revenue during the Material Time.

[87] The word **logs**, as one would expect, generally referred to trees that had been harvested into logs. However, we heard testimony that assets referred to as "logs" in Sino-Forest's disclosure documents could also have been a reference to "**standing logs**", which were essentially trees still growing in the ground but sold as if they were logs. There was some discussion during the hearing about the vertical versus horizontal nature of "standing logs" and "logs", but suffice it to say that a standing log is just a tree. More specifically in respect of Sino-Forest's revenue, standing logs referred to unharvested trees that were priced for sale at the expected value of the logs that the trees would yield. In fact, standing timber, logs and standing logs all referred to uncut trees in Sino-Forest's nomenclature.

[88] In addition to standing timber, Sino-Forest also owned the land use rights for some plantations. In these cases, Sino-Forest's assets were comprised of both the timber on the land and the rights to the land itself (*i.e.* to replant after harvesting). Because of government restrictions that prevented foreign companies from owning land use rights, these purchases of land use rights were only made in the WFOE Model.

[89] Sino-Forest disclosed the distribution of its timber holdings amongst its Planted Plantations and Purchased Plantations (discussed in the following section). It did not, however, disclose its holdings in each of the WFOE and BVI Models.

### 2. Description of Revenue Streams

#### (a) 2003-2006 – Standing Timber: Planted Plantations and Purchased Plantations

[90] Between 2003 and 2006, Sino-Forest reported its revenue from standing timber sales as being derived from sales of "planted plantations" and "purchased plantations". **Purchased Plantations** are described as "forestry plantations of third parties" from which Sino-Forest purchased immature trees. In its 2005 Annual Report, Sino-Forest describes them as "where we generate a high gross profit margin from purchasing young trees and cultivating them to maturity, and acquire the rights to lease the land for re-planting". **Planted Plantations** are described as "our own". In 2005, Sino-Forest described them as follows: "where we re-plant and share harvest proceeds with our joint-venture partners".

[91] In 2006, sales of standing timber accounted for 55% of Sino-Forest's total revenue. In addition to revenue from standing timber, Sino-Forest also recorded revenue from the following sources in 2006:

- imported wood products;
- wood chips and logs; and
- manufacturing and other operations.

[92] During this period, 2003 to 2006, Sino-Forest disclosed its revenue from its Purchased and Planted Plantations consisted entirely of sales of standing timber. Therefore, immediately prior to the Material Time, Sino-Forest's AIF disclosure indicated none of its revenue was derived from sales of harvested logs. However, other contradictory disclosure indicates Sino-Forest was engaged in harvesting operations.

**(b) 2007-2009 – Plantation Fibre: Planted Plantations, Purchased Plantations and Integrated Plantations**

[93] In 2007, Sino-Forest introduced the term “plantation fibre” in its financial reporting. **Plantation Fibre** revenue consisted of revenue derived from Sino-Forest’s operations in Purchased Plantations, Planted Plantations and “integrated plantations.” **Integrated Plantation** revenue was derived from Sino-Forest’s new integrated model, which Sino-Forest described in its 2007 Annual Report as follows: “We purchase mostly mature trees, harvest and sell the logs or vertically integrate the fibre with our manufacturing facilities to produce value-added wood products”.

[94] In 2007, Sino-Forest had no revenue from Integrated Plantations, and the term Plantation Fibre was used somewhat interchangeably with “standing timber”. In 2008 and 2009, Plantation Fibre revenue was reported as derived from all three plantation sources. Sino-Forest specifically disclosed that its Plantation Fibre revenue in 2008 and 2009 was the result of sales of both standing timber and harvested logs.

**(c) 2010 – Plantation Fibre: Standing Timber and Logs**

[95] In 2010, Sino-Forest reported Plantation Fibre revenue in two differently-named categories, (i) Standing Timber, and (ii) Logs. The Standing Timber revenue was from sources previously described as Purchased and Planted Plantations and Logs revenue was from sources previously described as from Integrated Plantations. Sino-Forest still reported sales of standing timber and harvested logs under Plantation Fibre revenue.

[96] In 2010, Sino-Forest reported revenue from two streams:

1. Wood Fibre Operations
  - Plantation Fibre
    - Standing Timber
    - Logs
  - Trading of Wood Logs
2. Manufacturing and other operations

[97] The frequent changes in terminology in Sino-Forest’s revenue disclosure make it challenging to compare its revenue year to year.

**(d) Revenue Reported from the Sale of Logs**

[98] Josephine Man, formerly of E&Y, testified she understood that as of at least 2008, log sales consisted of standing timber that had actually been cut down and harvested into logs. From an audit perspective, evidence of these log sales was provided by written confirmations, in which the customer would confirm the amount of logs received.

[99] By 2010, Ms. Man’s understanding of log revenue had changed, based on what she had been told by David Horsley. She testified Horsley informed her no harvesting was done for 2010, and instead Sino-Forest agreed with customers in advance of the sale how many logs the plantation would yield, and priced the sales as logs, accordingly. She confirmed for 2010, E&Y understood that none of the harvesting was being done by Sino-Forest, and all the “log” revenue of US \$893.3 million for that year was actually the sale of “standing logs” (*i.e.* uncut trees sold at log price). Ms. Man confirmed the term “standing logs”, however, was never referred to in the 2010 Financial Statements. The entire US \$1.4 billion in plantation fibre revenue that was broken down into standing timber revenue and log revenue was, in fact, all revenue from the sale of standing timber assets (*i.e.*, uncut trees).

[100] Although absent from Sino-Forest’s disclosure, the concept of standing logs was known to E&Y when it performed the audit for 2010. A February 26, 2011 internal E&Y memo written in respect of the 2010 audit, notes the following:

2. For sales which involve the harvesting of standing timber (either via third party or AI), ensure that the appropriate harvesting rights/logging quota have been obtained by obtaining such evidence as:
  - a. Confirmation from the AI/third party that the appropriate harvesting rights have been obtained.
  - b. Comparing the amount of logs harvested to the area for reasonableness

- *Per inquiry of management, EY was advised that the Company did not have any integrated sales by BVI subsidiaries that involved harvesting in the current year. The type of integrated sales made in the current year represents standing log sales. Standing log sales and its related unit price is made based on the expected yield of wood logs from the standing timber (i.e. fallen yield) whereas sales of standing timber is based on the standing yield of the plantation.*

*As the BVI Subsidiaries did not have any harvesting activities in the current year, this procedure was not performed.*

[emphasis added]

#### D. Other Issues Relevant to Sino-Forest's Timber Business

##### 1. *Fapiao* and Tax Implications

- [101] *Fapiao* are official tax receipts issued by a Tax Bureau in Mainland China for the purchase of goods or services. In exchange for payment to purchase forestry rights, Sino-Forest WFOEs would be issued *fapiao*. These *fapiao* could subsequently be used to obtain tax credits upon the sale of the forestry assets.
- [102] The Chinese characters for *fapiao* have been translated to English as "invoice" in various documents in evidence in this hearing, but we have referred to them as *fapiao* throughout these Reasons.
- [103] *Fapiao* are printed, administered and distributed by the Chinese Tax Bureau. Businesses are required to purchase *fapiao* from the Tax Bureau according to their business scope, and may provide *fapiao* to customers in exchange for goods or services. Each local office of the Tax Bureau has a quota for the number of *fapiao* it may issue, and, in turn, issues a set number of *fapiao* to each business in its jurisdiction. This quota system can result in a shortage of *fapiao* for a particular business or area.
- [104] Mr. Murphy, an expert in Chinese business practices that include tax regulation, testified that although every *fapiao* has its own serial number and is not fungible, companies in Mainland China will sometimes borrow *fapiao* from another company in order to be able to provide them to customers. He testified he had seen this done in situations where a business did not have the *fapiao* to issue to a customer, but wanted a transaction to move forward. He explained that these businesses run the risk that the Tax Bureau may impose fines or penalties for loaning or borrowing *fapiao*.
- [105] We heard expert evidence that different tax rates could apply to purchases of forestry assets in Mainland China, depending on the substance of the transaction. Land use rights were subject to a 5% Business Tax, whereas standing timber was subject to a 13% value-added tax (VAT). Different types of *fapiao* would therefore be issued for these transactions, referred to in this hearing as general *fapiao*, or VAT *fapiao*, respectively. Only businesses qualified as VAT general taxpayers were eligible to issue VAT *fapiao*. All other taxpayers were only able to issue general *fapiao*.
- [106] *Fapiao* were also useful in obtaining approval from SAFE (discussed below) for the exchange of foreign currency to renminbi, something Sino-Forest WFOEs were frequently required to do. To obtain approval for an additional exchange of foreign currency, a Chinese company was required to present SAFE with the *fapiao* resulting from the use of the renminbi from its previous foreign currency exchange.
- [107] Sino-Forest's subsidiaries never obtained *fapiao* for their standing timber purchases in the BVI Model. If Sino-Forest never obtained *fapiao* for purchases, it could not provide them to customers. From 2007 to 2010, Sino-Forest's reported revenue in the BVI Model was US \$3.35 billion. We find it beyond belief that no BVI customer ever required a *fapiao* from Sino-Forest, without which the full sales revenue could be taxable as profit.

##### 2. State Administration of Foreign Exchange (SAFE)

- [108] Three expert witnesses provided evidence with respect to SAFE, Dr. Peerenboom, Mr. Murphy and Mr. Liu. Because of strict government controls on foreign exchange, foreign currency cannot be freely brought into Mainland China. Approval must be obtained from SAFE, the regulatory body responsible for overseeing the conversion of foreign currency into renminbi. Although not specific to the forestry industry, SAFE played a notable role in Sino-Forest's business in Mainland China. Any cash that a WFOE subsidiary brought into Mainland China required SAFE approval.
- [109] SAFE places strict restrictions on the use of funds approved for foreign exchange. As part of its regulation of foreign exchange, SAFE inspects and audits the authenticity and legality of the receipt of payments of foreign exchange and punishes violations of foreign exchange regulations. In investigations into the legality of a company's foreign exchange transactions, SAFE could request information on transactions down the supply chain, and, as a result, companies

being investigated, such as Sino-Forest, can have greater insight into the books and records of their suppliers than would be expected of companies operating in North America. SAFE has the investigatory powers to review books and records of Sino-Forest's suppliers and those of its suppliers' suppliers if SAFE considers them directly related to Sino-Forest's transactions under investigation.

- [110] Dr. Peerenboom reported the global financial crisis and subsequent low interest rates led to an influx of "hot money" into emerging markets, including China. Mr. Murphy noted that the Chinese government has become increasingly concerned with this influx of "hot money". Dr. Peerenboom stated this has resulted in closer monitoring of capital flows into Mainland China by SAFE. Mr. Murphy reported that additional restrictions on the settlement of foreign exchange into renminbi were implemented.
- [111] Mr. Murphy stated these more stringent regulations restricted companies from converting foreign exchange funds to support activities related to their business scope, and required more substantial supporting documentation for a conversion of foreign funds to renminbi.
- [112] Sino-Forest WFOE subsidiaries were the subjects of a SAFE investigation in 2011. Documents in evidence that track banking and financial information for Sino-Forest suppliers and customers were created by Sino-Forest at the time of the SAFE investigation
- [113] The Respondents submit it was because of SAFE's monitoring and investigation that Sino-Forest obtained detailed information about the books and records of some of its suppliers and customers and why it was monitoring their bank accounts. Staff submits, however, Sino-Forest concocted this explanation for its "monitoring" of supplier bank accounts when it first came under scrutiny by SAFE and was forced to come up with an explanation for why it was controlling the bank accounts of its largest supplier, Yuda Wood. We consider this in our analysis of the allegations of Sino-Forest's undisclosed control of purportedly arm's length companies.

### **3. Company Registrations – SAIC Filings**

- [114] The regulatory body that oversees corporate filings is the State Administration for Industry and Commerce (or **SAIC**). Much of the evidence of the ownership, initial capitalization and officers of companies involved in these allegations has been provided in official SAIC filings.
- [115] Registration of a company requires filings with the SAIC and the SAIC requires yearly filings to renew business licenses.
- [116] According to Dr. Peerenboom, reliance on SAIC filings can be problematic because Mainland China's system of corporate filings, independent audits and imposition of taxes is still at an early stage of development. He noted in his expert report that discrepancies between information in SAIC filings and a company's books and records can be expected. Mr. Hyde, a former Sino-Forest director and Audit Committee Chair, testified the Independent Committee found the financial information disclosed in SAIC filings to be "wholly unreliable" (Hearing Transcript, November 7, 2014 at 183).

## **IV. SINO-FOREST'S BUSINESS MODELS: THE BVI MODEL AND THE WFOE MODEL**

- [117] Our analysis of Staff's allegations requires an explanation of the business models that Sino-Forest used as a means of operating as a foreign-owned forestry company in Mainland China. The company's operations in China were carried out through its two business models, the BVI Model and the WFOE Model, which we describe below. Sino-Forest conducted the vast majority of its business through the BVI Model during the Material Time.

### **A. The BVI Model**

- [118] The BVI Model was Sino-Forest's solution to challenges it faced operating in the context of Mainland Chinese government restrictions on foreign companies carrying on business in Mainland China. Under the BVI Model, Sino-Forest incorporated subsidiary companies in the British Virgin Islands to facilitate its purchase and sale of standing timber in Mainland China. The BVI Model also involved the use of "authorized intermediaries" (or AIs), purportedly arm's length companies that acted as sales agents in Mainland China for the Sino-Forest BVI subsidiaries, which could not directly carry on business in Mainland China.
- [119] The BVI subsidiaries could not hold bank accounts in Mainland China and therefore could not settle in cash their purchases and sales. They also could not bring in foreign currency for conversion to renminbi. Similarly, conversion from renminbi to foreign currency was limited. As a result, no cash flowed in or out of the Sino-Forest BVI subsidiaries within Mainland China. Instead, Sino-Forest created an off-book system of netting out its accounts receivable and

accounts payable such that Sino-Forest customers were instructed to make payments on behalf of Sino-Forest to its suppliers, rather than to Sino-Forest directly (the **AR/AP Set-Off Process**).

- [120] The AR/AP Set-Off Process created a continuous cycle of funds through the BVI Model: Sino-Forest BVI subsidiaries entered into purchase contracts with its suppliers and sales contracts with its customers, or AIs; payments due on the various purchase contracts were satisfied by directing AIs to make payments directly to suppliers; this in turn satisfied the customers' payment obligations pursuant to the sales contracts. This process continued quarter after quarter.
- [121] All revenue booked by the BVI subsidiaries from the sale of standing timber was used to purchase additional standing timber. Through this process, all the money recorded in the BVI Model remained in Mainland China, and was never held directly by Sino-Forest or any of its subsidiaries. In the BVI Model "[n]o proceeds are directly paid to the Company, either onshore or offshore" (*Second IC Report* at 51). Settlement of accounts receivable in the AR/AP Set-Off Process necessitated the continuous purchase of additional timber by Sino-Forest. The gap between the cost of timber and revenue from its sale meant Sino-Forest had to enter into additional purchase transactions with parties in Mainland China, funded by the settlement of its accounts receivable in the AR/AP Set-Off Process. As a result, all of Sino-Forest's reported profit in the BVI Model was trapped in Mainland China.
- [122] One consequence of the off-book nature of the AR/AP Set-Off Process was Sino-Forest's BVI subsidiaries did not deal directly with the tax liabilities that arose from standing timber sales. Instead, the AIs were responsible for remitting taxes to the Chinese tax authorities. However, Sino-Forest was not provided with any proof these taxes were ever paid by the AIs. To deal with the risk that Chinese tax authorities might seek to recover unpaid taxes from Sino-Forest, the company included an increasing tax liability provision in its Financial Statements. As of December 31, 2010, the amount of this accumulated provision was US \$156,941,000.
- [123] Internal Sino-Forest process documents for the AR/AP Set-Off Process describe customers' settlement of their accounts with Sino-Forest as being "payments directly" to suppliers from AIs. However, the Independent Committee investigation revealed the AR/AP Set-Off Process often involved multiple layers of payments, whereby third, fourth, fifth or sixth parties may have been involved in making payments to effect the settlement of Sino-Forest's accounts receivable and payable. The Independent Committee noted in the *Second IC Report* at page 53:
- ... some AIs visited stated that they may not in fact make payments themselves as instructed by SF [Sino-Forest] but would instead arrange for other parties ("fourth parties") to make payment on their behalf. Those fourth parties may then instruct "fifth" or "sixth" parties to make payment.
- In this situation, the Suppliers receiving payment will sometimes instruct its own "fourth" parties to receive payment on its behalf. ...
- [124] We heard throughout the hearing that similar set-off mechanisms involving third parties were commonly used to settle accounts in Mainland China, where the planned nature of the Chinese economy created cash flow difficulties. Mr. Murphy, an expert in Chinese business practices, testified liquidity problems in Mainland China often result in workarounds that allow companies to hold on to currency. He testified this can include a set-off process like the one employed by Sino-Forest BVIs. He further testified, although he had seen set-off arrangements involving additional parties, they were not common.
- [125] Notwithstanding the various parties involved, and the widespread cash flow difficulties experienced by companies in Mainland China, the payments made through the AR/AP Set-Off Process appeared to be remarkably efficient. Prior to the release of the Muddy Waters Report, Sino-Forest BVI subsidiaries had a perfect or near perfect collection record for their accounts receivable. Of the hundreds of millions of renminbi receivable in the BVI Model, Sino-Forest reportedly never experienced any significant collection issues. This changed dramatically after the Muddy Waters Report was released. Sino-Forest had significant difficulty in collecting accounts receivable. As of March 30, 2012, US \$887.4 million was still owed to Sino-Forest for standing timber sales in the BVI Model. Sino-Forest learned that many AIs, which owed money to Sino-Forest pursuant to sales contracts, had deregistered under Chinese law, and essentially ceased to exist.
- [126] Sino-Forest publicly disclosed its use of the AR/AP Set-Off Process as involving payments from customers to suppliers. However, what was not clear from Sino-Forest's disclosure was the reliance on additional third, or more, parties to settle accounts. Documents evidencing the multi-party flow of funds were not maintained by Sino-Forest or provided to its auditors. Mr. Clifford of E&Y testified this "daisy chain of cash" was absolutely inconsistent with his understanding of the AR/AP Set-Off Process at the time he was working for E&Y as auditor of Sino-Forest.
- [127] The Independent Committee was unable to confirm the actual movement of money within the AR/AP Set-Off Process:

The IC Advisors have received copies of the Set-off Documents related to all the BVI standing timber purchase transactions between the first fiscal quarter of 2006 and the first fiscal quarter of 2011. However, the IC Advisors have not been provided with any documents showing movement of money to confirm that such set-off arrangements have been carried out. During meetings of the IC Advisors with AIs and Suppliers, representatives from the AIs and Suppliers declined to produce such documents showing movements of money. ...

(Second IC Report at 53)

[128] Staff submits the BVI Model and its off-book settlement of accounts had the advantage of being opaque and malleable and notes that Sino-Forest was totally unable to substantiate its business in response to allegations in the Muddy Waters Report. Staff alleges Sino-Forest used the BVI Model to engage in a massive scheme to overstate its assets and revenue.

**B. The WFOE Model**

[129] In 2004, government restrictions on foreign ownership were relaxed and Sino-Forest was able to incorporate subsidiaries in Mainland China to conduct its standing timber business directly. Unlike the BVI subsidiaries, these Chinese subsidiaries, referred to as wholly foreign-owned enterprises (**WFOEs**), were able to hold bank accounts in Mainland China and bring in foreign currency from outside the country for conversion to renminbi (although still subject to strict government regulation). As a result, WFOE subsidiaries did not need to resort to the AR/AP Set-Off Process employed in the BVI Model as a means of purportedly paying suppliers and receiving payment from customers. Instead, WFOEs were able to pay suppliers and receive payment from customers directly. However, as noted elsewhere in these Reasons, some WFOE subsidiaries still employed the AR/AP Set-Off Process, notwithstanding their ability to deal directly with customers and suppliers in renminbi.

[130] Another advantage the WFOE Model had over the BVI Model was the ability to hold additional ownership rights for plantations in Mainland China. As discussed in more detail elsewhere in these Reasons, there are four rights associated with plantation ownership in Mainland China: (i) land ownership; (ii) land use rights; (iii) timber ownership; and (iv) timber use rights. These rights are separate and need not be held by the same entity. However, there are limitations on the kinds of entities that may own certain rights, and the ways in which Forestry Bureaus provide proof of ownership of these four rights by different entities. Because they could own not only the timber, but also the right to use the land on which the timber was growing, WFOEs had a distinct advantage over BVI subsidiaries. WFOE subsidiaries, which owned the land use rights, would be able to re-plant the land to grow standing timber after harvest.

[131] Proof of forestry rights ownership in Mainland China was generally provided through the issuance of PRCs by local Forestry Bureau offices. Forestry Bureaus would not generally issue PRCs in respect of a company’s timber ownership alone (*i.e.* where the company did not also own the land use rights, which BVIs could not do). However, we did see two examples of PRCs issued in situations where the land use and timber rights were separately owned.

[132] WFOE subsidiaries had another advantage over BVIs. Forestry Bureaus would issue PRCs to WFOE subsidiaries, but they were essentially impossible for Sino-Forest’s BVI subsidiaries to obtain. Instead, Sino-Forest’s BVI subsidiaries requested alternative evidence of their forestry rights ownership from Forestry Bureaus in the form of **Forestry Bureau Confirmations**, which are described in more detail elsewhere in these Reasons relating to allegations regarding deceitful documentation.

[133] Accounting in the BVI Model and the WFOE Model was conducted totally separately. For transactions in the WFOE Model, Sino-Forest used an accounting software program, Kingdee. The Kingdee program would not permit the booking of transactions that were backdated to a previous quarter. In addition, in WFOEs, accounting was done at the WFOE subsidiary level. In contrast, in the BVI Model, accounting was booked through Sino-Forest headquarters in Hong Kong, and was done using manual entry spreadsheets, which allowed backdating.

**C. Continued Use of the BVI Model and Sino-Forest’s “On-Shoring” Plan**

[134] Even after the relaxation of regulations on foreign-owned companies in 2004, Sino-Forest continued to conduct the vast majority of its standing timber business through the BVI Model. In the last four years for which Sino-Forest released audited financial statements, the distribution of Sino-Forest’s standing timber assets and revenue between the BVI Model and the WFOE Model was as follows:

Standing Timber Asset Holdings			Standing Timber Revenue		
BVI Model (US \$)	WFOE Model (US \$)	% in BVI Model	BVI Model (US \$)	WFOE Model (US \$)	% in BVI Model

**Reasons: Decisions, Orders and Rulings**

2007	1,088,556,000	85,597,000	92.71%	501,345,653,000	20,143,011,000	96.14%
2008	1,479,548,000	173,758,000	89.49%	644,900,557,000	40,503,807,000	94.09%
2009	1,901,983,000	281,506,000	87.11%	882,046,250,000	72,147,699,000	92.44%
2010	2,475,515,000	647,002,000	79.28% <sup>7</sup>	1,326,032,633,000	75,138,908,000	94.64%
Total				3,354,325,093,000	207,933,425,000	94.16%

- [135] From 2007 to 2010, Sino-Forest's recorded revenue from the BVI Model almost tripled and the balance sheet value of standing timber holdings in the BVI Model more than doubled. Growth rates in the WFOE Model were also substantial, but the proportion of Sino-Forest's business being done through WFOEs did not change significantly.
- [136] We heard evidence Sino-Forest had plans in 2009 and 2010 to shift from its reliance on the BVI Model to the WFOE Model through an "on-shoring" process. The on-shoring project was designed to reduce Sino-Forest's reliance on AIs, free-up the profits "trapped" in Mainland China that could only be used for reinvestment in additional standing timber, and contain the growth of the substantial tax exposure created in the BVI Model. E&Y had little comfort that the AIs were actually paying taxes on behalf of Sino-Forest, and encouraged Sino-Forest to move forward with the on-shoring initiative to cap and crystallize this liability. E&Y had been advising Sino-Forest to maintain the significant tax reserve, and as the company's profits increased, so too did the reserved amount. During the Material Time, the reserve increased from US \$39,106,000 as of December 31, 2006 to US \$156,941,000 as of December 31, 2010.
- [137] Sino-Forest's plan to on-shore assets held through the BVI Model had two elements. First, Sino-Forest would transact its new business through the WFOE Model going forward. As can be seen in the table above at paragraph [134] this did not happen. From 2005 onwards, the proportion of Sino-Forest's revenue recorded for its standing timber business done through the BVI Model remained well over 90%. Second, it would move assets acquired through the BVI Model into the WFOE Model – the on-shoring plan.
- [138] In 2008, 2009 and 2010, Sino-Forest was working with E&Y to devise its on-shoring plan. On-shoring the assets held in the BVI Model involved considerations that included determining and dealing with the amount owed to Chinese tax authorities; how and whether the standing timber rights held by a BVI company could be assigned or transferred to a WFOE; whether AIs would be required to intermediate the standing timber transaction; and foreign exchange regulatory implications.
- [139] Mr. Hyde, a member of the Sino-Forest Board, testified that the on-shoring project was extremely complex and required consultation with external tax and legal advisors. It was a priority for Sino-Forest and was the subject of significant discussions at meetings of Sino-Forest's Board of Directors and Audit Committee.
- [140] Sino-Forest was only able to complete four on-shoring transactions, in 2009 and 2010, in which assets held in the BVI Model were converted to cash and standing timber held in the WFOE Model. David Horsley testified the on-shoring process for these transactions "took some time" and involved costs for Sino-Forest including VAT and reduced Sino-Forest's profit margin for the assets involved (Hearing Transcript, November 26, 2014 at 32).
- [141] Sino-Forest management's efforts in the on-shoring process appear to have been minimal. E&Y was concerned about the slow progress on the on-shoring project. In an internal E&Y email from July 2010, a member of the audit team for Sino-Forest expressed the following concerns that needed to be addressed with management:
- onshoring work needs to be done and client needs to pay for us to help them do it even if they are in denial that they can do it themselves
  - the view that Sino can negotiate itself out of the "locked in profits" and "tax exposure issue" is not based on any actual evidence or supportable actions or testable.
- [142] Notwithstanding E&Y's concerns and suggested approaches to this problem, Allen Chan appeared to believe he could resolve some of the tax issues by personally negotiating a deal with his contacts in the Chinese government. An E&Y Internal Memorandum dated July 23, 2010 notes the difficulties E&Y had in dealing with Sino-Forest on the tax liability issues:

Back in 2007, client said they wanted to fix/cap the BVI tax exposure. We assisted in this exercise but on the client side, there was always a business or technical problem whereby the particular

<sup>7</sup> This percentage reflects the acquisition of Mandra, a WFOE, in the first quarter of 2010. Excluding Mandra, this percentage for 2010 was 84%.

plan was not desirable [it seemed very much that there were just too many challenges and issues such that none of the options we proposed would work]. Since then, they have made very little progress on this matter and the plantation's book value has gone from approximately \$1 billion to \$1.9 billion at March 31, 2010. They have last year transacted a few "onshoring" transactions where the BVI sold the timber to an AI that onsold the timber to Sino WFOE's for a small mark-up and thereafter the Sino WFOE's sold the timber resulting in taxable earnings for Sino WFOE's (much of taxable earning was offset by losses). However, there were technical challenges associated with the onshoring transactions as well as VAT costs because of the unwillingness of intermediary AI to issue VAT invoices, which has caused them to keep the amounts small. Except for these onshoring transactions, as to their "little progress" it seems they do not have much interest in dealing with challenges [tax or other] to fix or cap the issue. Not sure if the reason is because there may be a cash tax cost (highly likely reason given the VAT and income tax costs) to fix or some other reason.

- [143] The same Internal Memorandum notes Allen Chan continued to disagree with E&Y's concerns about payment of the outstanding tax liability. It reports Chan expressed the position "he has government connections and can cut a deal". E&Y expressed concern they had "not yet seen any evidence of his ability to cut a tax deal to clean up the BVI tax issue even after having been willing to sit down and work with him to get to that result" and that management based its position on a "gut feel" they could cut a deal on stated terms.
- [144] The witnesses from E&Y confirmed Sino-Forest's on-shoring project never really got off the ground. Mr. Clifford testified Chan was resistant to E&Y's solution. Chan rejected the approach suggested by E&Y and Mr. Clifford was unaware of any efforts by Sino-Forest to approach tax authorities. As of the first quarter of 2011, the Sino-Forest Board was continuing to consider alternative means for achieving its goal of on-shoring assets to the WFOE Model.
- [145] Staff suggests the explanation for the lack of progress on the on-shoring project is simple – Sino-Forest could not onshore assets that did not exist.
- [146] While the on-shoring exercise was complicated, Sino-Forest could have directed new purchases of standing timber (and land use rights) to WFOE subsidiaries beginning in 2004, rather than continuing to use the BVI Model. Senior management made the conscious decision not to, despite the advantages of the WFOE Model.

## **V. ALLEN CHAN'S ROLE AT SINO-FOREST**

- [147] Allen Chan was born, educated and resided in Hong Kong. His first language is Cantonese. He obtained an undergraduate degree in sociology. In 1992, Allen Chan co-founded Sino-Forest, together with K.K. Poon, who had worked for 15 years as an engineer with the Guangdong Province Forestry Bureau where he engaged in trading and manufacturing of forestry products, and Leslie Chan, Chan's former wife. Prior to founding Sino-Forest, Chan worked in project financing and as a management consultant, and had over 12 years of experience structuring joint ventures in China across industries such as hospitality, healthcare, oil and gas, real estate and manufacturing.
- [148] Messrs. Ardell, Hyde, Horsley, Ip and Hung testified Chan had extensive relationships with various levels of government including at the local and central levels. In 2007, Chan was appointed as Executive Council Member of Renmin University of China (the People's University of China) for a three-year term. In 2007, Chan was invited to be a member of the Chinese People's Political Consultative Conference. In 2009 and again in 2012, Chan was awarded by the China National Forestry Industry Association with Forestry Person of the Year Award. In December 2010, Chan was appointed as a Vice President of the China National Forestry Industry Federation. In 2011, he was presented with the Outstanding Achievement Award from China National Forestry Industry Federation.

## **A. Testimony of Thomas Maradin**

- [149] Thomas Maradin described Chan as having ultimate decision-making power at Sino-Forest:

A. My – from my perspective, I looked at it, especially from a Chinese culture, that the person at the top has power, more power in my mind than a North American perspective, so Allen –

Q. As CEO you mean?

A. Yes. Yes.

Q. Continue, please.



A. And power from a standpoint of decision-making, power from a perspective of people below respecting his position. And so from my standpoint, you know, there's a great deal of respect in that culture to that position and the authority that he has.

(Hearing Transcript, October 29, 2014 at 115:12-24)

[150] Mr. Maradin testified Chan's decision-making power extended to the selection of members of Sino-Forest's Disclosure Committee:

Q. And how was it determined who would be on this Disclosure Committee? Who was the selector of the team?

A. I guess ultimately I sought Allen's approval in terms of the people on the Committee. I certainly gave him the advice as far as the functional areas, but Allen was let's say the approver or acknowledger of committee members.

(Hearing Transcript, October 29, 2014 at 139:19-140:1)

[151] Mr. Maradin confirmed Chan acted as the ultimate and compensating control over Sino-Forest's contracts. He prepared a report, edited by Horsley, to the Audit Committee dated March 15, 2009, which summarized progress on remediating internal control deficiencies (the **March 15 Report**). The March 15 Report indicated:

My report highlights the individual process, description of deficiency, applicable business unit, and individual evaluation and remediation points. In a number of cases you will note that a deficiency exists ("no evidence", "no formal written policy", "no formal pre-approval") as there is no formal documented evidence although the control does take place in a verbal exchange. In these cases, our remediation will involve documenting the exercise of the control process. Ultimately, notwithstanding the lack of evidence of the control through the process, **the ultimate and compensating control is the CEO's signature on the final transaction be it purchase or sale of standing timber, transfer of funds or payment for goods/services.**

[emphasis added]

[152] The March 15 Report is incorrect in one respect. In practice, Chan did not sign purchase contracts. Chan pre-approved all purchases and signed all sales contracts. K.K. Poon signed purchase contracts until the second quarter of 2010, and Ip signed them thereafter.

[153] When questioned about the March 15 Report, Mr. Maradin testified:

... a year before this I remember having conversations with Fred [Clifford of Ernst & Young] about an ultimate control in terms of Allen reviewing and signing off on things, and so this is an accurate statement. And at the time, thinking, okay, Allen is reviewing these documents, receiving his authorization, so it is a compensating control. It doesn't eliminate the deficiency, but it's a strong evidence that somebody independent is signing the contracts.

(Hearing Transcript, October 29, 2014 at 154:4-12)

For further clarity, Mr. Maradin confirmed that the ultimate and compensating control "would be Allen Chan's signature" (Hearing Transcript, October 30, 2014 at 77:23-24).

## B. Testimony of William Ardell

[154] Mr. Ardell described Chan as the visionary and leader behind Sino-Forest:

... Mr. Chan was I think at that stage 57 years of age, he was a very key individual in the organization, and certainly, from what I saw or was aware of, there was not a backup plan for a company the size of Sino-Forest.

Q. And when you say he was a key individual in the company, what did you mean by that?

A. He was the visionary, he was the leader to the organization within, to the people within his organization, and as I understood it, he was the key man contact within the forestry industry in China.

(Hearing Transcript, November 19, 2014 at 136:4-14)

**C. Testimony of James Hyde**

[155] Mr. Hyde testified Chan attended meetings of the Audit Committee, and it was important to have Chan attend so he could answer questions the Audit Committee had on topics such as operations and company strategy. Chan was able to explain in broader detail some of the analysis that was being presented.

[156] Mr. Hyde viewed Chan as the person in management responsible for oversight of Sino-Forest's BVI Model (the focus of Staff's Standing Timber Fraud Allegations, described in more detail elsewhere in these Reasons):

Q. ... So, first, if I could just ask, what was your understanding at the time that you were a member of the Audit Committee in terms of which members of management had which respective responsibilities over that structure?

A. In line management I'm not sure who all the various people were. We, quite frankly, looked to Mr. Chan as the overall person. Tends to be a very senior-dominated team, and people look to the senior executive as the person. He was involved and told us he was involved in many of the activities and transactions that were going on.

(Hearing Transcript, November 5, 2014 at 35:4-15)

[157] Mr. Hyde also testified:

Q. And between Mr. Horsley and Mr. Chan, who had more of an involvement in the operations of the company?

A. Mr. Chan definitely in the day-to-day operations of the business.

(Hearing Transcript, November 5, 2014 at 101:16-20)

[158] Mr. Hyde also testified Chan was the compensating control with respect to the identified internal control weakness of a lack of segregation of duties:

... we were told there was a compensating control that Mr. Chan reviewed all the settlement agreements and he signed many of the – well, I think he signed the purchase agreements and the sale agreements, and that was a compensating control in the whole process.

(Hearing Transcript, November 5, 2014 at 102:18-23)

[159] Mr. Hyde testified although there were others involved, including Ip, Chan was signing the agreements and reviewing Hung's work with respect to accounts receivable and accounts payable settlements. He testified this was viewed as a compensating control.

[160] Mr. Hyde confirmed the Audit Committee took steps outside its regular, quarterly meetings to address the fact that the lack of segregation of duties was still an internal control weakness, which had not been resolved since 2007. Both Mr. Martin and Mr. Ardell, in their consecutive roles as Lead Director, approached Chan about this. When questioned why the Lead Director approached Chan about the remediation of this internal control weakness, Mr. Hyde testified:

Mr. Chan, as the chairman and chief executive officer, most senior person, that it was important to set the tone at the top. He was our most senior executive, and it was important to have – for him to set the tone that this was important that the staff/management address these issues, and it was important to him, and he wanted to see them resolved, that this needed attention.

(Hearing Transcript, November 5, 2014 at 108:8-15)

**D. Testimony of David Horsley**

[161] David Horsley testified if he wanted answers about Sino-Forest's vision moving forward, he would turn directly to Allen Chan. He described Chan's perceived strength as leader of Sino-Forest as follows:

Mr. Chan's, I would say, main strength was his – his, um, view of the future of where the company would go, where China was going, of how we need to align the business with opportunities that were arising in China. He was the strategic driver of the business, where we would go, what provinces to buy trees. So he was the strategic driver.

(Hearing Transcript, November 21, 2014 at 60:3-10)

[162] Horsley testified Chan's involvement in the operations of Sino-Forest included approval of details in the budget planning process and negotiations of terms of purchase and sales agreements.

[163] Like others, Horsley confirmed Chan was Sino-Forest's ultimate and compensating control:

Q. And why did you feel that that was the ultimate in compensating control?

A. It was certainly something that had been discussed at audit committees, the fact that Allen would – Allen Chan would be the final signator on those types of documents, and so it was a compensating control. You know, it talks about no evidence, no formal written policy, so if things are being done but aren't being documented, then there's a chance that somebody incurred an expense for something, they didn't get approval before they did it. Ultimately, Allen Chan signing the cheque for payment for goods and services was a compensating control to ensure that it was a legitimate expense of the company.

(Hearing Transcript, November 25, 2014 at 126:25-127:14)

[164] Horsley revised the March 15 Report prepared by Mr. Maradin to include the statement "the ultimate and compensating control is the CEO's signature on the final transaction be it purchase or sale of standing timber, transfer of funds or payment for goods/services". As noted previously, Chan signed only the sales contracts but pre-approved all purchases and sales.

**E. Testimony of Judson Martin**

[165] Mr. Martin testified his initial impression of Chan's role within Sino-Forest was that he was a statesman, strategic planner, visionary, driver and entrepreneur. Martin also testified Chan's practical contribution to Sino-Forest was his intelligence, experience, and great relationships and connections in China.

[166] Mr. Martin testified Chan's role with respect to the implementation of disclosure requirements under NI 52-109 was to provide the tone at the top. He further testified Chan was a very strong and respected leader who had very close relationships with the people who reported to him. Mr. Martin testified as a member of the Board, he placed a deep reliance on senior management, including the CEO, and would have a high degree of trust in, and respect for, senior management. Martin further testified without this trust, either he would not be on the board, or the person in the role of CEO would not be CEO.

**F. Testimony of Fred Clifford**

[167] Mr. Clifford testified that close to the end of the audit cycle, in March 2011, he met with Chan to ask how Chan got comfortable with the fraud risk at Sino-Forest. An internal E&Y memo prepared by Clifford in March 2011 described how Sino-Forest addressed its fraud risk. Chan indicated to Mr. Clifford that, in managing fraud risk, he was seeing all the contracts (both purchase and sale), signing off on all contracts, deciding which entity would acquire the standing timber, signing cheques, and seeing transaction by transaction. The internal E&Y memo notes "Allen [Chan] is very involved in the day to day operations. He reviews cheques and key transactions as they occur. He also has an intimate knowledge of the business and would be able to spot anomalies as they occur". Mr. Clifford testified Chan had "a great degree of visibility around what the company was doing at any moment in time", and Chan took "great comfort from the fact that he was seeing these transactions one by one and could spot something that was an anomaly" (Hearing Transcript, November 17, 2014 at 61:1-5).

[168] Mr. Clifford also testified Chan talked about Albert Zhao, who was responsible for operations in the Sino-Wood group of companies and was responsible for BVI standing timber sales, and Albert Ip who was responsible for operations in the Sino-Panel Group and BVI standing timber purchases, and that Chan would play them off against each other:

He also talked about the two Alberts, being Albert Zhao and Albert Ip, running two large, you know, pieces of the business, and he would, I think, for lack of a better word, perhaps play them off against each other and compare and contrast what was happening between those two senior executives to see if there was something that, quite frankly, looked odd to him, that stood out as being an anomaly. He thought that, by doing that, he would identify areas where things were happening that could be fraudulent.

(Hearing Transcript, November 17, 2014 at 58:22-59:6)

Mr. Clifford explained further, “He just was very comfortable that by comparing and contrasting those two operations, he could see anomalies and those anomalies he would follow up on.” (Hearing Transcript, November 17, 2014 at 59:11-14).

[169] Mr. Clifford testified Chan was the common denominator in all purchase and sales transactions – he was in the middle. E&Y was well aware of how involved Chan was in the day-to-day operations of Sino-Forest.

[170] Mr. Clifford also testified that Chan represented to E&Y he had extensive relationships at the local and central government levels and in the business community. Chan took great comfort that if something was happening within Sino-Forest of which he was unaware, someone from outside the organization would inform him.

[171] Mr. Clifford also testified Chan was resistant to E&Y’s solution regarding the on-shoring project (moving assets from the BVI Model to the WFOE Model to address problems associated with a substantial and growing tax liability). Mr. Clifford testified one suggestion from E&Y was for Chan to seek a settlement with the tax authorities and crystallize the potential tax liability Sino-Forest was exposed to as a result of transacting through the BVI Model (which, by 2010, was US \$156.9 million). However, Chan rejected that approach and Clifford was unaware of any efforts by Sino-Forest to approach tax authorities.

[172] In a separate proceeding, E&Y settled allegations brought by Staff regarding the audits of Sino-Forest without admitting or denying the facts or conclusions of Staff.

#### **G. Testimony of Dr. Randall Peerenboom**

[173] Chan called Dr. Randall Peerenboom as an expert witness in Chinese law and cultural and business practices in China within a comparative and global context.

[174] On March 31, 2015, Dr. Peerenboom was asked:

Q. And just talking for a minute about Mr. Chan, I want to ask you about the role of CEO and senior management in a Chinese company. So in your experience, how would you characterize the relationship between the CEO and their senior management in the company with operations in China?

A. Well, in Chinese companies it’s definitely the case that the CEO is the boss, the big boss. And so if they’re at a negotiation, for example, maybe the senior management would be discussing a lot of the detailed issues, but when it came time to the final decision-making to decide what to do with the basket of issues that’s always left over at the end of a negotiation, that would be when the CEO or the boss steps in and decides those issues.

In terms of the operational issues, it varies to some extent, depending upon whether the manager is a more hands-on or hands-off manager, but it certainly would be the case that the underlings would only operate within the parameters set by the boss. They would know that they’re not authorized to directly violate the parameters set by the boss.

(Hearing Transcript, March 31, 2015 at 151:6-25, 152:1-2)

[175] Dr. Peerenboom also testified on the significance of relationships with government in doing business in China. Dr. Peerenboom testified Chan’s participation with the Chinese National Forestry Industry Federation would be of benefit to Sino-Forest. He explained associations like this are private or semi-private business associations often with close relationships or ties to the government.

#### **H. Evidence of Ip and Hung**

[176] Both Ip and Hung testified Chan was closely involved in the review and approval of each purchase and sale of standing timber by Sino-Forest. They reported directly to Chan.

[177] Ip and Hung testified about Chan’s role as “ultimate and compensating control” as described in the March 15 Report. Ip agreed Chan carefully reviewed every purchase and sale of standing timber and any transfer of funds or payments for goods and services brought to him. Hung testified Chan signed every BVI standing timber sales contract and pre-approved every purchase of standing timber in the BVI Model.

[178] Hung testified he never had any signing authority and that even instructions to a bank, including transfers, required the signature of Chan and one of K.K. Poon, Ip, Albert Zhao or Chen Hua (responsible for finance at Sino-Wood). Hung

also testified Chan knew he was directing AIs to pay sizeable amounts of renminbi to suppliers without a written purchase contract between the supplier and Sino-Forest.

- [179] Ip testified Chan told him the locations of the forest purchases should be kept secret. As a result, purchase contracts were vaguely worded and did not indicate specific plantation locations. Ip testified the descriptions of locations were general in order to keep them a secret from Sino-Forest employees, competitors, and suppliers. Ip also testified Chan would determine which of 28 Sino-Forest subsidiaries was going to purchase the standing timber in the BVI Model.
- [180] Ip testified he attended weekly Monday morning senior management meetings led by Chan (**Monday Morning Meetings**). Ip agreed it was a constant that Chan was always at the Monday Morning Meetings, which also included Xu Ni (Sino-Forest's Vice-President of Legal Affairs), and sometimes Ho and Alvin Lim (Sino-Forest's Financial Controller). Monday Morning Meetings were mainly to discuss Sino-Forest's strategy and development, and to update Chan and the team on the progress of operations. Hung did not regularly attend these meetings but would attend when requested and would be at meetings when quarterly budgets were discussed. The Monday Morning Meetings were held in Hong Kong or Guangzhou throughout the Material Time and were conducted in Cantonese. Horsley and Maradin did not attend. Chan was provided with oral updates that included detailed information about the progress of Sino-Forest's forestry business in China.
- [181] Ip confirmed there was no documentation or written records of the Monday Morning Meetings. Ip testified the purpose was to update on the work done the previous week and discuss Sino-Forest's development plan and plan for the forthcoming weeks. Ip testified Chan had a macro view of things, was focused on the rate of return, market prices, profits and losses. Ip and others were focused on whether the trees were available and easy to harvest. Ip agreed Chan was the ultimate decision-maker with respect to the entire business of Sino-Forest. Ip testified in the BVI Model Chan would approve a quarterly budget for the purchase of timber, pre-approve the purchases, sign sales contracts and approve every plantation purchase acquisition form.
- [182] Ip confirmed Chan would review the profit margin to make a final decision on the sales transaction. Ip testified Chan was the last person to sign each sales contract. Ip confirmed Chan signed the approval for the purchases which preceded the actual purchase contract.
- [183] Ip testified he had signing authority under HK \$1,000,000 and went to Chan for approval of larger expenditures. Hung stated he never had any signing authority and even instructions to a bank required a signature from Chan and one of four other senior employees, which included Ip.
- [184] Hung testified he determined the sales budget by reviewing a spreadsheet of BVI standing timber holdings which he maintained. This spreadsheet included information about the area, volume, location, purchase price and year of planting. Hung testified he would discuss plantations with Chan and Albert Zhao, and Chan would tell Hung what the expected revenue would be.
- [185] Hung agreed Chan would know about any changes to purchase contracts because in order to make the purchase, Hung would need to obtain a new purchase requisition form which required Chan's approval.
- [186] Hung also testified the concept of Master Framework Agreement (**MFA**) came from Chan and Chan explained the concept as locking in a supplier who would either provide standing timber directly or get other suppliers to sell Sino-Forest the standing timber.
- [187] Hung confirmed, before a BVI sales contract was sent to a customer for signature, he would forward the contract to Albert Zhao for review and would also obtain an oral approval from Chan on each sales transaction. Hung confirmed Chan was the last person to sign every sales contract.

#### I. Conclusion

- [188] Chan's written submissions open with four statements:
1. Mr. Chan's conduct must be assessed by reference to a reasonably competent Chief Executive Officer acting in similar circumstances at the time. His conduct cannot be measured to a standard of perfection.
- [189] We agree Chan's conduct cannot be measured to a standard of perfection. As will be made clear in these Reasons, Chan's conduct does not meet the standard of a reasonably competent Chief Executive Officer acting in similar circumstances at the time. Notwithstanding the board of directors, Chan was the driver steering Sino-Forest's business.

2. As Chief Executive Officer of Sino-Forest, it was not Mr. Chan's job to be in the business so much as it was to be working on the business: its purpose, its direction, its strategy and its goals.

[190] We disagree. We find Chan was in the business. In addition to deciding its purpose, its direction, its strategy and its goals, he was also deeply involved in the day-to-day operations of Sino-Forest.

3. His conduct must be considered in the unique circumstances of this case. Sino-Forest business operations were located in mainland China which is a significantly different business and cultural environment than Ontario. Because Sino-Forest was engaged in the resource sector, it was particularly difficult, if not impossible, for it to divorce itself from this environment and simply impose North American business standards.

[191] We disagree. No matter what business Sino-Forest was engaged in, it was Chan's responsibility to ensure that Sino-Forest complied with Province of Ontario securities legislation as set out in the Ontario *Securities Act*.

4. Mr. Chan was born, raised and educated in Hong Kong. He had no prior financial, accounting, risk, capital markets/M&A or public company/corporate governance education, skills, or experience. He surrounded himself with North American experts to ensure that the public disclosure complied with Ontario securities law. He reported to a highly qualified board of directors who were experts in North American public company governance requirements. The Sino-Forest Board of Directors had a very experienced Lead Director who acted as the liaison between Mr. Chan and the rest of management and the Board. There is no evidence that the Board was unhappy with Mr. Chan's performance.

[192] We agree there is no evidence the Board was unhappy with Chan's performance prior to June 2, 2011. Mr. Ardell, Lead Director and Chair of the Independent Committee, testified his belief in Allen Chan changed as events unfolded following the Muddy Waters Report.

[193] Chan's role in the alleged frauds is discussed in more detail elsewhere in these Reasons.

## VI. ANALYSIS OF THE STANDING TIMBER FRAUD ALLEGATIONS

### A. The Standing Timber Fraud Allegations

[194] In the Standing Timber Fraud Allegations, Staff alleges the Respondents engaged in deceitful and dishonest courses of conduct that resulted in the fraudulent overstatement of assets and revenue derived from the purchase and sale of standing timber, putting the pecuniary interests of Investors at risk contrary to Ontario securities law and contrary to the public interest. Staff alleges three elements of the standing timber fraud, each of which Staff alleges constitute fraud:

- a. undisclosed control of companies purportedly at arm's length to Sino-Forest;
- b. a deceitful documentation process; and
- c. internal control weaknesses or failures.

Staff cites four examples of alleged fraud: (i) the Dacheng Transactions; (ii) the 450 Transactions; (iii) the Gengma #1 Transactions; and (iv) the Gengma #2 Transactions.

[195] Staff alleges differing involvement by the Respondents in each of the three elements of the standing timber fraud and the four fraud examples. We review the three elements and four alleged fraud examples, in turn, and consider the Respondents' individual involvement in each.

[196] Staff asks us to find each of the Respondents breached subsection 126.1(b) of the *Securities Act* as a result of their involvement in the Standing Timber Fraud Allegations, and that Chan, Ip, Hung, Ho and Yeung, in any case, authorized, permitted or acquiesced in Sino-Forest's breach of subsection 126.1(b) of the *Securities Act*.

**B. Undisclosed Control Allegations**

**1. Positions of the Parties**

**(a) Staff**

[197] The first of the three alleged elements of what Staff has termed the Standing Timber Fraud is Sino-Forest's undisclosed control of purportedly unrelated companies.

[198] Staff alleges Sino-Forest established a network of counterparties (suppliers and AIs, or customers) that were controlled on its behalf by various nominees. If true, this control or influence would call into question whether the transactions with these suppliers and AIs were carried out at arm's length and therefore recorded at fair value and, more basically, if the transactions actually occurred. The result of this would be that Investors could not rely on the revenue and assets reported on the financial statements because the true economic substance of the underlying transactions recorded with these companies would be misstated and the disclosure would be misleading.

[199] Staff submits Sino-Forest's control of, or influence over, certain parties was not disclosed to Investors. Staff alleges Sino-Forest established a network of nominee and peripheral companies involved in buying and selling standing timber in the BVI Model.

[200] Staff specifically submits Sino-Forest had undisclosed control over:

- Huaihua City Yuda Wood Co., Ltd. (**Yuda Wood**);
- Guangxi Hezhou City Kun'an Forestry Co., Ltd. (**Kun'an**);
- Guangxi Rongshui Taiyuan Wood Co. (**Taiyuan**);
- Dongkou Shuanglian Wood Co., Ltd. (**Dongkou**); and
- Dao County Juncheng Forestry Development Co., Ltd. (**Juncheng**).

[201] Staff submits the following were related parties:

- Yunnan Shun'xuan Forestry Co., Ltd. (**Shun'xuan**);
- Guangxi Dacheng Timber Co., Ltd. (**Dacheng**);
- Guangxi Hezhou City Yuangao Forestry Development Co., Ltd. (**Yuangao**); and
- Guangxi Rongshui Meishan Wood Products Factory (**Meishan**).<sup>8</sup>

[202] Staff refers to these and other companies that were counterparties to transactions carried out using Sino-Forest's BVI Model as the BVI Network. Some of the companies in the "BVI Network" were suppliers or customers in the WFOE Model. Some of these companies are involved in the four examples of allegedly fraudulent transactions: the Dacheng Transactions, the 450 Transactions, the Gengma #1 Transactions and the Gengma #2 Transactions (discussed below).

[203] In particular, Staff alleges Sino-Forest dishonestly failed to disclose the true nature of its relationship with two key companies in the BVI Network, Yuda Wood and Dongkou.

[204] A central player, whose involvement in many of these companies is interwoven, is Huang Ran, who will be discussed below.

**(b) Respondents**

[205] The Respondents submit Staff has failed to provide evidence to explain why the concept of control or influence over customers or suppliers matters. They submit the issue with respect to the BVI Network of companies is not control, but

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<sup>8</sup> These companies and others involved in this matter were Chinese companies that do not have official English company names. Different English translations have been provided for a number of these companies. For instance, the words "timber," "forestry," and "wood" have variously been provided as translations for the same Chinese character, and translations variously omit or include location information in the title of a company name such as the city, county or province in which it is located.

value: if Sino-Forest were transacting with parties it controlled, this would raise questions about whether its purchases and sales were recorded at fair market value.

- [206] The Respondents submit, while Staff did not introduce any expert valuation evidence, Staff is instead asking the Panel to draw adverse inferences of control and value based on circumstantial evidence that is quite remote from any concept of valuation.
- [207] The Respondents submit E&Y, which reviewed every contract in the BVI Model, in its audits never raised any concerns about the volume of purchases from a particular supplier, or its economic dependence on Sino-Forest. In addition, they note the Independent Committee made no conclusions that Sino-Forest controlled Yuda Wood, or any other company that is the subject of these allegations, but noted the Independent Committee was unable to “independently verify” that Sino-Forest’s relationship with Yuda Wood was at arm’s length, without articulating what sort of independent verification was required.
- [208] The Respondents contend the record supports the proposition that contracts of purchase and sale were conducted at fair value and that Sino-Forest did not exercise control over Yuda Wood or other suppliers.
- [209] The Respondents stress “context is king” and submit the effect of Sino-Forest’s cooperation with its suppliers should be assessed within the context of Chinese business practices, rather than North American practices. Further, the Respondents contest certain literal translations of Chinese idiomatic expressions (notably, *wai wei gong si*, variously translated as “peripheral”, “cooperative”, “outside” or “external” companies) that Staff is asking the Panel to accept. The Respondents submit those translations provide no insight into the actual meaning of the words or expressions.
- [210] Chan further submits there is no evidence he had any knowledge of these companies’ alleged control by, or relation to, Sino-Forest.

## 2. Differences in Translation of Various Terms

- [211] There has been much debate between Staff and the Respondents whether certain Chinese terms have been translated accurately. Many of the documents in evidence in this hearing were originally drafted in Chinese and have been translated into English. The Respondents and Staff have offered various versions of, and expert evidence on, translations of terms. The fact that literal translation versus idiomatic translation from the original Chinese may result in different interpretations adds to the complexity of understanding the evidence in this case.
- [212] For example, the Respondents submit the Chinese characters romanized as *guanli ren*, translated in some documentary evidence as “manager,” do not refer to someone acting as a business manager, within the common North American meaning of the term. Rather, they submit the more appropriate translation would be someone who takes care of something, as an intermediary or problem solver. They submit another Chinese term would have been used to indicate someone holding the kind of management function of an executive within a company.
- [213] Another term, translated as “follower”, was also used on company tables that included references to Huang Ran, Li Hua and Gao Fajun (all of whom are involved in companies named in the allegations of undisclosed control). The Respondents submit a contextual interpretation indicates these people were being referred to as intermediaries.
- [214] One frequently contested translation was that of the Chinese characters romanized as *wai wei gong si*. Staff submits the translation of this term as “peripheral company” provided in evidence is correct. The Respondents refer to the evidence of Dr. Robin Huang who was qualified to provide expert evidence in the four Chinese characters romanized as *wai wei gong si*. He agreed that the four Chinese characters could be translated as “peripheral companies” but stated that this term did not convey in English the Chinese meaning. Instead, Dr. Huang stated the term referred to an important business partner in a group of corporate entities, one that is arm’s length to other corporate entities in that group. In cross-examination, Dr. Huang agreed with Staff that in order to determine the full flavour of the term *wai wei gong si*, you would need to look at the context in which it is used, and different people might have different views on the meaning of *wai wei gong si*, depending on the context. The Respondents submit, although “peripheral company” may be a literal translation of the characters, the more appropriate translation, which was provided in at least one instance by a third party translation service, is “outside company”, a reference to companies independent of Sino-Forest, but with which it did business on a regular basis.
- [215] The Respondents submit “cooperative companies” refers not to collusion but, as Ho described in his affidavit, to those companies with which Sino-Forest did business and entered into transactions. Ho was referring to a document (originally in Chinese) entitled “List of Funds that Co-operative Companies Received from Sino and that are not Easy to Explain”. He stated that “not easy to explain” referred to those transactions that are likely to attract closer attention from the Chinese regulatory organization SAFE. Included in this document were transactions between Sino-Forest subsidiaries and the following companies:



- Kun'an (which the Panel finds below was related to Sino-Forest),
- Taiyuan (which the Panel finds was controlled by Sino-Forest),
- Meishan (which the Panel finds was related to Sino-Forest),
- Yuangao (which the Panel finds was related to Sino-Forest), and
- Yongzhou City Maoxiang Forestry Development Co. Ltd. (which played a prominent role in the alleged fraud relating to the 450 Transactions).

Moreover, there was one entry in this document referring to a transfer of funds between Taiyuan and Kun'an, and another entry between Kun'an and Guangxi Chihui Forestry Co., Ltd. Guangxi Chihui Forestry Co. Ltd. was 80% owned by Huang Ran, who the Panel finds below was Sino-Forest's nominee in order to control and influence other companies. These three companies were purportedly third party, arm's length suppliers independent of Sino-Forest, according to the Respondents, but details of transactions between them are found on an internal Sino-Forest document.

- [216] Given the extensive connections between these companies and Sino-Forest, as described in greater detail below, we do not accept Ho's explanation that these are companies with which Sino-Forest simply did business and entered into transactions. Having considered the context in which the term "co-operative" is used, the Panel accepts Staff's submission that the term "co-operative companies" refers to companies that are either acting as nominees for Sino-Forest or working in collusion with them.
- [217] We agree with the Respondents that when dealing with the fundamental issue of control, it is tenuous to rely on translations that may have several different meanings, such as manager, follower or co-operative. We have relied on extensive evidence and testimony on which to base our findings. Rather than interpreting a word in isolation, we adopt the approach that "context is key". The meaning of a term is best understood by looking at the context in which it is used.
- [218] We had multiple versions of emails in email chains in evidence where the translations of specific words or phrases differed. However, the meaning of the message in the various English versions of the document was consistent. We generally have confidence in the quality of translations, despite the few disputes raised by the parties. There were over 900 exhibits in evidence that were originally in Chinese. These documents varied in length, but many were multiple pages.
- [219] In conclusion, the Panel has not interpreted single words in isolation during the hearing, nor in our decision. We have looked at the context and at the numerous examples when each term is used in various emails in order to draw any conclusion as to the appropriate translation in the circumstances.

### **3. Independent Committee Investigation into Suppliers and AIs**

- [220] The Independent Committee advisors visited AIs and suppliers in order to confirm transactions, access source documents to link AI recorded payments to suppliers to Sino-Forest recorded revenue, and to confirm actual cash flows from AIs with suppliers to corroborate the set-off process (*i.e.* Sino-Forest's system of setting-off accounts payable with accounts receivable, described elsewhere in these Reasons). The advisors wanted to obtain independent third party verification of ownership and transactions. As with the Forestry Bureau visits, these interviews were arranged and attended by management.
- [221] Mr. Hyde testified the results of the interviews with AIs and suppliers were described as "mediocre at best" (Hearing Transcript, November 6, 2014 at 77:5). It had been very difficult to obtain interviews; management took more than two months to disclose basic details, did not provide complete names of contacts required for comprehensive analysis, or did not provide Chinese names. Because of cultural differences, it was very difficult to get past the "pleasantries and tea" (Hearing Transcript, November 6, 2014 at 77). The advisors had difficulty getting a complete list of AIs, suppliers and their contact information from management, specifically Ip. The advisors requested documentation from management, the AIs and the suppliers that would support the transactions that Sino-Forest had reported, which they did not receive.
- [222] In the *Second IC Report*, the Independent Committee stated management also did not disclose all the relationships between Sino-Forest and suppliers and AIs, nor between Sino-Forest employees and suppliers and AIs, nor among the suppliers and AIs. Many suppliers alluded to the use of nominees; as such, the true beneficial ownership of suppliers may not have been disclosed in corporate filings. The advisors selected nine suppliers to interview; four were interviewed. When interviews took place with the principal of Sino-Forest's largest supplier during the Material Time,

Yuda Wood, the advisors were told by management and Sino-Forest's Canadian counsel not to take any notes or ask any questions as a condition of participation.

#### 4. Sino-Forest's Relationships with Companies in the BVI Network

##### (a) *Did Sino-Forest have Undisclosed Control Over Companies in the BVI Network?*

###### i. *Yuda Wood*

[223] Yuda Wood was the largest supplier to Sino-Forest's BVIs from 2007 to 2010, with total transaction value of RMB 4,561,599,313 (US \$657,789,586), or more than 20% of total BVI transaction value during that period.

###### *Creation of Yuda Wood*

[224] Yuda Wood was 100% owned by Hong Kong Sonic Jita (**HK Sonic Jita**). HK Sonic Jita was incorporated on July 15, 1993 as Combine (Far East) Limited, and changed its name to Sonic Jita Engineering on August 1, 1997. From July 15, 1993 to March 10, 1997, ADS Capital Limited Corp., Kai Kit (K.K.) Poon, and Danny Wu Wai Leung each owned one-third of Combine (Far East) Limited. ADS Capital Limited Corp. was a company owned by Chan, a company owned by Chan's mother and another company owned by Chan's best friend, Alex Chau Chi Piu. Chan was a director of HK Sonic Jita (named at this time Combine (Far East) Limited) and CEO of Sino-Forest during this time. Both Chan and K.K. Poon were co-founders of Sino-Forest in 1992 and directors since 1994. K.K. Poon was also President of Sino-Forest until after the release of the Muddy Waters Report.

[225] From March 10, 1997 to July 28, 1998, Sino-Wood Partners Limited, a Hong Kong subsidiary of Sino-Forest, owned 99.99% of companies eventually renamed HK Sonic Jita. On July 28, 1998, the renamed HK Sonic Jita was sold to Jin Juemin (51%) and Li Haibao (49%). Ownership changed frequently between July 1998 and June 2011. Each of Li Haibao, Huang Ran, Zhan Xiaokun and Chen Jun was a shareholder of HK Sonic Jita during this period and was a Sino-Forest employee during periods that were adjacent to, or overlapped with, the periods they were shareholders of HK Sonic Jita. During the Material Time, Huang Ran was a director and 50% shareholder of HK Sonic Jita prior to August 2011, at which time he became a 100% shareholder.

[226] A 15-page loose document found on the computer of Chan's Executive Assistant lists corporate information for over 40 Sino-Forest BVI, Canadian and Hong Kong subsidiary companies, and includes information on HK Sonic Jita<sup>9</sup>. Under the names of each of the two listed shareholders of HK Sonic Jita and its predecessors is a note that states, "Held on behalf of the Company w/Declaration of Trust". All other companies listed in this document were Sino-Forest subsidiaries. Additional lists in the document identify the registered office and which corporate seals or chops each subsidiary has. Similar information is included for HK Sonic Jita. For HK Sonic Jita, the authorized signature, a chop and the minute book are checked off in similar fashion to the directly owned Sino-Forest subsidiaries.

[227] Sino-Forest employees, including Yeung and Ip, were also involved in the business operations of HK Sonic Jita. Examples include retaining a corporate chop and minute book belonging to HK Sonic Jita, handling corporate secretarial matters for the company, and arranging and holding signed cheques from HK Sonic Jita. Ms. Shao, Staff investigator, explained that corporate "chops" are seals used in China. One company may have various chops for different approvals – for instance, a general company chop, a legal representative chop, a finance department chop and a contract chop. The invoice for the corporate secretarial services for HK Sonic Jita was sent to Ip by a Sino-Forest employee who asked "Can I use your cheque to settle this bill?"

[228] Ip, Senior Vice-President of Sino-Forest, was overseeing the changing shareholder structure at HK Sonic Jita. Emails in evidence show that Ip instructed who should be made a shareholder and that he was provided with updates as corporate changes were made.

[229] The Respondents gave explanations why HK Sonic Jita shareholders were also employees of Sino-Forest. These explanations included:

- differing names for Beijing and Hong Kong companies, both called Sonic Jita: Yeung and Ip gave evidence that the individuals were employees of Beijing Sonic Jita, a separate company from HK Sonic Jita that did contract work for Sino-Forest;
- foreign exchange restrictions: Yeung gave evidence that paying Sonic Jita was slow and cumbersome because of the difficulties caused by China's foreign exchange regulations and system of *fapiao*. Since it was much easier and faster to get SAFE approval for regular payments like rent and payroll than for engineering or construction services, the Beijing Sonic Jita employees were put on Sino-Forest's payroll; and

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<sup>9</sup> We note this document was last modified in 2002 when Yosanda Chiang was working at Sino-Forest for Chan's then-wife.

- lack of capital at Sino-Panel: Ip testified that Sino-Panel did not have enough capital to pay Beijing Sonic Jita for work that it was doing on Sino-Forest projects, so Sino-Panel paid the salaries of Beijing Sonic Jita's employees in order to keep the work going.

[230] These explanations do not help the Panel.

[231] Yeung's evidence is that in February 2006, Sino-Forest originally planned to create a subsidiary in Hunan Province called Hongjiang City Yuda Wood Company Ltd., but instead named this subsidiary Hunan Jiayu Wood Products Co., Ltd. (**Jiayu Wood**). Yuda Wood, which was incorporated at the same time, had its registered office in the same city – Hongjiang City – as Jiayu Wood and Sino-Forest's employees assisted with its incorporation.

[232] An indication of Sino-Forest's control over Yuda Wood was the participation of Sino-Forest's employees in Yuda Wood's purchase of a plastic products factory in Hunan Province in March 2006 (the **Ansu Factory**). Sino-Forest employees prepared, drafted and signed the Ansu Factory purchase agreement on behalf of Yuda Wood without including Huang Ran, the legal representative of Yuda Wood at that time, on any of the communications. The draft purchase documents were emailed to Ip on March 21, 2006 to review and finalize. Yeung signed the final agreement on March 29, 2006 in the name of Yuda Wood, prior to Yuda Wood's incorporation. Yeung stated when he signed the agreement, he was confused about whether it was in fact a Sino-Forest subsidiary, or an outside company. Yeung testified his confusion arose because the names of Yuda Wood and the subsidiary that Sino-Forest did, in the end, incorporate (Jiayu Wood) both have two Chinese characters and share one character in common, "yu".

[233] Sino-Forest indirectly paid for the Ansu Factory. A third company that Sino-Forest was interested in purchasing at the time, Hongjiang City Hecheng Forestry Development Co. Ltd., used funds Sino-Forest had loaned it to make the initial acquisition payment on behalf of Yuda Wood. Ip testified Chan approved this advance to Hecheng.

[234] The Respondents submit Sino-Forest considered purchasing this factory, but offered the opportunity to Huang Ran when internal approvals were delayed. They submit Sino-Forest personnel told Huang Ran that, subject to Sino-Forest obtaining these approvals, Sino-Forest would purchase the factory from Huang Ran. The Respondents' position is not supported by the evidence, which demonstrates that Sino-Forest acquired the Ansu Factory in Yuda Wood's name.

[235] Yeung stated that within a few days of signing the Ansu Factory purchase agreement on March 29, 2006, he became certain that Yuda Wood was not going to be a Sino-Forest company. He signed the agreement on behalf of Yuda Wood after receiving permission from his manager and notifying Ip. Yeung did not remember if Huang Ran knew of the transaction.

[236] It is not disputed that Huang Ran requested Yeung's help in registering Yuda Wood. Subsequently, a Sino-Forest employee registered Yuda Wood as a corporation, under Yeung's direction. This same Sino-Forest employee is listed as a contact person with SAFE on an approval form for opening a foreign capital account for Yuda Wood.

[237] Yeung testified that, at the time of Yuda Wood's incorporation, he was doing a lot of work, was not feeling well psychologically and was working at a location far away from the city. This location was known as the "ghost" or "haunted house", a location shared by Yuda Wood and Sino-Forest employees. At the time Yeung was living at the "ghost house" between March and July 2006, Yuda Wood and Sino-Forest shared one phone line and one fax line.

[238] We find Yuda Wood was capitalized by Sino-Forest with US \$1.05 million. In an April 2006 email to Ip, Yeung stated in English: "Hunan Yuda registration completed. We could remit max USD 1.05M to its A/C" and attached the following business documents for Yuda Wood: business license, registration information, SAFE document approving the opening of a US dollar account and a bank signature card, with Huang Ran as signatory. Attached to another email sent to Sino-Forest employees in June 2006 was the site office telephone list for a Sino-Forest subsidiary, Guangdong Jiayao Wood Products Development Co., Ltd. Included in the list of contacts for employees are Ip, Yeung, other Sino-Forest employees involved in the incorporation of Yuda Wood and Huang Ran.

[239] The Respondents provide explanations for the involvement of Sino-Forest employees in Yuda Wood's business, which include Yeung's lack of English proficiency and confusion about the same character appearing in both names, Jiayu Wood and Yuda Wood. Nevertheless, the Panel finds it difficult to believe Huang Ran, whose base salary with the Sino-Forest subsidiary Heilongjiang Jiamu Panel Co., Ltd. was RMB 5,200 per month at this time, would have over US \$1,000,000 with which to capitalize Yuda Wood. We find Sino-Forest capitalized Yuda Wood.

[240] Yeung stated in his affidavit that at the precise moment he sent Ip the email "Hunan Yuda registration was completed. We could remit max USD 1.05M to its A/C", he must have been confused and either thought Yuda Wood was going to be a Sino-Forest company or he momentarily confused Yuda Wood and Jiayu Wood with each other. However, four days prior to sending this April 22, 2006 email to Ip, he had sent Ip and Hung a similar email stating "Our 'Hunan Jiayu' has registered already ... Please arrange max USD2.1M for capital audit." He also attached the business license and

bank account scanned pictures for reference. Both this email and the April 22, 2006 email were sent in English; the former was sent to both Hung and Ip while the latter was sent only to Ip. We find Yeung knew he was dealing with two different companies when he sent the emails regarding the capitalization of Jiayu Wood and Yuda Wood.

- [241] We find Yeung's explanation in his affidavit and testimony not credible. First, he stated in his affidavit that approximately three weeks earlier, he became certain Yuda Wood was not going to be a Sino-Forest company so it is difficult to accept his explanation that he was confused. Second, the fact that he sent two emails only four days apart, with very similar wording which he chose to send in English, not Chinese, also makes it difficult to believe he could have been confused, particularly when dealing with such large sums of money. His previous explanation that there is a character in common in Chinese between Yuda and Jiayu does not explain his confusion in two emails sent in English. We find Yuda Wood was capitalized by Sino-Forest.

*Sino-Forest's Control over Yuda Wood's Bank Accounts*

- [242] Sino-Forest controlled two bank accounts in Yuda Wood's name, which were opened in Guangzhou, and monitored other Yuda Wood bank accounts. Online transfers out of the Guangzhou bank accounts required approval from Sino-Forest employees. During the Material Time, Sino-Forest paid over RMB 347 million into Yuda Wood's Guangzhou accounts, 67% of the total cash Sino-Forest paid directly to Yuda Wood during this period.
- [243] Huang Ran stated in his 2011 interview during the Independent Committee investigation that Ho controlled one of Yuda Wood's bank accounts.
- [244] Between November 2008 and October 2010, Yuda Wood made six payments to Gengma Dai and Wa Tribe Autonomous County Forestry Co., Ltd. (**Gengma Dai**), another supplier, totaling RMB 30.3 million from these Guangzhou accounts. Ip and Ho approved these payments and Sino-Forest employees were directly involved in coordinating these payments. While the question of whether or not these are *bona fide* transactions between two suppliers will be dealt with in our analysis of the Gengma #1 Transactions below, the fact remains that Sino-Forest would not be involved whatsoever in these Guangzhou accounts of Yuda Wood or payments by Yuda Wood if Yuda Wood was indeed independent of Sino-Forest.
- [245] The Respondents maintain Sino-Forest was only monitoring Yuda Wood's bank account to have leverage over Yuda Wood to support Sino-Forest in case, as Ho stated in his affidavit, "a supplier failed to deliver on our expectation to resolve problems". If this happened, "Sino-Panel could exercise leverage by limiting the supplier's ability to make further payments from the bank account we monitored".
- [246] The first attempt to explain the monitoring of accounts as a way to exert influence over suppliers was an email sent in connection with SAFE's investigation of Sino-Forest subsidiaries in 2011, giving weight to Staff's contention that this explanation was simply devised for SAFE's benefit. Ho explained suppliers resolved problems that might arise after a purchase had been completed and provided examples of problems such as farmers asking for more money and farmers not allowing operations teams to enter the forests. In his affidavit, Mr. Ho states "I suggested we get some leverage over suppliers by monitoring supplier bank accounts". He discussed this concept with Chan, who agreed. Ho did not recall if this concept was his idea alone or if it arose in discussions with Chan. In addition to Sino-Forest's monitoring of Yuda Wood's bank accounts, in Ho's cross-examination, we heard one Taiyuan bank account and another bank account of a different company were already monitored by Ip prior to Ho's arrival at Sino-Forest, although "there was not much money that went through these bank accounts". Huang Ran was also involved with both these companies and the Panel finds Sino-Forest controlled Taiyuan (as discussed below). Ho arranged for another bank account of a separate company to be monitored, however Sino-Forest never did any business with this company in the end.
- [247] Ultimately, only the two Guangzhou Yuda Wood bank accounts were truly "monitored" although the Panel finds the role played by Sino-Forest was more than simply monitoring but actually controlling the cash flows out of these accounts. Sino-Forest held a USB key that was required for transfers out of these accounts. Ho had the password for this USB key; Huang Ran and other Yuda Wood employees did not.
- [248] Ho's testimony is inconsistent: unlike what he said in his affidavit, he was not the prime mover behind the concept of monitoring supplier bank accounts – this was going on before he joined Sino-Forest. Other than the accounts previously referred to, we saw no evidence of Sino-Forest's control of bank accounts of other suppliers, despite the fact that Sino-Forest transacted with at least 18 suppliers in the BVI Model. It is difficult to believe only Yuda Wood permitted this monitoring to occur, as the Respondents submit.
- [249] Therefore, we find it more likely than not that the monitoring explanation was concocted for the SAFE investigation in 2011. Moreover, Ho's explanation that Sino-Forest could exert leverage over Huang Ran to resolve problems is inconsistent. Huang Ran only dealt with aggregators, not farmers, so he could not help resolve these types of

problems. As well, Sino-Forest rarely logged timber but simply resold forests, so they likely would not encounter many operational problems and thus would not need this type of leverage. In one example where the Respondents submit Yuda Wood was positioned in a transaction to act as an intermediary, Sino-Forest engaged directly with the supplier in dispute resolution, as discussed in our analysis of the Gengma #1 Transactions below.

- [250] The Respondents provide great detail in their submissions and called extensive expert evidence regarding “*guanxi*”, the business culture in Mainland China and the culture of close cooperation among Chinese companies. *Guanxi* is discussed more extensively in paragraphs [347] to [350]; briefly however, it relates to trust, communication and loyalty in all aspects of Chinese life. The requirement to monitor a supplier’s bank accounts and the necessity to have leverage to enforce expectations appear to the Panel to be inconsistent with the concept of *guanxi*, a concept the Respondents rely on to explain Sino-Forest’s relationships with Yuda Wood and other companies.
- [251] The issue of *guanxi* is not relevant as we have found this monitoring/leverage explanation was only concocted for the SAFE investigation in 2011. The control over Yuda Wood’s bank accounts was just one aspect of Sino-Forest’s control over Yuda Wood. Furthermore, Sino-Forest would be a very significant and highly valued customer of Yuda Wood. Yuda Wood transacted RMB 4.56 billion with Sino-Forest between 2007 and 2010, and Sino-Forest represented at least 40% of Yuda Wood’s business. The mere threat that Sino-Forest would stop doing business with Yuda Wood would have been enough to ensure Yuda Wood would follow through on Sino-Forest’s expectations. As such, the Respondents’ explanation for monitoring, which we find was actually control over, Yuda Wood’s bank account, is not accepted.

*Sino-Forest’s Ongoing Control of Yuda Wood*

- [252] Sino-Forest had access to Yuda Wood’s business records, including its tax obligations and accounting records with the cost basis of assets sold to Sino-Forest. If Yuda Wood was independent, it does not make sense that it would disclose what it paid for timber to Sino-Forest as this is a competitive advantage Yuda Wood would not want to lose.
- [253] On April 13, 2011, a Sino-Forest employee emailed Huang Ran telling him how much income tax Yuda Wood owed for the first quarter of 2011, and that she could not get these funds ready in time. In this email, she instructs Huang Ran to find other ways to make payment. Huang Ran then emailed Ip asking for help. Ip forwarded this email chain to Ho and copied Chan. In his email to Ho on April 15, 2011, Ip tells Ho Huang Ran’s account has no money to make the transfer and that “you’d better help Yuda resolve this issue externally”.
- [254] This email is instructive in two ways: first, if Yuda Wood was independent, the Sino-Forest employee would not be telling Huang Ran what his company owes in taxes or arranging payment options. Second, Chan is copied on this email, when he had not been on the email chain before, which indicates Ip is escalating this issue to Chan because it is important. This raises the likelihood Chan read these emails and is therefore aware of Sino-Forest’s control over Yuda Wood.
- [255] On May 10, 2011, a Sino-Forest employee emailed Ho regarding “Yuda-Bohu Adjustment of Forest Purchase Cost”. Four emails in the subsequent chain discuss various ways in which to increase the cost by up to RMB 60 million. The final email on May 15, 2011 is from Ip to Ho, among others, and copied to Chan. Ip forwards an email from another Sino-Forest employee and asks Ho if he has any solutions to what the employee has described as the “great concerns” about reversing current account records that Bohu has. Three issues are outlined in the email from the employee: first, “[t]he purchase of the forest by Sino Guangxi Company from Bohu is not true” as the PRCs had not been transferred to Bohu; second, “[t]he sale of the forest by Sino Hunan to Bohu is not true”, and third, “Sino transferred the foreign exchange funds through Yuda and Bohu back to Sino”. The email goes on to state: “it can only be adding to the evidence of continuing falsification on purpose”.
- [256] “Bohu” refers to Sino-Forest’s second largest supplier between 2007 and 2010 after Yuda Wood, Zhanjiang Bohu Wood Co., Ltd., which had RMB 3,069,924,356 in sales to Sino-Forest in that period.
- [257] The May 15, 2011 email clearly indicates Sino-Forest has control over Yuda Wood since it was able to adjust the cost at which Yuda Wood recorded its purchases and because Sino-Forest could control funds through Yuda Wood. As before, the fact that Chan is copied on this email, when he had not been on the email chain before, indicates Ip is escalating this issue to Chan because of the gravity of these issues, particularly with respect to the “continuing falsification” of transactions. This raises the likelihood Chan read these emails and is therefore aware of Sino-Forest’s control over Yuda Wood.
- [258] This Yuda Wood-Bohu arrangement is also discussed in the 31-page email chain regarding the SAFE investigation, on which Chan is copied on every email in the chain.

- [259] Sino-Forest had control over the use of Yuda Wood's corporate chops, which Yeung held from April to August 2006. He directed his subordinates to use the chops to open a bank account in Yuda Wood's name in April of that year. A 2010 email to Yeung indicates Ho's approval was needed to apply Yuda Wood's chops to a proof of receipt of funds document. This email is followed by another from Yeung to Huang Ran telling him to take back the chops. While the chops were with Huang Ran at this time, according to the Respondents, Yeung was under the impression they were still at Sino-Forest four years later. Employees of Yuda Wood and Sino-Forest who were included in the email also were under the impression Ho's approval was needed and that the company seals were still with Sino-Forest.
- [260] In June 2006, in email correspondence among Yeung, Ip and others, it is recommended Yuda Wood apply for a loan for Sino-Forest's benefit for reasons that include "its operating authority is 100% under our control".
- [261] Mr. Henderson testified that during the Independent Committee investigation Chan was shown this email and attachment. Mr. Henderson testified Chan's response to the Independent Committee advisors was: "He [Chan] said it was all in the beginning" (Hearing Transcript, December 5, 2014 at 126:10-11). The Independent Committee advisors' notes of Chan's response in his interview were read to Mr. Henderson in cross-examination: "... Tight supervision to make sure they [Yuda Wood] would perform as we asked them to perform ... That was in the beginning, to make sure that they don't do something which would be – I don't want them to cause trouble in the local community and reflect badly on us" (Hearing Transcript, December 5, 2014 at 180:4-5 and 9-12). Chan's explanation appears to address why Sino-Forest had control over Yuda Wood's two Guangzhou bank accounts – for leverage – as explained by Ip elsewhere in these Reasons. Chan's explanation regarding an email in 2006 does not address the fact that control of Yuda's two Guangzhou bank accounts continued until 2011, well past "the beginning". Further, it does not in any way explain Sino-Forest's ability to use Yuda Wood to apply for a loan, or explain the phrase "100% under our control".
- [262] When Ip was shown this email and its attachment during his interview by Staff during the investigation in this matter, he replied: "I don't know what 100 percent control means. In what extent? In what aspect?" (Hearing Transcript, December 5, 2014 at 143:14-15).
- [263] Mr. Pomeroy testified that when Yeung was shown this email and attachment during his interview in 2011, Yeung stated: "Those are what the words say, but that's not what it means." Mr. Pomeroy testified Yeung "dismissed it out of hand, and indicated that, 'Although the words say that we, Sino-Forest, controlled Yuda 100 percent, or it's within 100 percent of our control, that's not what it meant.'" (Hearing Transcript, December 9, 2014 at 119:23-24 and 120:3-6) Yeung did not elaborate further.
- [264] Later, Yeung explained in his affidavit, dated August 23, 2015, he used the phrase "100% under our control" because he had retained Yuda Wood's chops and could control the proceeds from Yuda Wood's loan. The Panel rejects Yeung's explanation and Ip's professed lack of understanding and interprets the phrase "100% under our control" literally: Yuda Wood was 100% under Sino-Forest's control.
- [265] The difference between the purchase transactions with Yuda Wood recorded by Sino-Forest and the revenue recorded by Yuda Wood in its SAIC corporate filings is dramatic: cumulatively between 2007 and 2010, this difference is in excess of RMB 4.36 billion. Sino-Forest BVIs recorded purchases from Yuda Wood of RMB 4.56 billion, while Yuda Wood reported revenue from Sino-Forest of approximately RMB 197 million in its SAIC filings. This difference represents 96% of the total transaction volume that Sino-Forest claimed to have done with Yuda Wood over the same period. We heard evidence that revenue is under-reported in Mainland China in order to avoid and/or minimize taxes paid; however, this difference is significant and supports Staff's allegation that transactions with Yuda Wood were fictitious and therefore there was no real revenue to report to SAIC.
- [266] Sino-Forest and Yuda Wood shared telephone numbers throughout the Material Time and, in particular, in 2007 when they shared land lines in the same "ghost house".
- [267] Further evidence of Yuda Wood's lack of independence is the fact that Yuda Wood's Accounting Manager was not able to respond to audit confirmation letters without Sino-Forest's assistance. The purpose of these Audit Confirmation Letters was to provide independent confirmation from Sino-Forest's suppliers and customers to E&Y of the details of their transactions with Sino-Forest. On February 16 2009, the Accounting Manager at Yuda Wood emailed a Sino-Forest employee asking for more information for the "due to and due from amounts" as the transactions were "not in the books of Yuda". There are two main conclusions that we draw from Yuda Wood's questions to Sino-Forest about what the details ought to be: first, the Audit Confirmation Letter provided by Yuda Wood is not independent, thus negating its value to E&Y for audit purposes; and second, it supports Staff's allegation that Yuda Wood was controlled by Sino-Forest.
- [268] The Respondents submit the Independent Committee was satisfied Huang Ran was not an employee of Sino-Forest and that Yuda Wood was not a subsidiary. We agree Huang Ran was not employed by Sino-Forest in 2011 and that Yuda Wood was not a subsidiary of Sino-Forest. However, the Independent Committee never got comfortable with the

idea that Yuda Wood was not a related party to Sino-Forest, and this is one of the reasons that the third quarter 2011 results were never released. The question of Yuda Wood's independence was still an unresolved issue at the time E&Y resigned as auditor in April 2012.

[269] Based on the foregoing, we find Yuda Wood was controlled by Sino-Forest. The evidence that underlies our conclusion includes:

- the myriad former and current employees of Sino-Forest who were owners of Yuda Wood through HK Sonic Jita at various periods. They were clearly nominees, only holding shares on behalf of Sino-Forest. Their position as nominees is further supported by the fact that the ownership was simply transferred among them and not sold for any consideration;
- the involvement of Ip, Yeung, Ho and other Sino-Forest employees in key aspects of Yuda Wood's business: acquiring the Ansu Factory, possession of corporate books, records and chops, and knowledge of Yuda Wood's tax obligations;
- the fact that Sino-Forest capitalized Yuda Wood;
- the control of Yuda Wood's Guangzhou bank accounts by Sino-Forest;
- the documents evidencing a proposal that Sino-Forest use Yuda Wood to apply for a loan for Sino-Forest's benefit because Sino-Forest had 100% control of Yuda Wood; and
- Yuda Wood's lack of knowledge of the details of transactions that had purportedly already occurred between Yuda Wood and Sino-Forest upon receiving the E&Y Audit Confirmation Letter.

[270] For these reasons, the Panel finds Sino-Forest controlled its supplier, Yuda Wood. For reasons more clearly set out below, the Panel finds Sino-Forest used Huang Ran as its nominee.

ii. *Kun'an*

[271] Kun'an was a supplier to Sino-Forest in 2009. It was registered on January 20, 2009 with RMB 500,000 in initial capital and two shareholders, Yu Degang (who owned 60% and was also the Legal Representative of Kun'an) and Tian Jianguo (who owned 40%). Yang Jun was responsible for finance at Kun'an. Both Yu Degang and Tian Jianguo were former Sino-Forest employees: Yu Degang between May 2007 and October 2008, and Tian Jianguo between March 2005 and October 2008. Yang Jun was a former employee of Sino-Forest and also worked for Huang Ran, whom the Panel finds below acted as nominee on behalf of Sino-Forest. Kun'an had the same address as Sino-Panel (Hezhou) Co., Ltd., a Sino-Forest WFOE subsidiary. Chan was involved in determining Kun'an's name.

[272] In 2009, Sino-Forest BVIs purchased standing timber totalling RMB 1,807,078,984 (US \$264,486,380) from Kun'an. It was Sino-Forest's largest supplier in the BVI Model in 2009, accounting for over 29% of total BVI purchases. One transaction was recorded by Sino-Forest 11 days before Kun'an was even registered. Yet, in Kun'an's SAIC filings at April 20, 2010, Kun'an reported no income from sales, no profits or losses and no taxes paid since its establishment.

[273] An email on September 29, 2009 shows that Sino-Forest exerted significant influence over how Kun'an was run: Yeung told Huang Ran by email, copied to Ip and another Sino-Forest employee, that Kun'an needed a fixed office location. He told Huang Ran that Kun'an was to be built up so that "it looks like a company with substance". Huang Ran was also instructed: to collect all contracts signed between Kun'an and Sino-Forest or between Kun'an and Yuangao (another supplier of standing timber) and keep them on file; that documents such as accounts receivable should be issued in the name of Kun'an; and that he should get back Kun'an's seals (*i.e.* company chops), licenses and certificates.

[274] In this same email, Yeung told Huang Ran that Ip had instructed Kun'an should have two bank accounts and that two seals for each account should be kept, one of each with Yang Jun (who was responsible for Kun'an's finances) and the others with a supposed competitor of Kun'an's and Sino-Forest's.

[275] Yeung ends the email by telling Huang Ran to "build up Kun'an as if it is a new company", yet by this time, Sino-Forest had recorded 12 contracts with Kun'an worth RMB 1,226,683,784 (US \$179,549,163).

[276] In a reply email from a Sino-Forest employee to Huang Ran, copied to Yeung, the Sino-Forest employee writes that Kun'an is to "cooperate with our side tacitly" and that he "can recommend a candidate who ... can fully understand and carry out our intentions".

- [277] An attachment to an email dated April 20, 2011 copied to Ip and Ho shows that a subsidiary of Sino-Forest transferred RMB 4,000,000 to Kun'an to pay the registered capital of RMB 2,000,000 for each of Guangxi Chihui Forestry Development Co., Ltd and Shun'xuan (both purportedly independent of Sino-Forest).
- [278] Huang Ran's Kun'an business card shows his title is General Manager. He is listed on Sino-Forest internal documents as "manager" and "follower" for Kun'an. Huang Ran is listed as follower for: Taiyuan, Kun'an, Meishan and Juncheng, among others. These translations are disputed by the Respondents. They submit that the original Chinese term should not be translated as "manager", but as someone who takes care of problems. Similarly they submit that "follower" is more properly translated as someone who follows up on these matters. Whatever the translation, it is clear that Huang Ran is acting with respect to Kun'an on behalf of Sino-Forest. The instructions Huang Ran receives from Yeung make it clear that Yeung is directing Kun'an's business and that Huang Ran is responsible for its business matters on behalf of Sino-Forest.
- [279] Further connecting Huang Ran and Kun'an to Sino-Forest, he provided Kun'an's bank account balance information to Ip.
- [280] The Respondents submit Sino-Forest used Huang Ran as an intermediary with Kun'an to express Sino-Forest's dissatisfaction with Kun'an's performance. They submit Kun'an sent Sino-Forest a demand letter for an overdue payment, behaviour they submit is inconsistent with Kun'an being controlled by Sino-Forest.
- [281] Staff submits the purpose of the demand letter to Sino-Forest was to facilitate Sino-Forest obtaining SAFE's approval to access foreign exchange funds.
- [282] Based on the detailed email from Yeung described above, the interwoven connections between Kun'an and former Sino-Forest employees including Huang Ran, and the inconsistencies in Kun'an's SAIC filings, the Panel finds Sino-Forest exercised significant influence over Kun'an and that Kun'an was a related party to Sino-Forest.
- iii. Taiyuan*
- [283] Taiyuan was a supplier to Sino-Forest in the WFOE Model. At the request of Sino-Forest, Taiyuan was registered on June 20, 2005 by two Sino-Forest employees, Shen Siguo and Chen Jinxing, each of whom owned 50%. They each contributed RMB 250,000 of registered capital, which was loaned to them by Sino-Forest. There is no evidence these loans were repaid. Ip agreed that Sino-Forest was using Shen Siguo and Chen Jinxing as nominees.
- [284] The Respondents submit Sino-Forest was interested in moving into the Rongshui area of Guangxi Province, where Taiyuan was located, and where Sino-Forest was considering the acquisition of a state-owned factory. Ip testified Sino-Forest wished to purchase the factory while hiding Sino-Forest's identity. He further testified the plan was for Sino-Forest to acquire Taiyuan from Shen Siguo and Chen Jinxing, but Taiyuan was an asset not recorded on Sino-Forest's financial statements. Sino-Forest did not ultimately acquire the factory.
- [285] In February 2006 Huang Ran became a 50% shareholder of Taiyuan by acquiring Shen Siguo's shares for no consideration and also became its Legal Representative. In November 2006, Huang Ran acquired the remaining 50% from Chen Jinxing, also for no consideration. Ip testified Huang Ran repaid Sino-Forest with particle board but there was no evidence to corroborate his testimony. Ip did not know when this repayment was made and also indicated it was "repaid through offset and recovered" (Hearing Transcript, May 27, 2015 at 57:12-14). No further details were provided.
- [286] From June 1, 2006 until at least November 2006, Huang Ran was both a shareholder of Taiyuan and on Sino-Forest's payroll. Huang Ran continued to report to Ip on the operations and financial condition of Taiyuan. In an attachment to an email dated March 3, 2011 regarding Audit Confirmation Letters, copied to Ip and Ho, Huang Ran is listed as "Follower" with respect to Taiyuan.
- [287] On December 1, 2006, Gao Fajun was appointed Taiyuan's Supervisor under Chinese company law. Gao Fajun was an employee of Sino-Forest from February 2006 until March 2010. He was also a shareholder in other Sino-Forest suppliers and customers: Guangxi Pingle Haosen Forestry Development Co., Ltd. (involved in the 450 Transactions), Guangxi Chihui Forestry Development Co., Ltd. and Meishan.
- [288] Ho testified that Ip had been monitoring Taiyuan's bank account prior to 2007.
- [289] We find Sino-Forest capitalized Taiyuan with RMB 500,000. There is no evidence Huang Ran or his predecessor shareholders repaid Sino-Forest for this capitalization of Taiyuan, other than Ip's testimony. Sino-Forest employees owned and operated Taiyuan. Ip monitored Taiyuan's bank account.



[290] The Panel finds Sino-Forest controlled Taiyuan.

*iv. Dongkou*

[291] Dongkou was a Sino-Forest customer in the BVI Model and was established in Hunan Province on March 30, 2005. In October 2005, Sino-Forest became interested in acquiring Dongkou's wood processing factory and standing timber business and investigated the company. Sino-Forest bought the factory assets on November 18, 2006. Ip testified that Sino-Forest continued to be interested in the remaining plantation assets of Dongkou. Liu Zhiwei, later a Sino-Forest employee, became a 47.5% shareholder at an unspecified date and continued to hold shares in Dongkou until December 31, 2008. Du Aiguo, later a Sino-Forest employee, became a 52.5% shareholder of Dongkou on November 16, 2006, two days before Sino-Forest acquired Dongkou's factory, and remained so until sometime after April 1, 2009. While Sino-Forest explored purchasing the shares of Dongkou, it ultimately acquired only the factory facilities.

[292] Du Aiguo was a Sino-Forest employee from December 8, 2006 until July 1, 2008 and Liu Zhiwei was a Sino-Forest employee from March 19, 2007 until at least December 2010. Thus, both individuals were employees of Sino-Forest at the same time they were co-owners of a Sino-Forest customer. Ip did not dispute the overlap in time, explaining that this arrangement was part of the negotiations with Liu Zhiwei and Du Aiguo.

[293] In 2008, Dongkou was Sino-Forest's largest customer, accounting for sales of RMB 867,708,084 (approximately US \$125 million). No cash was received with respect to any of these sales; rather, the AR/AP Set-Off process was used to settle the receivables.

[294] A 2007 Project Funding Schedule for Sino-Panel lists three contracts between Dongkou and three third party suppliers: Guangxi Hezhou City Shengdong Forestry Development Co., Ltd., Gengma Dai<sup>10</sup> and Yongshun Shunfa Agriculture and Forestry Information Consulting Co., Ltd. Also included on this schedule is the Yunnan Master Framework Agreement between Sino-Panel and Gengma Dai. Sino-Forest therefore appears to be tracking Dongkou's transactions as it would one of its subsidiaries.

[295] On January 12, 2007, a Sino-Forest employee emailed Ip attaching a contract between Dongkou as buyer and Gengma Dai as seller. In the email, the employee asks Ip if the contract should be "sent to Mr. Xie of Gengma". No employees from Dongkou are copied on this email.

[296] On February 3, 2007, a Sino-Forest employee emailed the final contract version to Ip, stating: "Attached please find the latest final version of the contract that **we plan to sign** ..." [emphasis added]. It is clear the terms and conditions of the contract were negotiated between Sino-Forest employees and Gengma Dai. Ip was asked to advise if he had any comments for further amendments. The employee emailing Ip wanted to "stress and highlight" that payment must be made by a certain deadline, otherwise "they will not sell to **us**" [emphasis added].

[297] Another contract, between Dongkou and Guangxi Hezhou City Shengdong Forestry Development Co., Ltd. was emailed by Ip to a Sino-Forest employee on January 13, 2007.

[298] None of these contracts were signed or chopped.

[299] The Respondents submit Sino-Forest was preparing contracts in the name of Dongkou because, at that time, Sino-Forest was still considering purchasing the shares of Dongkou for its timber management business, in addition to the factory asset. By March or April 2007, Sino-Forest had decided not to proceed with this acquisition.

[300] We reject the Respondents' argument that Sino-Forest was preparing Dongkou contracts because Sino-Forest was considering a share purchase. For example, the email to Ip on February 3, 2007, discussed in detail in paragraph [296], refers to an attachment entitled "Final Contract Version". In this contract for approximately 80,410 mu at a price of RMB 1,000 per mu, Dongkou agrees to pay RMB 25 million to Gengma Dai by February 15, 2007 and to participate in a survey by March 1, 2007. Following the Respondents' explanation, Sino-Forest would have had to acquire Dongkou between February 3 and February 15, 2007, the date when RMB 25 million was due. This timeframe seems unlikely. Therefore, the Respondents ask us to believe Sino-Forest was committing an unrelated third party to a substantial liability; otherwise Sino-Forest would be assuming this liability in 12 days, even though at this stage, Sino-Forest was simply "considering" the share acquisition. There were no concrete plans to acquire the shares. We reject the Respondents' submission.

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<sup>10</sup> The Project Funding Schedule identifies the seller as "Yunnan Gengma County Forestry Co., Ltd.", which Ip testified was another name for Gengma Dai. Although Gengma Dai is identified as "Gengma Dai and Wa Tribes Autonomous County Forestry Co., Ltd., Yunnan" elsewhere in the Project Funding Schedule, the evidence is clear that the Dongkou contract was with Gengma Dai.

- [301] In addition, the phone number listed for Dongkou in a contract with Gengma Dai is the same as a cell phone number of a Sino-Forest employee.
- [302] Dongkou was Sino-Forest's largest customer in the BVI Model in 2008 with sales of RMB 867,708,084 or US \$125,028,109. All six sales contracts were signed by Chan on behalf of Sino-Forest and by Du Aiguo on behalf of Dongkou. Three of these contracts were signed by Du Aiguo on behalf of Dongkou at the same time that he was an employee of Sino-Forest.
- [303] Based on the cumulative weight of the evidence, we reject the Respondents' explanation and find that Sino-Forest controlled Dongkou.

**(b) Other companies Staff alleges are related to Sino-Forest**

- [304] Staff submits Juncheng, Shun'xuan, Dacheng, Yuangao and Meishan are also related and worked in collusion with, or were influenced by, Sino-Forest and played a role in the Standing Timber Fraud Allegations.

*i. Juncheng*

- [305] Juncheng was a Sino-Forest supplier in the BVI Model and was established May 27, 2010; He Yongning owned 80% and contributed RMB 800,000 in registered capital. He was 23 years old at this time. During the third and fourth quarters of 2010, soon after Juncheng was capitalized, Juncheng supplied Sino-Forest BVI subsidiaries with RMB 1.825 billion in standing timber. Ip suggested there was a backer behind He Yongning, the identity of whom Ip did not know and about whom he could not recall any details at the time of the hearing.
- [306] In total, Sino-Forest transacted RMB 3.56 billion of purchases from Juncheng in the second half of 2010 and the first quarter of 2011.
- [307] In cross-examination, Ip testified he knew little about the company despite its substantial transaction volume with Sino-Forest. He said the 20% shareholder had previously been employed with Sino-Forest and had good forestry connections and knowledge.
- [308] Yang Jun, who was also connected to Yuda Wood, Kun'an and Yuangao, worked for Huang Ran and was a former Sino-Forest employee, was also involved with Juncheng. On March 3, 2011, Yang Jun emailed a Sino-Forest employee, and asked her to confirm seven letters of enquiry from E&Y regarding settlements of offsets between Sino-Forest BVI subsidiaries and Juncheng. In the English translation of this email, Juncheng is described as a "peripheral company". The Sino-Forest employee then forwards this email to Hung five minutes later, stating she will print out the letters and send them to E&Y.
- [309] Two conclusions can be drawn from this email. First, Sino-Forest had discretion over correspondence between E&Y and Juncheng. Second, because E&Y depends on this supposed independent confirmation in its audit process, the fact that the confirmation is not independent calls into question the veracity of the financial statements based upon this audit process. In this context, we reject the Respondents' submission that the correct translation of the term "peripheral company" is "outside company".
- [310] Both Ip and Ho are copied on a March 2011 internal Sino-Forest email regarding Audit Confirmation Letters from E&Y sent to Sino-Forest suppliers and AIs. Attached to the email is a chart that tracks the delivery status of the Audit Confirmation Letters to each listed "Related Entity". Huang Ran and Yang Jun are listed in this report as "followers" for Juncheng. Huang Ran is also listed on this document as a "follower" for Taiyuan, Kun'an and Meishan. The Respondents submit that a contextual interpretation of the term indicates the entities are being referred to as "intermediaries". Whatever the English translation, in this context, it can only be negative. We reject the Respondents' submission. This email and attachment refer to Sino-Forest's involvement in supposedly independently-derived Audit Confirmation Letters required by E&Y. Sino-Forest should not be involved in this confirmation process between E&Y and Sino-Forest's suppliers and customers, nor should Huang Ran who we find acted as Sino-Forest's nominee in companies Sino-Forest secretly controlled or over which it had significant influence.
- [311] Huang Ran also provided Juncheng's bank account information, including cash balances, to Ip in March 2011.
- [312] Based on these facts, the Panel finds Sino-Forest exerted significant influence over Juncheng and that it was a related party.

*ii. Shun'xuan*

- [313] Shun'xuan was a supplier to Sino-Forest WFOEs with transactions worth RMB 39 million between December 10, 2010, its date of registration, and March 2011.
- [314] Ip and Ho are copied on the April 20, 2011 email (previously referred to in our analysis of Kun'an) between Sino-Forest employees with a subject line of "Details of the disposal of the funds received from Sino-forest by the Cooperating Unit(s)", and that contains the instruction "... the term "periphery" should not appear in emails or documents/forms". Shun'xuan is included in the attached charts of payments between Sino-Forest subsidiaries and "cooperating units" or peripheral companies.
- [315] The attachment indicates a subsidiary of Sino-Forest transferred RMB 2,000,000 to Kun'an that ultimately was used to pay Shun'xuan's registered capital. Yu Degang is a 30% shareholder in Shun'xuan and a former employee of Sino-Forest, who worked there from May 1, 2007 to October 31, 2008. Wu Ruiming owns 70% of Shun'xuan and was a Sino-Forest employee from September 24, 2007 until August 6, 2010.
- [316] An email sent May 9, 2011 to Ip and Ho, among others, shows that Sino-Forest was considering using Shun'xuan to falsify transactions during the SAFE investigation but could not, as Shun'xuan had not yet been incorporated in 2008.
- [317] The Panel finds Shun'xuan is a related party for the following reasons: Kun'an was used by Sino-Forest to provide the funds to capitalize Shun'xuan and we earlier concluded that Kun'an is a related party to Sino-Forest, and Yu Degang is a shareholder of both Kun'an and Shun'xuan.

*iii. Dacheng*

- [318] Dacheng, a supplier to Sino-Forest in the WFOE Model, was part of a group of companies in what was called the "Bohu Group", all owned by Li Hua.
- [319] There is limited evidence of a control-like relationship between Sino-Forest and Dacheng: a senior employee of Sino-Forest borrowed RMB 800,000 from Li Hua; Dacheng was included in a Sino-Forest email that described it as a "cooperative company"; and Li Hua may have a personal relationship with Huang Ran. The evidence is insufficient to find that Dacheng was related to Sino-Forest.

*iv. Yuangao*

- [320] Yuangao was a supplier to Sino-Forest WFOEs in October 2009 in the 450 Transactions (addressed later in these Reasons). Its total transaction value with Sino-Forest was RMB 182,522,798 (US \$26,711,073).
- [321] Huang Ran was a 39% shareholder of Yuangao.
- [322] On July 16, 2010, Ho was sent an email titled "FW: The Yuangao Company's jointly managed account information", which refers to Ip having arranged Yuangao's bank account. The Sino-Forest employee asks if internal approval procedures are needed to use the account and asks if Ho and Ip can confirm.
- [323] A March 4, 2011 email from Huang Ran to Ip outlining the "situation of funds for the periphery companies is as follows" lists Yuangao, among other "periphery companies". Whether "periphery companies" or "outside companies" is the correct translation is not most critical in this email. What is important is the context of this email. It lists various suppliers' and customers' (some of which may be competitors to Sino-Forest) bank account information, including cash balances. Other companies listed in this email include Kun'an, Taiyuan, Juncheng and Meishan, which the Panel finds were controlled by or related to Sino-Forest. Yuangao figured prominently in the 450 Transactions, which the Panel finds were fraudulent (described in our Reasons below). Yuangao was instrumental in facilitating the circular flow of funds, which we find later in these reasons was controlled by Sino-Forest, not Yuangao.
- [324] Based on this evidence, the Panel finds Yuangao is related to Sino-Forest.

*v. Meishan*

- [325] Meishan was a customer in the WFOE Model that was brought to Sino-Forest's attention by Huang Ran in May 2007. Huang Ran provided a brief report to Sino-Forest on the acquisition potential of the Meishan factory. The report appears to have been prepared by Taiyuan and ends with the line "Awaiting the leaders' instruction on whether it is suitable!"

[326] Gao Fajun, while a Sino-Forest employee, did the due diligence on the potential acquisition of Meishan on behalf of Sino-Forest, after which he bought the factory himself in October 2007, while remaining an employee of Sino-Forest.

[327] The March 2011 email from Huang Ran to Ip that provides bank account information for suppliers and customers lists Meishan among the “periphery companies”. As noted above in our analysis of Yuangao, what is important in this email is that the bank account details for Meishan and other purportedly independent companies were provided to Sino-Forest.

[328] The Panel finds Meishan is related to Sino-Forest.

**(c) Company Caretaker List**

[329] One document obtained during Staff’s investigation whose significance was contested was the Company Caretaker List.

[330] The **Company Caretaker List** was a five-page Chinese-language spreadsheet that contained references to companies that are involved in the allegations against Sino-Forest. It was found on the computer of Chan’s assistant, Yosanda Chiang. The metadata indicated it was last modified on January 20, 2011 on Ms. Chiang’s computer. It does not indicate the date the spreadsheet was actually created. It is titled “nominee managers/information of managed companies” and lists more than 120 companies. The Respondents dispute how some words have been translated.

[331] The following are among the 120 companies listed:

- Bohu,
- Dacheng,
- Meishan,
- Taiyuan,
- Kun’an,
- Guangxi Chihui Forestry Co., Ltd.,
- Gaoyao City Xinqi Forestry Development Co., Ltd. and Guangxi Pingle Haosen Forestry Development Co., Ltd. (referred to in our analysis of the 450 Transactions),
- Jiangxi Province Senchangtai Forestry Co. Ltd. (referred to in our analysis of the Gengma #1 Transactions),
- Yongzhou City Maoxiang Forestry Development Co. Ltd. (referred to in our analysis of the allegations about deceitful documentation and the 450 Transactions), and
- Renshi (China) Real Estate Development Ltd. (referred to in our analysis of the Greenheart allegations).

[332] The document lists the following individuals, among others: Huang Ran, Pauline Chan (Chan’s sister), Marco Lam (a Sino-Forest employee), John Zeng (involved in the Greenheart Transactions, Sino-Forest’s external counsel, and represented Chan during his interview by Staff in connection with this matter), Lok Ho Ting (involved in the Greenheart Transactions), Li Hua (legal representative of Bohu), Lei Guangyu (involved in the Greenheart Transactions), and George Ho.

[333] It is not clear who created this document. Ms. Chiang testified John Zeng asked her to print out a copy from a USB drive that he gave her while he was waiting to meet with Chan. She testified that she printed out one copy and gave it to Mr. Zeng.

[334] Chan submits there is no evidence that Mr. Zeng discussed this List with Chan during their meeting that day, or on any other day. Chan further submits there is no evidence that Chan saw this List during the Material Time.

[335] It is clear Chan was aware of the Company Caretaker List. Mr. Martin testified he saw the List after Sino-Forest filed for CCAA, “was quite upset by it”, since it implied these companies were related parties to Sino-Forest, and spoke to Chan about it (Hearing Transcript, December 3, 2014 at 103:15). Chan explained to Mr. Martin that the List was translated incorrectly or “misunderstood” and was “his way of managing on a knowledge basis all of the companies that are ...

significant companies doing business with Sino-Forest” (Hearing Transcript, December 3, 2014 at 104:16-18). Clearly there is evidence that Chan was quite knowledgeable about the List during the Material Time.

[336] It is reasonable to infer Mr. Zeng discussed this List with Chan, at the meeting on the day he asked Ms. Chiang to print it out. Why else would he need the List, the contents of which related entirely to Sino-Forest, at the very same time he was meeting with Chan? If he didn’t need it immediately, Mr. Zeng could have had his own assistant print it out at a later time. Mr. Zeng’s actions imply some urgency to have the spreadsheet printed out in time for his meeting with Chan.

[337] We reject Chan’s submission. There is evidence Chan was well aware of the Company Caretaker List and Mr. Zeng discussed it with him.

[338] Ip, Ho, Hung and Yeung submit they did not see this List before this proceeding commenced and have no knowledge about its origins. The Respondents challenge the translation of “manager” within the title in the traditional English meaning. Rather, they say it refers to someone who “follows up on matters”, is an intermediary or liaison officer. They submit that to rely on a List that is inadequately translated is a far too tenuous basis on which to conclude Sino-Forest controlled its suppliers.

[339] The Company Caretaker List includes companies that we find above, for other reasons, were controlled by or related to Sino-Forest. The Panel further finds this List makes it more likely than not Chan was aware Sino-Forest had control, or significant influence, over these companies.

**(d) Huang Ran**

[340] Huang Ran figures prominently in Sino-Forest’s operations. Huang Ran is listed in the Company Caretaker List as either Registered Shareholder, Legal Representative, Nominee Manager, Follower or Manager for companies including:

- Yuda Wood (supplier)
- Gaoyao City Xinqi Forestry Development Co., Ltd. (customer)
- Meishan (customer)
- Taiyuan (supplier)
- Guangxi Pingle Haosen Forestry Development Co. Ltd. (customer and supplier)
- Kun’an (supplier)
- Guangxi Chihui Forestry Co. Ltd. (supplier)
- Jiangxi Province Senchangtai Forestry Co. Ltd. (supplier)
- Yongzhou City Maoxiang Forestry Development Co. Ltd. (supplier)
- Yuangao (supplier)
- Dacheng (supplier)

[341] These companies are located in the four bordering provinces of Hunan, Jiangxi, Guangxi and Guangdong. As has been noted previously, the Respondents take issue with the translations of the words used in these documents to describe Huang Ran’s role. Putting the issue of specific translations aside, these documents show that Huang Ran was involved with many suppliers and customers purported to be operating at arm’s length to Sino-Forest. The fact of his prolific involvement with companies purportedly operating independently is more important to us than the title ascribed to his role with each company.

[342] The evidence shows Huang Ran participated in internal Sino-Forest meetings and was on the Sino-Forest payroll during some of the same periods he was involved with suppliers and a customer.

[343] The Respondents submit that because of obstacles, including tensions between residents of Mainland China and Hong Kong, and difficulties in conducting business between Hong Kong and Mainland China, including those related to the language differences of Mandarin and Cantonese speakers, Huang Ran was used as an intermediary to bridge the gap

in *guanxi*, language and culture. If true, this would mean Huang Ran's influence spanned the four provinces in which these companies did business. Sino-Forest had control over the bank accounts of Yuda Wood, a company owned 50% by Huang Ran (through his 50% ownership of HK Sonic Jita). The Respondents submit the reason Sino-Forest controlled these bank accounts was to maintain leverage over this supplier in cases of disagreement. This does not accord with Sino-Forest's reliance on Huang Ran, based on *guanxi*, to act on its behalf with other suppliers and AIs to bridge the gap in language and culture.

- [344] We did not hear direct testimony from Huang Ran and must draw inferences based on the evidence presented, including numerous emails.
- [345] When interviewed in September 2011 by the advisors to the Independent Committee, Huang Ran declined to disclose the names of the supporters behind Yuda Wood, whether himself or others. Huang Ran was also recorded as majority owner in three other Sino-Forest suppliers: Guagnxi Chihui Forestry Co. Ltd., Jiangxi Senchangtai Forestry Co. Ltd. and Taiyuan. Huang Ran also stated he dealt only with aggregators, not farmers. Ho however, testified Huang Ran would act as an intermediary or facilitator with farmers. This inconsistency further undermines the Respondents' explanation of Huang Ran's role.
- [346] We find Yuda Wood, Taiyuan and Kun'an were controlled by, or related to, Sino-Forest through Huang Ran as its nominee. Huang Ran facilitated the control or significant influence Sino-Forest had over supposedly independent third party suppliers and customers.

## 5. *Guanxi*

- [347] The Respondents provided extensive expert evidence on the concept of *guanxi* in a cultural and business context. Mr. Martin testified that *guanxi* relates to a level of cooperation that is essential to business and personal relationships in China. *Guanxi* is the concept of drawing on connections in order to secure favours and reciprocal obligations, is based on intricate and pervasive relational networks, and can be distinguished from the Western concept of networking (Yadong Luo, *Guanxi and Business*, 2d ed (Singapore: World Scientific Publishing Co. Ptd. Ltd., 2007) at 2). Dr. Peerenboom described *guanxi* as being a reference to ethical relationships based on communication, trust and loyalty built over time. It refers to relationships between people, primarily, not companies and is a form of human capital. Dr. Peerenboom, who provided expert evidence on Chinese law, culture and business, likens *guanxi* to concentric circles, with the sense of obligation higher the closer one is situated in the circles to the centre. While *guanxi* is not meant to facilitate illegal business transactions, he testified that it could lead to someone doing something illegal on behalf of someone else.
- [348] The Respondents submit the prevalence of *guanxi* explains the close cooperation with suppliers and customers and is not evidence of control or influence. They submit that, in the rural locations in which Sino-Forest purchased plantations, the fact that one had a contract for standing timber did not necessarily guarantee access to the trees. Therefore, Sino-Forest relied heavily on its suppliers. This of course does not address the "close cooperation" Sino-Forest exhibited with some of its customers, including Meishan and Dongkou.
- [349] While the submission regarding access to trees is disconcerting because it calls into question the enforceability of contract law, the close relationship that Sino-Forest had with many of its suppliers and customers goes far beyond *guanxi*. The evidence shows Sino-Forest had control over bank accounts, was negotiating contracts between supposed independent third parties, had access to confidential competitive information and tax information, was considering using Yuda Wood to apply for a loan for Sino-Forest, and can be traced to having capitalized various companies. An email from a Sino-Forest employee stating a company was "100% under our control" is evidence of a relationship that went far beyond *guanxi*. Dr. Peerenboom, when asked in cross-examination if he would expect a supplier to share its financial records with its customers, he replied:

You know, this is a very unusual type of information for – to be asked for in this context, and so they would, yes, be reluctant to provide that type of information. ... To share the details of your purchase and sales agreements and all and so forth, yes. It's not generally the normal course of business.

(Hearing Transcript, April 8, 2015 at 103:25-104:9)

- [350] The Panel is cognizant of cultural differences that companies encounter globally; however, Sino-Forest was listed on the TSX, was an Ontario reporting issuer, raised US \$3 billion of capital from Investors, and was required to issue financial statements prepared in accordance with Canadian generally accepted accounting principles. For the purposes of our analysis, Ontario securities law is paramount and overrides any explanations for illegal conduct being excusable in the name of *guanxi*, however it is defined.

**6. Conclusion: The Real Issue is Control and Value**

- [351] Staff alleges Sino-Forest established a network of counterparties that were controlled on its behalf by various nominees. If true, this control or influence would call into question whether the transactions with these suppliers and AIs were carried out at arm's length and therefore recorded at fair value and, more basically, if the transactions actually occurred. The result of this would be that Investors could not rely on the revenue and assets reported on Sino-Forest's financial statements. The true economic substance of the underlying transactions recorded with these companies would be misstated and the disclosure would be misleading.
- [352] The question of control is directly related to value, existence and ownership. In the BVI Model, because there were no cash records or bank statements to verify transactions, significant weight was placed by E&Y during their audit process on the Audit Confirmation Letters. The auditors relied on these for independent verification of Sino-Forest's business – with independence being a key fundamental test.
- [353] After the Muddy Waters Report, when Fred Clifford of E&Y learned that the payments made in the AR/AP Set-Off Process were not directly between the supplier and the AI but instead may have involved three, four, five or more intermediaries, he referred to this as a “daisy chain of cash” and testified the risk of fraud and the risk of the existence of the transactions would be dramatically increased (Hearing Transcript, November 17, 2014 at 84). When asked to explain the risk he was speaking of, Mr. Clifford stated: “Well, I think it goes to the fraud risk. It goes to the risk to the existence of these transactions, the completeness of these transactions. I think it's pretty broad-based” (Hearing Transcript, November 17, 2014 at 140:20-24). With this “daisy chain of cash”, there was no way for E&Y to confirm the transactions actually took place.
- [354] Further, if suppliers and customers were related to Sino-Forest, then the Audit Confirmation Letters were, according to Mr. Clifford, “not really audit worthy evidence” (Hearing Transcript – November 17, 2014 at 130). Mr. Clifford testified the Audit Confirmation Letters were documents E&Y would produce and retain custody of, would separately forward to suppliers and customers and would retain to get assurance about the nature and validity of these transactions. Mr. Clifford called these letters key and foundational to the audit process. The auditors sent these letters directly to suppliers and customers and believed they were receiving the letters directly back as well. However, the evidence shows Sino-Forest was inserted into this process to provide the information to supply to E&Y. The objective of these Audit Confirmation Letters was to support the legal ownership of the assets by Sino-Forest. The Audit Confirmation Letters did not provide any independent verification of ownership or revenue in the BVI Model. The fact that these suppliers and customers were controlled or related parties, and not independent of Sino-Forest, was extremely significant in the context of ownership and the revenue reported by Sino-Forest from sales of standing timber.
- [355] E&Y received direct confirmation in management representation letters from Sino-Forest senior management, including Chan, that suppliers and AIs were not related parties. Clifford described these as the “foundation to the audit process” (Hearing Transcript – November 17, 2014 at 34). They were critical and without them, the auditor would not release its audit opinion. In these management representation letters, management confirmed the information provided was complete, there were no related parties that were not disclosed and the offsets were genuine and complete. The auditor required management to represent: (1) the transactions are real; (2) they happened; and (3) they were between third parties without any mutual interest among them. Each year this management letter was signed by Sino-Forest senior management and specifically by Chan. After the Muddy Waters Report, Sino-Forest management, including Chan, were asked to provide an updated management representation letter. They did not.
- [356] The Respondents submit the real issue is not control but value, and criticize Staff for not providing expert accounting evidence as to why the concept of control over suppliers or customers actually matters. To the Panel, the “why” is self-evident, and was explained very comprehensively by Mr. Clifford.
- [357] The Panel finds the lack of independence of purportedly arm's length customers and suppliers has been well established. This directly calls into question the true economic substance of transactions between Sino-Forest and these companies, and therefore the value of assets and revenues recorded. The financial statements that the individual Respondents certified or sub-certified as true and on which investors are entitled to rely, did not present fairly the financial position of Sino-Forest and the results of its operations. Sino-Forest's deceitful disclosure put the financial interests of its investors at risk.

**7. The Roles of Chan, Ip, Hung, Ho and Yeung**

- [358] We find Chan knew of, and was involved in, Sino-Forest's undisclosed control of Yuda Wood.
- Between 1993 and 1997, Chan, Chan's mother and his best friend owned the company that had a one-third interest in HK Sonic Jita, Yuda Wood's parent company. During this time, Chan was a director of HK Sonic Jita's predecessor company and CEO of Sino-Forest.

- A loose document on his executive assistant's computer that listed corporate information for Sino-Forest's BVI, Canadian and Hong Kong subsidiaries included HK Sonic Jita.
- Chan was also involved in the monitoring of Yuda Wood's accounts. Ho's evidence was that he discussed getting leverage over suppliers by monitoring their bank accounts with Chan, and could not recall whether this was his idea or whether it came up in discussions with Chan.
- Chan was copied on two emails regarding an increase in tax owed by Yuda Wood and adjusting Yuda Wood's cost base on a purchase from another supplier, which evidence Sino-Forest's control of Yuda Wood.
- Chan was also copied on every email in the 31-page email chain regarding the SAFE investigation. Emails in this chain indicate Sino-Forest's control over Yuda Wood.
- When shown the document that states Yuda Wood was "100% under our control" during the Independent Committee investigation, Chan's response indicates he was aware Sino-Forest controlled Yuda Wood.
- Chan approved the advance of Sino-Forest funds for payment for the Ansu Factory purchased in the name of Yuda Wood.

[359] Chan was involved in selecting the corporate name for Kun'an, another Sino-Forest supplier in the BVI Model, which we find was related to Sino-Forest.

[360] Chan was well aware of the contents of the Company Caretaker List, which we find makes it more likely than not Chan was aware Sino-Forest had control, or significant influence, over the companies it listed.

[361] We find Ip was involved in, and therefore knew of, Sino-Forest's control of Yuda Wood:

- He was involved in the business operations of Yuda Wood's parent company, HK Sonic Jita.
- Ip oversaw the changing shareholder structure of HK Sonic Jita and was provided with updates as corporate changes were made.
- Ip was kept informed about the capitalization of Yuda Wood by Sino-Forest.
- Ip was sent draft documents for Yuda Wood's purchase of the Ansu Factory.
- Along with Ho, Ip approved six payments to Gengma Dai from the Yuda Wood bank accounts controlled by Sino-Forest that totaled RMB 30.3 million.
- Ip was sent the document that states Yuda Wood is "100% under our control".
- Ip directed Ho to resolve Yuda Wood's income tax issues.
- Ip was involved in adjusting Yuda Wood's cost base on a purchase from another supplier.

[362] We find Ip was aware of Sino-Forest's non-arm's length relationship with Kun'an:

- He was copied on emails from Yeung, which indicate the significant influence Sino-Forest exerted over Kun'an.
- He instructed that Kun'an should have two bank accounts and two seals.
- Along with Ho, he was copied on an email that shows a Sino-Forest subsidiary transferring RMB 4 million to Kun'an to pay the registered capital for two other purportedly arm's length companies.

[363] We find Ip was also involved in Sino-Forest's control over Taiyuan:

- Huang Ran reported to Ip on the operations and financial condition of Taiyuan.
- Ip had been monitoring Taiyuan's bank account since before 2007.
- He agreed that Sino-Forest was using its employees as nominee directors for Taiyuan.



- [364] We find Ip was also involved in Sino-Forest's control or significant influence over other companies. Ip was sent multiple drafts of contracts between Dongkou and Gengma Dai for his review and comment, and was asked to arrange payment to Gengma Dai. Ip was sent a May 2011 email that shows Sino-Forest was considering using the purportedly independent company Shun'xuan to falsify transactions during the SAFE investigation but could not as Shun'xuan had not been incorporated at the time of the 2008 transactions. He arranged Yuangao's bank account. Huang Ran provided him with bank account balance information for suppliers and customers of Sino-Forest including Kun'an, Juncheng, Yuangao and Meishan, which we find were related to, Sino-Forest.
- [365] Ip was copied on an internal Sino-Forest email regarding E&Y Audit Confirmation Letters, in which Huang Ran and Yang Jun are listed as "followers" for supposedly independent companies listed as "related entity". We concluded that Sino-Forest should have been far removed from this confirmation process between E&Y and Sino-Forest's suppliers and customers.
- [366] We find Hung was less involved in Sino-Forest's undisclosed control of purportedly independent companies. He was involved in and knew of Sino-Forest's involvement with the supposedly independent Audit Confirmation Letter process. He was forwarded an email from an employee of Juncheng to a Sino-Forest employee in which Juncheng is described as a peripheral company and the Sino-Forest employee is asked to confirm seven letters of enquiry from E&Y regarding settlements of receivables. In her forwarding email, the Sino-Forest employee informs Hung that she will print out the letters and send them to E&Y.
- [367] We find Ho was involved in Sino-Forest's control of Yuda Wood. Huang Ran stated in an interview during the Independent Committee investigation that Ho controlled one of Yuda Wood's bank accounts. Along with Ip, Ho approved payments from Yuda Wood to Gengma Dai totaling RMB 30.3 million from accounts controlled by Sino-Forest. Ho's approval was also required to apply Yuda Wood's corporate chops to a proof of receipt of funds document.
- [368] Ho was copied on an email that indicated a Sino-Forest subsidiary paid RMB 4 million to Kun'an to pay for the registered capital of two other companies that were purportedly independent of Sino-Forest. He was also asked to confirm whether internal approval procedures were needed to use an account belonging to Yuangao, a purportedly independent company, which we found was related to Sino-Forest.
- [369] Ho was copied on an internal Sino-Forest email regarding E&Y Audit Confirmation Letters, in which Huang Ran and Yang Jun are listed as "followers" for supposedly independent companies listed under the heading "related entity". We concluded that Sino-Forest should have been far removed from this confirmation process between E&Y and Sino-Forest's suppliers and customers. Ho was also sent the May 2011 email that shows Sino-Forest was considering using Shun'xuan to falsify transactions during the SAFE investigation.
- [370] We find Yeung was very involved in Sino-Forest's control over Yuda Wood:
- He held Yuda Wood's corporate chops on behalf of Sino-Forest from April to August 2006 and directed his subordinates to use them to open a bank account in Yuda Wood's name.
  - Yeung signed the Ansu Factory purchase agreement in the name of Yuda Wood, prior to Yuda Wood's incorporation.
  - It is not disputed that Huang Ran requested Yeung's help in registering Yuda Wood, and subsequently a Sino-Forest employee registered Yuda Wood as a corporation, under Yeung's direction.
  - Finally, Yeung sent out the document regarding Yuda Wood that states "its operating authority is 100% under our control".
- [371] We find Yeung was also involved in Sino-Forest's non-arm's length relationship with Kun'an. He informed Huang Ran that Kun'an needed a fixed office location and that it was to be built up so that "it looks like a company with substance". Yeung also told Huang Ran to "build up Kun'an as if it is a new company". By the time of these emails from Yeung, Sino-Forest had recorded 12 contracts with Kun'an worth RMB 1,226,683,784 (US \$179,549,163).

## **C. Deceitful Documentation Allegations**

### **1. Positions of the Parties**

#### **(a) Staff**

- [372] The second element of the Standing Timber Fraud Allegations by Staff is a deceitful documentation process. Staff alleges Sino-Forest falsified evidence of ownership of the vast majority of its standing timber assets by engaging in a

deceitful documentation process. The alleged **Deceitful Documentation Process** employed in the BVI Model involved the creation of deceitful purchase and sales contracts and their key attachments. Staff submits this resulted in Sino-Forest consistently misstating its revenue throughout the Material Time. Staff alleges the Deceitful Documentation Process put the pecuniary interests of investors at risk and constitutes fraud. Staff submits Sino-Forest, Chan, Ip and Hung were directly involved in the fraudulent deceitful documentation and that Ho authorized, permitted and acquiesced in Sino-Forest's actions in breach of Ontario securities law regarding the fraudulent Deceitful Documentation Process. Staff does not allege Yeung had a role in the Deceitful Documentation Process.

- [373] Staff alleges the documentation processes for both Sino-Forest's purchases and sales were dishonest.
- [374] Staff alleges BVI purchase contracts and their three attachments were fundamentally flawed in the following ways:
- a. since the BVI subsidiaries could not obtain PRCs (Forestry Rights Certificates) from the Chinese Forestry Bureau, Sino-Forest relied on Forestry Bureau Confirmations as evidence of ownership of standing timber allegedly purchased by the BVI subsidiaries;
  - b. Sino-Forest employed a deceitful quarterly documentation process whereby Sino-Forest drafted and executed the BVI purchase contracts and created the Forestry Bureau Confirmations in the quarter after the dates on which the purchases allegedly occurred and were included in Sino-Forest's public financial disclosure;
  - c. although the purchase contracts referred to attached letters of authorization and resolutions of the villagers (**Villagers' Resolutions**) (sometimes translated as "farmers authorizations"), these documents were not attached, and there is no evidence that ownership of the standing timber was ever properly transferred to Sino-Forest or its suppliers; and
  - d. the attached reports on a survey conducted for the plantation being purchased (the **Survey Reports**) were prepared by one survey company, and drafts of the Survey Reports were, in some cases, located on the computer of a Sino-Forest employee and were deceitfully dated to the quarter prior to their creation.
- [375] Staff submits this flawed purchase documentation does not constitute proof of ownership and does not identify the precise location of the standing timber being purchased such that its existence could be readily verified and independently valued.
- [376] With respect to the sales contracts, Staff alleges they were similarly created and executed in the quarter after the date on which Sino-Forest purportedly entered into the sales contracts. This resulted in Sino-Forest recognizing revenue in the BVI Model in the quarter prior to the creation of the sales contracts and publicly disclosing its revenue from standing timber for that quarter in a manner that was materially misleading and deceitful.
- [377] Staff alleges Sino-Forest misled the Commission regarding its revenue recognition process during the Material Time in its correspondence to Staff.

**(b) Respondents**

- [378] Chan denies Sino-Forest's purchase and sales documentation process was deceitful or fraudulent.
- [379] Ip, Hung and Ho admit Sino-Forest employed a quarterly process of drafting and executing purchase contracts and Forestry Bureau Confirmations in the quarter after the purchases occurred, but they submit there was nothing deceitful about the timing of documents within the BVI business. They submit the purchase and sales documentation was based on oral contracts entered into on the stated date of the contract and the Respondents believed there were valid business efficiency reasons for preparing contracts and their supporting documents towards the end of a quarter or early the following quarter.
- [380] Hung and Ip submit they were forthcoming about the fact the written contracts were prepared at the end of the quarter or early in the following quarter. They submit Sino-Forest's Legal Department, Mr. Horsley, Mr. Maradin and the Audit Committee were all aware of Sino-Forest's practice with respect to contract preparation and Chan's role in signing and approving the final contracts. Ip, Hung and Ho submit, given the Audit Committee, the CEO, the CFO and the Vice-President, Risk Management knew the practice of batching and post-dating contracts, it is unfair to expect more junior members of management of Sino-Forest, such as Ip, Hung and Ho, to be wary of this practice.
- [381] The Respondents submit the BVI AR/AP Set-Off Process was employed by many companies in Mainland China and was well-known within Sino-Forest, including to the Board of Directors, and to E&Y. Moreover, Pöyry, an independent forestry valuator, conducted annual site visits to Sino-Forest's timber assets and never raised any questions about the

legitimacy of the BVI business. Hung and Ip maintain they would therefore be justified in thinking the BVI Model, which was in use when they both joined Sino-Forest, constituted a *bona fide* business.

- [382] In addition, Chan submits, as CEO, he relied on K.K. Poon and the Operations Department for their forestry education, skills and expertise and, in particular, to interface with the Chinese domestic companies and people necessary to conduct the day-to-day standing timber business.
- [383] Chan submits Mr. Poon established Sino-Forest's forestry business and had the technical knowledge about the species of trees, growing considerations, forest management, resource conservation and harvesting. He submits Mr. Poon was responsible for managing all Sino-Forest's operations, including the standing timber business, for the ten years before Ip became involved, recruited management for Sino-Panel's Operations Department and established Sino-Forest's business relationships in the Chinese forestry industry.
- [384] Chan submits he similarly relied on Albert Ip and Albert Zhao, who took over Mr. Poon's responsibilities for BVI standing timber purchases and sales. Chan submits Mr. Zhao was responsible for negotiating sales with the AIs and, additionally, liaising with local governments, and Ip was responsible for the general supervision and management of the Sino-Panel Group.
- [385] Chan submits his role in Sino-Forest's standing timber business was to set the strategy, including which provinces to expand into, establish a budget, approve purchases, and sign contracts for standing timber. He submits his "frontline" role in the field as CEO was largely ceremonial, and his reliance on others was reasonable as there were no red flags that should have alerted him to potential issues in Sino-Forest's BVI business.

## 2. BVI Purchase Documentation

- [386] Staff alleges the BVI purchase contracts and their three attachments were fundamentally flawed.
- [387] Mr. Horsley, Mr. Clifford and the Independent Committee all believed the purchase contracts and the Forestry Bureau Confirmations were the primary evidence of Sino-Forest's ownership of the BVI standing timber holdings. We first consider the purchase contracts.

### (a) Purchase Contracts

- [388] Sino-Forest's purchase contracts in the BVI Model followed the same standard template. They were prepared by Sino-Forest personnel and signed and/or chopped by K.K. Poon or Ip, and the supplier. When translated into English, they were generally four pages in length.
- [389] Purchase contracts contained a "Subject of Acquisition" clause which provided little detail about the asset being purchased. For example, a BVI purchase contract from October 2010 provides the following limited amount of detail about the asset that is the subject of the transaction:

Tree Species: Yunnan pine, broad-leaved trees.

Location: Lijiang City

Area: 102,449.90 mu (6,829.99 hectares)

Timber Stock: 810,792.17 m<sup>3</sup>

Proprietorship: Collective proprietor

Plantation area measurements are generally expressed in "mu", a Chinese measurement of land. 15 mu is roughly equivalent to one hectare. Harvested timber is generally priced by volume and measured in cubic meters. The stock volume in a purchase contract for standing timber would be an estimate of the yield upon harvesting.

- [390] BVI purchase contracts also included provisions for obtaining harvesting permits and logging the timber, and the right of first refusal on the transfer of forestland after harvest. They also specified that the rights being transferred were standing timber rights.
- [391] Sino-Forest entered into MFAs (Master Framework Agreements) for provinces in which it purchased standing timber. MFAs were designed to lock in a supplier who would either provide standing timber directly, or get other suppliers to sell standing timber, to Sino-Forest. These MFAs were not referenced in Sino-Forest's purchase contracts, which were with various third party suppliers and not limited to suppliers with whom Sino-Forest entered into MFAs.

- [392] Each Sino-Forest standing timber purchase contract recited it included the following three attachments:
- a. Survey Report;
  - b. Villagers' Resolutions; and
  - c. Forestry Rights Certificate (*i.e.*, PRC) or other proof of ownership to verify the ownership of such timber.
- [393] Each purchase contract referred to Villagers' Resolutions and PRCs as attachments. Ip, Xu Ni (Sino-Forest's Vice-President of Legal Affairs) and Kenny Wong (a Sino-Panel employee who reported to Hung) stated they never saw a Villagers' Resolution attached to any BVI standing timber purchase contracts. The *Second IC Report* states none of the BVI contracts had either a PRC or a Villagers' Resolution attached. Following the release of the Muddy Waters Report, the Independent Committee asked Sino-Forest management to obtain these attachments and the Independent Committee advisors asked the suppliers to obtain the same documentation. Nothing was produced.
- [394] In Staff's review of the BVI purchase contracts during the investigation into this matter, Staff was unable to find any attachment (b) or (c), above. Ms. Shao testified that these were never provided by Sino-Forest, although requested by Staff. Ms. Man confirmed that she never saw a Villagers' Resolution attached to a BVI purchase contract and never saw a PRC for a BVI standing timber purchase
- [395] The Respondents submit Sino-Forest's Legal Department developed the purchase contract template and Forestry Bureau Confirmation template. Xu Ni had no forestry experience or legal training in forestry. She stated the templates were drafted with the help of outside legal counsel and including the PRCs and Villagers' Resolutions as attachments was on the advice of external counsel. She stated, however, that she had never seen these attachments for purchases in the BVI Model. She agreed if attachments were missing, there would be problems "to understand the ownership of title, if the timberland exists, and where those trees are". Ms. Xu Ni stated she raised these issues about attachments to purchase contracts with Chan and the Operations Department.
- [396] Prior to Q2 2010, K.K. Poon signed every BVI purchase contract on behalf of Sino-Forest. Subsequently, they were signed by Ip. Each quarter, the purchase contracts were prepared by Kenny Wong along with the Forestry Bureau Confirmations, which we discuss next. Kenny Wong prepared all the BVI purchase contracts by merging a template contract with an Excel spreadsheet of purchase information emailed to him by Hung.
- [397] Mr. Clifford explained the process he followed in E&Y's review of the purchase contracts for the audits of Sino-Forest from 2007 to 2010. He testified the critical components of standing timber purchase and sales contracts, which were in Chinese, were explained to him by an E&Y Chartered Accountant on the audit team who was fluent in that language. Mr. Clifford testified he was not aware two of the attachments contemplated in the purchase contracts were not in fact attached, and did not recall whether he was aware that these attachments were required. After reviewing the *Second IC Report*, Mr. Clifford was "disappointed in the fact that, you know, evidence that was supposed to be there was not attached to those contracts" (Hearing Transcript, November 17, 2014 at 94:21-23).

**(b) Forestry Bureau Confirmations and PRCs**

*i. Forestry Bureau Confirmations*

- [398] We first consider one of the three documents meant to be attached to purchase contracts, Forestry Rights Certificates (*i.e.*, PRCs) or other proof of ownership.
- [399] Official government PRCs were never issued as proof of ownership for Sino-Forest's purchases in the BVI Model. Ip and Xu Ni stated PRCs could not be obtained for standing timber ownership alone. Hyde and Ip further testified that BVIs, as foreign companies, could not own land use rights. As discussed elsewhere in these Reasons, eligibility of foreign companies to obtain PRCs in different provinces and counties varied during the Material Time, as did Forestry Bureau practices with respect to the registration of separate ownership of standing timber and land use rights. We heard evidence changes to the legal regime were contemplated that would permit the registration of standing timber alone; this practice had not been implemented by the Forestry Bureaus in the regions where Sino-Forest operated. When the Independent Committee advisors visited Forestry Bureaus, a number of Forestry Bureaus expressly indicated foreign offshore companies (such as BVIs) were not entitled to obtain PRCs. We find it more likely than not PRCs could not and would not be issued to Sino-Forest BVIs during the Material Time because (i) they traded in only standing timber, and (ii) they were foreign offshore companies.
- [400] In circumstances where Sino-Forest subsidiaries (BVI and WFOE) could not obtain PRCs as proof of their asset ownership, Sino-Forest sought alternative evidence of ownership in the form of Forestry Bureau Confirmations. For every BVI purchase and for those WFOE purchases that did not involve land use rights, Sino-Forest instead requested

Forestry Bureau Confirmations. Forestry Bureau Confirmations were documents prepared by Sino-Forest on the basis of a template, issued on the letterhead of the applicable local Forestry Bureau and addressed to the supplier selling timber assets to Sino-Forest. During the Material Time, the content of the Forestry Bureau Confirmation followed the same general format, an example of which is provided in a Confirmation issued by the Hezhou City Forestry Bureau to one of Sino-Forest's suppliers, Dacheng, in 2008. It reads:

To: Guangxi Dacheng Wood Co., Ltd.

CC: Sino-Panel (Hezhou) Co., Ltd.

We have received the "Timber Acquisition Contract" ("Contract") (see the attached detailed list of contracts) submitted to our office by your company. After examination, we agree to your company's transfer of the relevant eucalyptus, pinewood, and mixed-wood to Sino-Panel (Hezhou) Co., Ltd. according to the terms specified in the Contract.

With regard to your application for processing the change of timber ownership, we are temporarily not able to process the registration of the change in the relevant timber ownership to the transferee, Sino-Panel (Hezhou) Co, Ltd. since our city has not implemented in full the works of forest rights registration, licensing, and the reissue of the new version of the forest rights certificate. Our office agrees that we shall arrange to process the above for Sino-Panel (Hezhou) Co., Ltd. and issue "The People's Republic of China Forest Rights Certificate" according to the uniform timetable of the city government.

At the same time, our office confirms that, upon the maturity of the eucalyptus, pinewood and mixed-wood under the provisions of the Contract, Sino-Panel (Hezhou) Co., Ltd. shall have the rights to harvest, transport and sell the aforementioned mature timber according to the law. We also agree that the aforementioned mature timber shall be listed in the harvesting quota of that year and ensure the harvesting quota allocation to Sino-Panel (Hezhou) Co., Ltd. However, prior to harvesting and transportation, applications for the corresponding harvesting and transportation permits must be made to our office according to the law.

This serves as our certification.

The Forestry Bureau Confirmation was sealed with the chop of the issuing Forestry Bureau. Listed on a second page was the name of the seller, purchaser, area in hectares, stock volume in cubic metres and the date the contract was signed, which was also the same date as on the Confirmation. Forestry Bureau Confirmations issued during the Material Time consistently stated, in effect, the local Forestry Bureau had not yet fully implemented changes to the forestry registration regime but would issue PRCs at some future time. The message did not change during this five-year period.

[401] Ip testified Forestry Bureau Confirmations were sought at the request of Sino-Forest's Legal Department. He explained industry practice was not to issue PRCs unless the transfer of land use rights was involved and it was uncommon to request some other form of proof of ownership from Forestry Bureaus. Rather, Forestry Bureaus obliged the request from the "Canadian side" and agreed to issue Forestry Bureau Confirmations as evidence of standing timber ownership. Ip explained the requirement for Forestry Bureau Confirmations as being a unique requirement for Sino-Forest, as a Canadian company operating in Mainland China:

It is a cultural difference between the East and the West. In China, in the forestry industry, it was very straightforward. You buy, you sell. And the PRC is only issued where land is involved.

For Sino-Forest, the legal department requested for the confirmation letter because of the Canadian side request to – in order to evidence ownership, the confirmation letter had to be issued, and therefore the suppliers had to arrange with the forestry bureau to issue this confirmation letter.

And, in fact, sometimes I would be laughed at. They would say, jokingly, "You want to buy these vegetables growing in the fields? Would you request the farmer to issue an ownership right before you will buy these vegetables from the fields?" They would say that.

(Hearing Transcript, September 16, 2015 at 16:2-17)

[402] Signed Forestry Bureau Confirmations were supplied to, and relied on by, Sino-Forest's auditors. Josephine Man of E&Y testified that, based on discussions with Sino-Forest management and legal opinions from Sino-Forest's counsel, E&Y understood Forestry Bureau Confirmations to be documents the Forestry Bureau would issue under normal

circumstances and were evidence BVI subsidiaries were the legal owners of the plantation assets from the date of the purchase contract. She understood Forestry Bureau Confirmations were obtained in circumstances where Sino-Forest was not able to obtain the new form of PRC as a result of Forestry Bureau backlog in implementing forestry reform at the local level. This was consistent with statements in the Forestry Bureau Confirmation letters. From discussions with Mr. Horsley, she further understood Sino-Forest had applied for PRCs for all its plantation purchases, but because Sino-Forest held timber assets for relatively short periods, the Forestry Bureau did not have enough time to process its requests for PRCs. As we discuss further below, Sino-Forest did not apply for PRCs in the BVI Model. Although E&Y reviewed PRCs for some WFOE purchases, Ms. Man never saw a PRC for a BVI standing timber purchase and was never told they were not available to BVIs for standing timber purchases.

- [403] Mr. Clifford testified he understood Forestry Bureau Confirmations to be official government documents that were only issued after the purchaser and vendor delivered the purchase agreement to the Forestry Bureau, along with supporting documentation that could, in fact, be the PRC. He understood the Forestry Bureau would complete its due diligence with respect to that transaction and would then issue the Forestry Bureau Confirmation, which was satisfactory evidence of title.
- [404] Josephine Man testified she understood the Forestry Bureau Confirmations were prepared and issued by the Forestry Bureau. Ms. Man further testified the terms “Forest Rights Certificate” (*i.e.*, PRC) and Forestry Bureau Confirmation were used interchangeably by the E&Y audit team in documents that referenced checking to ensure Sino-Forest had legal title and ownership. We find these two documents were not equivalent.
- [405] The Respondents submit the Forestry Bureau Confirmation together with the purchase contract are sufficient proof of the transfer of ownership of forestry rights. Sino-Forest obtained legal opinions from external counsel, including one for the benefit of E&Y in 2008, which stated if PRCs could not be processed because of Forestry Bureau backlog, Forestry Bureau Confirmations were valid proof that Sino-Forest BVI subsidiaries owned the standing timber they acquired through purchase contracts. In an interview with Staff during its investigation into this matter, Xu Ni agreed that without the PRC, there was a significant risk that Sino-Forest did not own the assets it claimed to own. The issue of BVIs not being able to obtain PRCs came to Xu Ni’s attention in 2003, the year she joined Sino-Forest. Nonetheless, the BVI purchase contracts continued to reference PRCs.
- [406] During the hearing, we learned the Forestry Bureau Confirmation was originally created by Sino-Forest and was presented to the Forestry Bureau by the supplier to affix its official chop to the document. The Independent Committee advisors initially understood the Forestry Bureau Confirmations were independently obtained by suppliers from the Forestry Bureaus. However, they learned these Forestry Bureau Confirmations were actually prepared by Sino-Forest, and, in at least some cases, on the official letterhead of the local Forestry Bureau. Generally, the supplier had the local Forestry Bureau transfer the Confirmation, prepared by Sino-Forest, onto Forestry Bureau letterhead and chop it. Hung oversaw the preparation of Forestry Bureau Confirmations. They were prepared by Kenny Wong, along with the purchase contract documentation, after the quarter in which Sino-Forest recorded the purchase. Although the Confirmations had the same date as the purchase contract to which they related, Hung explained this was at the request of the Sino-Forest Legal Department and was not the date on which the Forestry Bureau actually chopped the document.
- [407] In contrast to the process for issuance of PRCs, according to Ip, the Forestry Bureau did not require the presence of the seller and purchaser for the issuance of Forestry Bureau Confirmations. Rather, Ip explained it was the supplier’s responsibility to have the Confirmations issued, and Sino-Forest personnel would only visit the Forestry Bureau to deal with issues about harvesting quotas and inquiries about whether there were forests available for purchase in the jurisdiction. Sino-Forest would ask the supplier to request the Forestry Bureau issue the Confirmation.
- [408] The Forestry Bureau Confirmations were standard in format and stated the Forestry Bureau had reviewed the purchase contract, approved the contract arrangement and confirmed that BVIs were entitled to harvest, transport and sell timber. The term regarding harvesting contradicts evidence we heard from Mr. Liu that an owner of standing timber requires a PRC, or the assistance of a PRC holder, to obtain a harvesting permit.
- [409] The sample Forestry Bureau Confirmation at paragraph [400], above, states the Forestry Bureau is “temporarily not able to process the registration”. This is misleading, as it implies the Forestry Bureau would be able to issue a PRC to a BVI at some point in the future. This is untrue – a PRC would not be issued to a BVI.
- [410] The Forestry Bureau Confirmation also states the Forestry Bureau agrees to issue PRCs to BVIs and to register the timber ownership “according to the uniform timetable of the city government”. This term – that the Forestry Bureau will issue a PRC to the BVI – is false and calls into question the authenticity of the document itself, as Forestry Bureaus would have been aware that foreign companies, such as BVIs, could not obtain PRCs. No evidence was presented that there was a “uniform timetable” to issue PRCs to BVIs.

[411] Mr. Henderson testified the primary objective from the onset of the Independent Committee investigation was to reconfirm the original Forestry Bureau Confirmations, as they were the primary piece of information supporting title to Sino-Forest's standing timber. In their November 13, 2011 Report on Process to Date (a schedule to the *Second IC Report*), the Independent Committee advisors state:

Senior Management expressed strong concerns about approaching the forestry bureaus to reconfirm existing confirmations obtained by the Company. Reasons for these concerns included:

- (i) such confirmations were not standard forestry bureau documents, contained statements that could embarrass the forestry bureau officials (see (iii) and (iv) below), and were issued as a favour to the Company;
- (ii) SF had been asked to keep the existence of such documents confidential, so if any party other than SF was to seek reconfirmation of them, the forestry bureaus would likely deny having issued them;
- (iii) the forestry bureaus may have exceeded their authority in issuing such confirmations, especially as they related to harvesting and transportation rights, and therefore the officials could risk sanctions if they reconfirmed the earlier documents;
- (iv) references contained in the existing confirmations may contradict the position of the Chinese Central Government and thus cause embarrassment to officials, since many of the forestry reforms may not have been implemented; and
- (v) the relationships developed by SF with the forestry bureaus would be jeopardized by this process.

[412] The *Report on Process to Date* set forth 18 factors which affected these visits and the confirmation process, including:

- management did not provide a comprehensive list of plantation assets reconciled to its financial statements until June 23, 2011;
- shortly after the Muddy Waters Report, management caused all Forestry Bureau Confirmations to be relocated from their various locations in the Sino-Forest organization to Guangzhou, which resulted in a delay in these documents being available to the Independent Committee advisors. Management explained the Forestry Bureaus wanted them returned as they may have exceeded their authorities in confirming some rights. The confirmations were not returned to Forestry Bureaus, but were sighted by Independent Committee advisors in the offices of Sino-Forest's Chinese counsel;
- Forestry Bureau officials were not required to meet with the advisors;
- prior to August 29, 2011, the Advisors were not allowed to ask any questions relating to existing Forestry Bureau Confirmations. The new Forestry Bureau Confirmations that were issued simply confirmed that Sino-Forest had a contract to purchase standing timber;
- the time made available for meetings with Forestry Bureaus was limited and the Independent Committee advisors were not permitted to ask certain questions;
- certain Forestry Bureaus either deferred or denied advisors access to their plantation rights registries;
- in some instances, the new Forestry Bureau Confirmations would not be issued on Forestry Bureau letterhead, which was inconsistent with prior practices and in one instance, the new Confirmation was not issued by the Forestry Bureau but by the "social institution legal person"; and
- at one Forestry Bureau meeting, management represented an individual to be Forestry Bureau First Vice Chief, when in fact this person was no longer in that position and had been paid by Sino-Forest for several months prior to the visit to act as a consultant. In another visit, the Independent Committee advisors learned that the former Vice Chief of the Forestry Bureau was assigned since 2008 to work with Sino-Forest to assist it in conducting its business. This Vice Chief continued to receive a salary from the Forestry Bureau while working with Sino-Forest.

- [413] The Independent Committee was unable to obtain insight into the Forestry Bureaus' process for issuing Confirmations. The internal authorization process is unclear, as the Confirmations were chopped by the Forestry Bureaus but the name of the authorizing Forestry Bureau official did not appear on the document.
- [414] The due diligence process is also unclear, especially given the apparently short turnaround time in which the Forestry Bureau Confirmations were issued. Evidence of 17 Forestry Bureau Confirmations prepared by Sino-Forest in Q4 2010 illustrates this point. These Forestry Bureau Confirmations were sent out, chopped and returned all within 34 days.
- [415] However, the evidence suggests the process for confirming or transferring ownership was both cumbersome and complex. As of January 12, 2011, Sino-Forest had prepared unsigned, unchopped draft purchase contracts and Forestry Bureau Confirmations. For the 17 BVI standing timber acquisitions in Q4 2010, Sino-Forest would presumably have adhered to the following purchase process timeline:
- draft purchase contracts would have been sent to five different suppliers in Mainland China to be signed (and/or chopped);
  - these contracts would then be sent back to Sino-Forest for Ip to sign;<sup>11</sup>
  - the signed contracts and draft Forestry Bureau Confirmations would then be sent to the five suppliers who sold standing timber to Sino-Forest BVIs in Q4 2010 for distribution to 13 different county Forestry Bureaus spread across five provinces;
  - after a due diligence process, which according to the *Second IC Report* and confirmed by Ip, would include Forestry Bureau officials reviewing contracts and upstream PRCs, an on-site investigation and confirmation of ownership with villagers, the Confirmations would have been chopped by the Forestry Bureaus;
  - the 13 Forestry Bureaus would return the contracts and chopped Confirmations to the five suppliers; and
  - finally, by February 14, 2011, the five suppliers would return the contracts and chopped Confirmations for the 17 purchases to Sino-Forest.

According to Sino-Forest's documentation for Q4 2010, this process occurred within 34 days.

- [416] The Forestry Bureaus were located in 13 different counties, in remote locations, described by Chan's counsel as "far-flung provinces of China" (Hearing Transcript, April 27, 2016 at 70:16-17). Mr. Hao testified, in order to confirm ownership and issue a PRC, the Forestry Bureaus would have to confirm the boundaries of the plantation, that there were no disputes and, where the land use rights were held by a village collective, that two-thirds of the villagers consented to the transfer. However, Mr. Hao could not opine on whether the Forestry Bureaus' due diligence for Confirmations was equivalent to the process that occurred when issuing PRCs. When the Independent Committee advisors sought to have new Forestry Bureau Confirmations issued following the release of the allegations in the Muddy Waters Report, they were told by a Forestry Bureau Vice-Chief that it would take approximately four weeks to issue a new Confirmation because due diligence needed to be conducted. Ip agreed the due diligence process described in the *Second IC Report* was consistent with his understanding of the work done by Forestry Bureaus prior to chopping a Confirmation.
- [417] However, the Independent Committee advisors established Forestry Bureaus did not keep track of standing timber-only changes in ownership. Hyde explained they asked several Forestry Bureaus how they were able to issue new Confirmations if they did not maintain records or monitor transfers of standing timber. The Forestry Bureaus stated they had done work, but the Independent Committee advisors were not able to ascertain the nature of this work. The Panel did not hear an explanation as to how the Forestry Bureaus could therefore confirm the supplier had the legal right to transfer ownership of the standing timber to Sino-Forest. We find the geographic distances, the many steps to get the contracts signed and the Forestry Bureau Confirmations issued, make it more likely than not the process for confirming ownership simply did not happen.
- [418] Examples of the dubious reliability of Forestry Bureau Confirmations are found in the Gengma #1 Transactions and the Gengma #2 Transactions, analyzed elsewhere in these Reasons. In the Gengma #1 Transactions, a Forestry Bureau Confirmation purports to confirm the transfer of standing timber from Yuda Wood to a Sino-Forest BVI subsidiary, Suri-Wood Inc. (**Suri-Wood**). Yuda Wood never registered its ownership, and a WFOE subsidiary of Sino-Forest already

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<sup>11</sup> There is some discrepancy about where BVI purchase and sales contracts were physically signed. Management representation letters provided to E&Y and Sino-Forest process descriptions indicate that they were signed in Mainland China. However, Horsley testified it was important the contracts be signed in Hong Kong, and not Mainland China, so there would be no risk of creating a permanent establishment in Mainland China relating to the BVI business.



held a PRC issued for the same plantation. In the Gengma #2 Transactions, a Forestry Bureau Confirmation purports to confirm a transfer of standing timber from Yuda Wood to Suri-Wood despite the fact that Yuda Wood was never the registered owner. Moreover, in both the Gengma #1 and Gengma #2 Transactions, the contracts indicate that Sino-Panel (Yunnan) is the purchaser, not Suri-Wood.

- [419] E&Y, in its annual due diligence audit process, never visited a Forestry Bureau. An internal E&Y memorandum dated July 26, 2010 refers to a rumour from a business contact of a retired E&Y partner who raised concerns about the authenticity of sales and purchase transactions with authorized intermediaries. As a result, E&Y had contemplated visiting the Forestry Bureaus during the 2010 audit as part of the increased rigour of audit procedures around Sino-Forest's business with the authorized intermediaries. However, Horsley informed E&Y that Sino-Forest management, and Chan specifically, was not supportive of E&Y visiting the Forestry Bureaus. Clifford testified E&Y determined in the end it was unnecessary for them to visit Forestry Bureaus.
- [420] Initially, the Independent Committee had been under the (mistaken) impression that the Forestry Bureau Confirmations had been independently obtained by the suppliers. Mr. Henderson testified the Independent Committee advisors initially did not think there would be any problem in obtaining reconfirmation as they had no reason to believe there was any issue in doing so. In the end, the Independent Committee did not reconfirm existing Forestry Bureau Confirmations, as they concluded this would be disruptive to Sino-Forest's existing Forestry Bureau relations. Instead, a new form of Confirmation was issued in some, but not all, instances. The *Second IC Report* describes these new form Confirmations as having "a more limited scope (*i.e.* did not address issues such as transportation, harvesting, and sale, as SF did not have those rights)" (*Second IC Report* at 42) and only state BVIs had contractual rights, rather than addressing other ownership characteristics. The new Confirmations only confirmed the existence of purchase contracts, but they did not confirm Sino-Forest owned the standing timber. In contrast, the original Forestry Bureau Confirmations contain the statement that the Forestry Bureau confirms the Sino-Forest BVI subsidiary "shall have the rights to harvest, transport and sell the aforementioned mature timber according to the law". The original Forestry Bureau Confirmations purport to confirm rights to the timber Sino-Forest never had.
- [421] Mr. Henderson of PwC testified he discussed the Forestry Bureau visits with Chan. The Independent Committee advisors were instructed by the Independent Committee not to make direct contact with Forestry Bureau officials as management had cited strong concerns such contact would negatively impact Sino-Forest's relationship with Forestry Bureaus. As such, the Independent Committee advisors required management's assistance in organizing Forestry Bureau visits. However, they encountered various problems, some of which are detailed here. First, the Forestry Bureau Confirmations had been relocated from Sino-Forest offices in Hong Kong to John Zeng's Kai Tong Law Firm's offices in Guangzhou. John Zeng played a central role in the Greenheart Transactions. Ip admits to issuing the request to move the Forestry Bureau Confirmations to Mainland China after the release of the Muddy Waters Report. Staff submits Sino-Forest initially tried to hide the Forestry Bureau Confirmations, but in the end had no choice but to produce them since Sino-Forest had been holding them out in support of their ownership claims to standing timber. Ip claims this was simply a miscommunication. Second, the Forestry Bureau officials were under no obligation to meet with the advisors. Third, prior to August 29, 2011, meetings were limited in time and the advisors were not permitted to ask questions to the officials. Fourth, the *Second IC Report* states the process for Sino-Forest employees to arrange meetings had "taken some time". Mr. Ardell considered these visits so crucial in establishing ownership he got down on his knees asking for Ip's help to arrange these visits.
- [422] The Independent Committee advisors ultimately visited nine Forestry Bureaus. However, they were not provided with contact information for the individuals with whom they met, as they requested. Although the Independent Committee advisors planned to meet with multiple senior individuals, in five instances, they met only one individual, which, according to the Independent Committee advisors, increased the risk the individual may be impersonated. Two Forestry Bureau officials were on Sino-Forest's payroll during the Material Time. In addition, the *Second IC Report* notes that gifts or cash payments were made to Forestry Bureau officials. Finally, every Forestry Bureau official confirmed they did not keep track of standing timber-only transactions, which again raises the question: How could the Forestry Bureaus confirm standing timber ownership in the BVI Model to Sino-Forest?
- [423] The Forestry Bureau Confirmations were drafted by Sino-Forest, prepared after the end of the quarter and backdated to the date of the contract. As a result, the dates of the Confirmations were not the dates on which they were chopped by Forestry Bureaus, which, in some cases, were months after the date on the Confirmation. Mr. Hao agreed the date on the Confirmation should reflect the date the Forestry Bureau chopped the document, which could not be the date of the contract. Of greater significance, the Forestry Bureau Confirmations do not contain specific location information or identify the specific forest asset transferred to Sino-Forest.

ii. *Comparison of PRCs and Forestry Bureau Confirmations*

- [424] PRCs provided specific information on the location of the forestry assets, often to the county level, along with any colloquial name. They also provided descriptions of each compartment's boundaries to the four cardinal directions. As

an example, one of the PRCs relating to the Gengma #1 Transactions includes the following location information for a plantation acquired by Sino-Panel (Gengma):

- Situated at: Upper Xinhua Group, Nanmounong Village Committee, Gengma Town
- Colloquial Name: Yanbabashan
- Forest Compartment: 9, 49
- Sub-Compartment: 9(9, 16), 49(10)
- To the Four Cardinal Directions
  - East: To Village level highway as the boundary
  - South: To the land of Lower Xinhua as the boundary
  - West: To the boundary with Lower Xinhua collective forest
  - North: To the land of Yang Laosi family

[425] The forest compartment and sub-compartment numbers listed in PRCs were those maintained by the Forestry Bureau. As discussed elsewhere in these Reasons, in contrast, compartment numbers in the BVI Survey Reports did not correspond with those maintained by the Forestry Bureaus, making them useless in locating plantation assets and therefore attempting to confirm Sino-Forest's ownership of a plantation.

[426] No location details similar to those in PRCs are provided for plantations whose ownership is evidenced by Forestry Bureau Confirmations. The information provided in Forestry Bureau Confirmations, as described in paragraph [400], was merely a brief summary of some key data (*i.e.*, seller name, purchaser name, area, stock volume and contract date) taken directly from the purchase contract.

[427] Another distinguishing feature of Forestry Bureau Confirmations is they do not include the name of the Forestry Bureau official who chopped them. In contrast, forestry regulations required PRCs be issued by qualified persons and that those persons be identified on the PRC.

[428] We heard expert evidence from Mr. Hao and Mr. Liu on forestry regulation and registration of forestry ownership in Mainland China.

[429] Mr. Hao explained forestry reform in China began with amendments to the *Forestry Act* in 1998 when China began to implement a new registration system, whereby the legal proof of ownership of forestry rights is provided by the issuance of PRCs. Forestry plantation ownership in Mainland China is reviewed in greater detail elsewhere in these Reasons in our discussion of Sino-Forest's Timber Business in Mainland China.

[430] The due diligence process undertaken to issue a PRC required the confirmation of land boundaries and a two-week public notice period aimed at identifying any disputes. This process took approximately one month. If the transfer involved forestry land owned by a village collective, the consent of two-thirds of the villagers was also required.

[431] Jinrong Liu, a lawyer licensed to practice Mainland Chinese law, was qualified as an expert in the hearing in areas that include whether a BVI entity may hold a PRC. He testified the owner of standing timber must register that ownership via a PRC, as well as any change in ownership. Mr. Liu explained the difference between a contractual right and an ownership right. In the case of a standing timber transfer, while a contract may be valid against the parties, the ownership and property rights cannot be transferred until the ownership is registered. Therefore, even if all the conditions of a purchase contract are satisfied, the transfer of ownership is not effected until registration is completed. This means, in the absence of registration, a purchaser of standing timber does not own the standing timber and therefore cannot mortgage the standing timber, obtain a harvesting permit without the assistance of the registered owner, or transfer (*i.e.*, sell) the standing timber. Sino-Forest never registered its ownership of standing timber in the BVI Model.

[432] Ownership is registered through a PRC. Mr. Liu testified about the difference between a valid contract and a registered right. With a valid contract, a purchaser can enforce its rights against the other contracting party but not third parties. With a registered right, a purchaser can enforce its rights against all parties. A Forestry Bureau Confirmation is not a registered right.

[433] The Panel heard conflicting evidence as to whether or not a Forestry Bureau would issue a PRC for standing timber only, that is, without land use rights. This is further discussed elsewhere in these Reasons in our discussion of Sino-Forest's Timber Business in Mainland China. There was evidence that Sino-Forest had obtained at least one PRC for standing timber, but only in the WFOE Model for two compartments. However, Ip and Xu Ni stated BVIs could not obtain PRCs. The Panel also heard evidence suppliers would not always obtain PRCs in their own names before selling the standing timber to Sino-Forest, further complicating the process. In any case, we have evidence Forestry Bureaus did not keep track of changes in ownership of standing timber-only transfers, and they therefore would not know if any standing timber-only transfers had taken place after a PRC had been issued.

[434] The Panel finds the Forestry Bureau Confirmations are of no use in establishing Sino-Forest's ownership.

*iii. Legal Opinions*

[435] The Respondents submit legal opinions from external counsel affirmed Sino-Forest had title to standing timber purchased in the BVI Model by virtue of a contract and a Forestry Bureau Confirmation. Staff submits the legal opinions are, with one exception, very general; they do not provide sufficient context and none indicate Sino-Forest's BVI subsidiaries legally owned the standing timber.

[436] The March 2008 legal opinion from Jingtian & Gongcheng Attorneys at Law (**Jingtian**), obtained by Sino-Forest for E&Y, begins with the following legal disclaimer:

Your Company [Sino-Forest] has given your assurance that the documents made available are complete and genuine, all the seals affixed to the document made available are genuine, photocopies of the documents are consistent with the original documents, and that all facts and documents that can affect this legal opinion letter have been disclosed to Our Firm without any concealment, inadvertent omissions or errors.

In this legal opinion letter, Our Firm has expressed our legal opinions only on the basis of the relevant facts confirmed by Your Company as well as Our Firm's understanding of such facts and comprehension of the relevant laws and regulations.

It is clear from this disclaimer Jingtian is relying on the documents that Sino-Forest provided them, including the Forestry Bureau Confirmation, which states the Forestry Bureau is temporarily unable to issue a PRC since the "county is in the process of developing the work concerning the reissue of new forest rights certificates [PRCs]" and that PRCs will be issued to the BVI subsidiaries "according to the uniform time". Based on the information provided by Sino-Forest, Jingtian's opinion letter states the PRCs may be issued to the BVI subsidiaries after they have legally signed the acquisition contract (a statement we find to be incorrect). Further, the legal opinion does not reference oral agreements or the fact the Forestry Bureau Confirmations are backdated. The opinion also states it has not reviewed three of the four attachments to the contract: a second report by the survey company, the Villagers' Resolutions or the PRC "or other documents of ownership proof".

[437] Jingtian's opinion letter further states that Sino-Forest can provide Forestry Bureau Confirmations as evidence to third parties on the "lawfulness of the forest rights that they possess." Yet, the Independent Committee noted that some Forestry Bureaus indicated the Confirmations could not be shown to third parties.

[438] Jingtian also stated after the BVI subsidiaries have a legally signed acquisition contract with the supplier and processed the required approval formalities as well as obtained a PRC, their lawful rights over the acquired forests can be proved as such. Jingtian further stated if the old version of the PRC cannot be processed, the BVI can apply for a letter of confirmation as valid proof of ownership of standing timber. We have no evidence as to whether or not Jingtian knew or should have known BVIs could not obtain PRCs, but it appears Jingtian was under the impression that BVIs could obtain them.

[439] In a December 2006 Commerce & Finance Law Offices (**C&F**) opinion in evidence, which is in draft form and unsigned, C&F states BVIs' rights to log, transport and sell standing timber are subject to the BVIs obtaining the authorizations and/or consents from the original owners of the plantations. This is consistent with Mr. Liu's testimony that without registration of standing timber ownership, a purchaser does not own the timber and could not mortgage, harvest or sell the timber without the assistance of the registered owner. As we have noted elsewhere, these authorizations (*i.e.*, Villagers' Resolutions) were never attached to BVI purchase contracts. This condition was not included in any later opinion letter by either C&F or Jingtian. Mr. Clifford testified this point was never raised in any due diligence calls with underwriters and this condition was inconsistent with his understanding of the contract process.

- [440] In their June 2009 opinion, C&F also assumed BVIs could obtain PRCs. It appears these two major Mainland China law firms believed Sino-Forest BVIs could obtain PRCs, and the reason they did not was due to backlogs and/or the slow transition to a newer version of PRCs. It is unclear to us why both firms laboured under this mistaken assumption.
- [441] In addition to the Jun He opinion discussed below, we have reviewed 11 opinion letters from two law firms (Jingtian and C&F) provided between 2006 and 2010 in connection with various underwritings. The substance and wording of each of the 11 opinion letters were remarkably similar – essentially boilerplate. Each reviewed a standard purchase contract, a Survey Report and a Forestry Bureau Confirmation. We have already addressed the incorrect facts within the Confirmation letters.
- [442] Jun He Law Offices (**Jun He**) was Chinese counsel retained as advisors by the Independent Committee. In closing submissions, counsel for Ip, Hung, Ho and Yeung stated that:
- ... whatever ambiguity or whatever questions we may have about the Jingtian opinion or the forestry bureau confirmation letter, Jun He and the Independent Committee with full knowledge of all of that still said these forestry bureau confirmation letters are helpful, they're going to give us a measure of comfort because the forestry bureau is the adjudicator of first instance.
- ...
- The forestry bureau confirmation letter gets us to a half-full glass. All my clients are saying is a half-full glass is better than an empty glass and we got the best that we could on the instructions of external and internal legal counsel.
- (Hearing Transcript, May 4, 2016 at 38:19-39:9)
- [443] One of the assumptions of Jun He's opinion letter to the Independent Committee was that each party to the Forestry Bureau Confirmation had the necessary capacity, power and authority to execute, deliver and perform its obligations. Yet, as the Independent Committee indicated, the Forestry Bureaus may have exceeded their authority by issuing these Confirmations to Sino-Forest. Second, the letter states the Forestry Bureau Confirmations do not serve as PRCs and are not definitive evidence of ownership of the standing timber. Third, the enforceability of the standing timber purchase contracts is subject to potential challenges from the *de facto* owners of PRCs or *bona fide* third parties. Fourth, Jun He's letter confirms the purchase contracts in the BVI Model are legally binding on the parties to the contract. Mr. Liu confirmed the contracts could be used to enforce rights against the contracting parties, but not against third parties. Last, Jun He stated a BVI purchase contract with only a Forestry Bureau Confirmation would be void without a PRC or a Villagers' Resolution. Sino-Forest would have no contractual right except a cause of action against the supplier who was counterparty to the contract. We disagree with the Respondents; we find Jun He's opinion did not provide comfort that the glass was "half full".
- [444] The legal opinions of Jingtian and C&F were based on the assumption that Sino-Forest provided complete and genuine disclosure of all relevant documents and facts, as is evidenced by the disclaimers in their letters. We find Sino-Forest did not provide accurate and full disclosure to its outside counsel in respect of the Forestry Bureau Confirmations.
- [445] The Respondents submit Staff's allegation regarding the availability of PRCs is a new allegation. They argue Staff only raised this allegation in its closing submissions, and they were deprived of, among other things, the opportunity to cross-examine witnesses about their knowledge of this issue. In response, Staff points to specific references in the Statement of Allegations that explicitly reference Sino-Forest's disclosure of PRCs for its purchased plantations. There is no requirement to plead all evidence in the Statement of Allegations. The Panel agrees with Staff; we find the issue regarding BVIs not being able to obtain PRCs is not a new allegation.
- [446] Sino-Forest's disclosure gave the impression the reason it did not obtain PRCs in the BVI Model was because there were backlogs at Forestry Bureaus due to a change in forestry policy, and the delays in obtaining PRCs would be rectified. Ip knew foreign companies, such as BVI subsidiaries, could not obtain PRCs and Sino-Forest was not even applying for them.
- [447] Xu Ni raised problems of missing key documents with Chan, specifically, with respect to ownership of title, existence of timberland and location of trees. Given his strong understanding of the forestry business and industry in China, his close connections to government and his intimate involvement in the process for every purchase of standing timber, we find Chan was fully aware Sino-Forest BVI subsidiaries could not obtain PRCs.
- [448] We find Chan, Ip and Sino-Forest did not disclose that Sino-Forest's BVI subsidiaries could not obtain PRCs and thus could have no ownership claim to the BVI standing timber assets because those rights had not been registered.

[449] Given the fact Forestry Bureau Confirmations did not provide registration of ownership of standing timber, the questionable due diligence process undertaken by Forestry Bureaus and the lack of any specific location information included in the Forestry Bureaus Confirmations, the Panel finds the disclosure relating to Forestry Bureau Confirmations as proof of legal ownership to be deceitful. We find the Forestry Bureau Confirmations do not establish Sino-Forest's legal ownership of standing timber in the BVI Model.

**(c) Villagers' Resolutions**

[450] Villagers' Resolutions are explained in the *Second IC Report*. It notes if forestry land is owned by a village collective, the validity of each standing timber purchase contract is subject to the authorization of that village collective, which takes the form of a Villagers' Resolution.

[451] No examples of Villagers' Resolutions were submitted in evidence. As noted above, Ms. Man testified she did not recall ever having seen a Villagers' Resolution attached to any BVI standing timber purchase contract.

[452] Xu Ni also testified she had never seen a Villagers' Resolution attached to any contract, despite the fact every purchase contract listed one as an attachment.

[453] Hung testified he did not know the importance of Villagers' Resolutions:

Q. Just again on the issue of farmers' authorizations, did you yourself have any insight as to whether or not these documents were important for purchases of standing timber?

A. I do not know.

Q. So you don't know whether they were important or unimportant?

A. Because I was not involved in the process I do not know whether it's important.

Q. Do you know whether or not they were referenced as attachments to purchase contracts?

A. I know.

Q. And these were purchase contracts that you directed their creation of?

A. Yes.

(Hearing Transcript, October 23, 2015 at 37:7-21)

[454] We find Hung's response incredible. Hung was a process owner for the purchase documentation process which we describe elsewhere in these Reasons. The Villagers' Resolution was a key missing element of the purchase documentation.

**(d) Locating the Standing Timber**

[455] Neither the BVI purchase contracts nor their attachments enabled one to locate the standing timber assets Sino-Forest purported to own.

[456] Part of the Independent Committee's asset verification process was intended to locate specific plantations owned by Sino-Forest using Survey Reports that accompanied each BVI standing timber purchase contract. The *Second IC Report* recounts the inability of the Independent Committee advisors to verify locations of standing timber based only on location descriptions that were general in nature. Mr. Pomeroy was asked if the Independent Committee advisors ever considered buying a chain saw. He responded: "... it was a bit of a running joke that we should cut down a tree and see who comes running, and that's how you'd find the true owner of the trees". The Independent Committee advisors never participated in such an exercise because "... No one on our team ever made it to a plantation" (Hearing Transcript, December 9, 2014 at 94:3-6 and 9-10). It is clear from the testimony of Mr. Pomeroy and Mr. Henderson the Independent Committee advisors exhausted every available avenue trying to locate BVI plantations, but ultimately failed.

[457] One of the main objectives of the Independent Committee investigation was to locate the plantations in order to help prove existence, ownership and value of Sino-Forest's standing timber assets — in other words, it would help answer the question, "Where are the trees?" Sino-Forest did not maintain records of locations of specific plantations, and the

Independent Committee advisors found the contracts, Survey Reports, maps and Forestry Bureau Confirmations did not contain sufficient detail to identify the plantation locations.

[458] Ip admitted a plantation could not be located using solely a purchase contract and a Survey Report. The Independent Committee arrived at the same conclusion. Ip explained when Sino-Forest needed to obtain the exact location of a plantation in the BVI Model, it would get this information from the survey company. The location descriptions in the BVI contracts are general, and Ip testified Chan instructed: “We should keep secret the location of the forest purchase, not letting other people know because we discovered that wherever Sino-Forest went, other competitors followed, causing prices of forest purchase to rise and the forest purchase not being that smooth” (Hearing Transcript, May 7, 2015 at 38:25-39:5). WFOE purchase contracts, in contrast, provide detailed information through the attached PRCs, which reference the village name and the plantation’s boundaries to the four cardinal directions. The Panel was not provided with any explanation why WFOE plantation locations did not have to be kept secret, in contrast to Ip’s explanation about the need for secrecy for BVI plantation locations.

*i. Maps*

[459] Ip testified that Sino-Forest’s BVI subsidiaries could not retain maps because of their military significance. The possession of maps was a sensitive security issue in China, and we heard anecdotal evidence regarding an individual who was imprisoned by the Chinese government for losing a map and Pöyry employees who were expelled from town for being in possession of maps. Mr. Hyde testified this fear of criminal sanctions was a reason other forestry companies in China do not retain maps. We note Pöyry reports reference maps; however, there was no explanation as to how this foreign company retained maps legally.

[460] Mr. Clifford of E&Y testified he understood Sino-Forest and Pöyry could locate the timber. He attended site visits with Pöyry and observed the timber. He did not, however, know the approximate area covered in Pöyry site visits.

[461] Mr. Hao testified there is a legal restriction on maps of a certain scale. In the forestry industry, only maps to the legal scale may be held. Mr. Hao acknowledged that, in his experience, maps were attached to contracts.

[462] The *Second IC Report* concluded:

Management has explained that it reviews maps that allow them to locate the properties but does not retain them. The IC has not been able to verify this explanation and notes the Plantation Rights Certificates in the Company’s possession in respect of WFOE timber transactions have detailed location descriptions. The IC Advisors were able to verify that most Mandra and SW [Sino-Wood] purchase contracts have attached to them either a map or a description of boundaries or both. It is not clear to the IC Advisors how the Company would be able to identify the relevant areas of timber purchased by the BVIs at the time of sale or harvesting.

Mr. Hyde confirmed the Independent Committee was told other forestry companies in China similarly do not retain maps, which were considered state secrets, for fear this practice could subject them to criminal sanctions.

[463] The Respondents submit Pöyry reviewed plantations annually and never had any issues regarding the adequacy of the maps provided. Pöyry reviewed less than 1% of the area that Sino-Forest reported it owned every year (0.5%, 0.5% and 0.3%, respectively, in each of 2007, 2008 and 2009). We do not know whether or how much of this area was owned through the BVI or WFOE Models. It is also important to note that Pöyry did not review contracts, PRCs, Forestry Bureau Confirmations or Survey Reports and did not address ownership of the assets. Rather, Pöyry’s assumption was that title to forest assets was in accordance with data provided by Sino-Forest. On a conference call with analysts on June 2, 2011 at 1:00 a.m. GMT, Pöyry agreed the area reviewed was “extremely small” and that the area where satellite imagery information was compared with mapping information “was about 0.1 [%] of the forest estate”. Pöyry goes on to state: “... we are not holding this out that this is a verification of the total area ... we ... largely rely on the area estimates provided by the client”. Pöyry’s role in the annual valuation of Sino-Forest’s forestry assets is discussed elsewhere in these Reasons in our discussion of Sino-Forest’s Timber Business in Mainland China.

[464] Following the release of the Muddy Waters Report, the Independent Committee undertook a proof of concept exercise. The Independent Committee selected two compartments to test, which were successfully located using maps provided by Sino-Forest. These compartments represented only 147 hectares out of the 466,826 hectares Sino-Forest owned in the BVI Model as of 2010. Given the sample size, the results could not be extrapolated to all of Sino-Forest’s holdings. Further, the asset verification did not address title to, or value of, the assets.

[465] Following the initial proof of concept exercise, a broader asset verification test was implemented. This test was discontinued at the request of Sino-Forest’s bondholders due to cost constraints and difficulties in obtaining maps for non-leased land (*i.e.*, BVI holdings). Of the 520,435 hectares Sino-Forest reported owning in the BVI Model as of

December 31, 2011, the independent forestry experts were only provided maps for 5,542 hectares for BVI plantations, representing approximately 1% of BVI holdings. At that date, the total BVI standing timber book value was US \$2.9 billion.

ii. *Survey Reports*

- [466] Sino-Forest used the company Zhanjiang Southern Forestry Projects Quality Supervision Co. Ltd. (**Zhanjiang Southern**) exclusively to prepare Survey Reports for BVI purchase contracts. Lu Qiding was Vice-President, Wood Resources of Sino-Panel (China) Investments Ltd. until November 2008. Throughout the Material Time, he functioned as the head of Sino-Panel's Resource Department, reported to Ip, was involved in the due diligence process to determine the suitability of timber acquisitions, and was a 10% shareholder of Zhanjiang Southern. Subsequent to November 2008, Lu Qiding retired but worked for Sino-Forest as a consultant and received monthly compensation of RMB 24,000. From Ip's testimony, it did not appear that his responsibilities changed after November 2008. Lu Qiding retained Zhanjiang Southern to prepare Survey Reports, and he oversaw survey preparations and survey company field visits. Further, Qi Shuxiong, a former director of two Sino-Forest subsidiaries and a former supervisor of a Sino-Forest subsidiary was an 80% shareholder of Zhanjiang Southern. According to the *Second IC Report*, Zhanjiang Southern was paid a consultancy fee of RMB 883,750 for its work for Sino-Forest during 2010 and Q1 2011.
- [467] Survey Reports were prepared in batches after quarter-end and backdated. Survey Reports were purportedly completed before the date of the oral purchase agreement. They were all signed by a single person, notwithstanding they related to plantations located all over Mainland China. In addition, they did not include specific location descriptions necessary to locate the plantation being purchased. Evidence shows Sino-Forest staff was involved in preparing the Survey Reports and making changes to the completed reports. Locations were changing in Survey Reports even after financial statements had been filed and made public. For example, locations changed in February 2011 for contracts purportedly entered in October and November 2010 with a value of RMB 436 million. Corresponding Survey Reports were revised in April 2011. The assets at issue would have been included in the 2010 financial statements which were filed on SEDAR on March 15, 2011. Evidence was presented that indicates Sino-Forest employees reverse-engineered some Survey Reports in order to arrive at the desired area, volume and yield. This is discussed in more detail in our review of the Q4 2010 purchase documentation process.
- [468] It is significant the compartment numbers identifying the land that was the subject of the Zhanjiang Southern Survey Reports were specific to Sino-Forest and did not correspond to any official centralized Forestry Bureau database. This is in contrast to the compartment numbers listed on PRCs found in the WFOE Model, which did correspond to the official database. As a result, there was no way to ensure the compartments outlined in a particular Forestry Bureau map were, in fact, the compartments referenced in a particular Survey Report or contract. This meant third parties could not independently confirm ownership of Sino-Forest's standing timber in the BVI Model since they would be unable to locate the plantation.
- [469] When asked whether Sino-Forest assigned the compartment numbers in the Zhanjiang Southern Survey Reports, Ip responded:
- According to my understanding, after the survey, some of the compartments were changed and there were changes, therefore, to the numbering of the compartments. From what I understand, when doing the survey work, the survey company would get the maps from the supplier, from the forestry bureau, and the survey company will, according to the maps, carry out the work, and the compartments at times will be changed and given new numbers after that.
- (Hearing Transcript, October 7, 2015 at 94:14-22)
- [470] When asked whether he was aware the compartment numbers in the PRCs did not match those in the Survey Reports, Ip said: "It was not brought to my attention. ... It is possible that the survey companies would rearrange the compartment numbers" (Hearing Transcript, October 7, 2015 at 95:3-4, 8-9). Although Ip referred here to "survey companies," the Zhanjiang Southern Survey Reports were the only ones in evidence that provided compartment numbers for land in respect of purported BVI purchases that did not correspond to compartment numbers at the Forestry Bureaus.
- [471] The lack of specific location identifiers in the Zhanjiang Southern Survey Reports does not appear to be consistent with industry standards. Mr. Hao testified he would expect a Survey Report to specify the location of assets, with references to the village name and the plantation's boundaries to the four cardinal directions. He also testified it was important for a survey company to be an independent source of verification.
- [472] The Respondents deny having any improper role in creating and reverse-engineering Survey Reports. They also deny having any knowledge that Lu Qiding was a shareholder of Zhanjiang Southern. Lu Qiding advised Sino-Forest he

received shares of Zhanjiang Southern in 2003, did not pay for them and shortly after resigned from that company in 2004, at which time he no longer considered himself to be a shareholder of Zhanjiang Southern. The SAIC filings in respect of Zhanjiang Southern however, continued to report Lu Qiding as a 10% shareholder.

- [473] Neither Survey Reports nor maps in the BVI Model during the Material Time provided sufficient information to locate the trees owned by Sino-Forest. This failure to disclose specific locations contributes to our finding that Investors' pecuniary interests were put at risk.

**(e) Timing and Scope of the Purchase Documentation Process**

- [474] Sino-Forest prepared, approved or revised documentation (including the Forestry Bureau Confirmations) at the end of, or after, each quarter.

*i. The BVI Model*

- [475] The BVI Model is described in detail elsewhere in these Reasons in our discussion of Sino-Forest's Business Models. While the rationale for using BVIs ended in 2004 with the change in Chinese government policy and law, Sino-Forest continued to conduct the majority of its business through the BVI Model during the Material Time. Staff submits the reason for this was because the BVI Model was opaque and malleable.

- [476] The BVI Model was opaque because there was no cash audit trail. BVI companies could not have bank accounts in Mainland China. Currency controls in China restricted payments of cash by Chinese companies to BVI companies. As a result, the BVI accounts receivable and payable were all settled through offset payments, the authenticity of which could not be verified because there was no evidence of cash changing hands for any of the transactions (further explained below). There were no maps attached to, and no specific locations described in, the contracts, the Forestry Bureau Confirmations or the Survey Reports. Finally, the BVI Model involved a concentration of duties among a small group of senior management, including Chan, Ip, Poon, Hung, Lu Qiding and Mr. Zhao (Senior Vice-President of Sino-Forest).

- [477] The BVI Model was malleable because the entire model existed entirely on manual spreadsheets created and maintained by Hung, which could be edited at any point in time and could accommodate the backdating of contracts. This method of record-keeping is in contrast to the Kingdee accounting software used in the WFOE Model, which did not allow for the backdating of contracts. The Survey Reports were all prepared by a company in which Lu Qiding had a 10% ownership. Lu Qiding reported to Ip and was directly responsible for purchasing forestry assets and hiring the survey company. Evidence indicates Sino-Forest employees made changes to Survey Reports long after purchase contracts were signed and settled, and even after financial statements reflecting those purchases were published. Internal approval forms were backdated and Forestry Bureau Confirmations were prepared by Hung and his team at the same time purchase contracts were prepared at or after the end of the quarter when the purchase was made and recorded in the financial records of Sino-Forest. Essentially, all relevant documentation was prepared by Sino-Forest and backdated.

- [478] The Panel finds the BVI Model was opaque and malleable and enabled the Respondents to perpetrate fraud, as we conclude elsewhere in these Reasons.

- [479] Hung was at the centre of the BVI documentation process and was a key player in the concealment of Sino-Forest's internal control weaknesses, described in greater detail elsewhere in these Reasons. He created spreadsheets, which recorded the details of purchase and sale transactions. He stated that he obtained these details about the purchase and sales transactions in phone conversations with Ip and Albert Zhao, respectively. He testified that during these phone calls, he recorded the details of transactions worth billions of renminbi on sticky notes that he kept in his office and later transferred those details onto his spreadsheets. Hung also created the schedules for offset payments, deciding which customer should pay which supplier according to the aging of receivables. From these schedules, the set-off documents described below were derived. Further, Hung attended all the customer and supplier interviews during E&Y's annual audits. We find Hung was the central and crucial figure in the Deceitful Documentation Process.

- [480] The documentation process for BVI purchase contracts was generally unchanged throughout the Material Time. To illustrate the process, we have reviewed the evidence Staff submitted for Q4 2010 and Q3 2009 and highlight certain noteworthy facts. These examples provide clear evidence Sino-Forest's post-quarter documentation process was not merely an exercise of transcribing oral agreements entered into during the previous quarter. Changes to fundamental aspects of purchase contracts and supporting documents occurred long after the dates of the oral agreements and after the quarter in which Sino-Forest recorded the acquisition of the asset.



ii. Q4 2010

- [481] We reviewed the process documentation for the Q4 2010 transactions, which began a few days prior to the quarter-end. This started with email exchanges between Ip, Chan and Hung dated December 28 and 29, 2010, which discuss the purchases to be recorded for Q4 2010.
- [482] On January 4, 2011, the Resource Department sent Hung a spreadsheet of purchases without dates, prices or names of the BVI subsidiary making the purchase or the supplier. When questioned as to why this information was missing, despite the fact it all would have been available at the time of purchase, Hung could not provide an explanation. Hung then added this missing information, as well as the sequential numbering of transactions. Hung testified he received this missing information from Ip during the course of the quarter, which he would have recorded on sticky notes. Purchase contracts for Q4 2010 had not yet been prepared at this time in January 2011, after the end of Q4.
- [483] Throughout January 2011, changes were repeatedly made to details of purchases in order to meet certain volume targets. The first summary table sent to Hung on January 4, 2011, lists 14 purchases with a stock volume of 9,174,846.98 m<sup>3</sup>. On January 6, 2011, an employee of Sino-Forest's Resource Department sent Ip an email with a revised summary table. The email states: "700,000 cubic metres have been added according to your instruction." The revised table lists an additional two purchases, for a total stock volume of 9,910,086.56 m<sup>3</sup>. Hung explained he had recorded more purchases on his sticky notes than those in the original summary table provided, and he asked Ip to have employees from the Resource Department check their records.
- [484] On January 7, 2011, the same employee from the Resource Department sent Hung an email attaching a further revised summary table that records an increase in total stock volume by 800,000 m<sup>3</sup> and asking Hung to provide the "contracting parties, amounts, etc., so that the timber acquisition documents can be completed." We note the Resource Department is asking Hung for information it should already have.
- [485] The Respondents submit there is some confusion regarding the translation of this email which makes it unreliable. Ip testified he understood the employee to be asking for the contract format or template, not the parties to the contract. However, the Resource Department had no need for contract templates as these were prepared by Hung's department. Hung testified the employee knew the missing purchase information and was merely being sarcastic, or "ironic," as Hung had notified Ip of the Resource Department's error with respect to the missing recorded purchases. In reading this last email in conjunction with the previous emails, we reject Ip's and Hung's explanations.
- [486] An attachment to an email dated January 9, 2011 lists 17 purchases in five provinces for a total stock volume of 9,972,230.53 m<sup>3</sup>. This contrasts with the first summary table that lists 14 purchase contracts with a total stock volume of 9,174,846.98 m<sup>3</sup>. At this stage, Kenny Wong, Hung's subordinate, inserted the information from the latest spreadsheet into standard template purchase contracts by doing a "mail merge".
- [487] On that same date, contract numbers were added sequentially to the final iteration of the table. The sequential numbering of the purchases listed in the table was designed to be a control feature. As each purchase was made, it would be added to the table and assigned a number in sequence, chronologically. This was important from a cut-off perspective as it was designed to ensure the transactions entered into within the reporting period were properly recorded. The process that actually happened with the purchases in Q4 2010 did not have the control benefit of sequential numbering. Rather, the contracts were sequentially numbered after the end of the quarter, a process which adds no value from a control perspective.
- [488] On January 11, 2011, an email from another employee of Sino-Forest's Resource Department to Kenny Wong indicates the contracts had been "split up" and the Survey Reports were "currently under preparation". The splitting of contracts refers to the splitting of one large purchase into smaller purchases. This enabled Sino-Forest to obtain Forestry Bureau Confirmations from county Forestry Bureaus rather than from provincial Forestry Bureaus, whose approval would be required for larger plantations. Instead, Sino-Forest applied to the local level Forestry Bureaus, which according to Kenny Wong, was less "troublesome." Kenny Wong never prepared a Confirmation for a provincial level Forestry Bureau. The comment in the January 11 email regarding the Survey Reports being "currently under preparation" contradicts Sino-Forest's process documents, which indicate the Survey Reports needed to be completed before the stock volume could be determined.
- [489] On January 12, 2011, an email to Hung and others includes attachments showing the purchase contracts, purchase requisition forms (approval forms to enter into these contracts) and Forestry Bureau Confirmations were prepared after the quarter-end and backdated. According to the process description described below, requisition forms were required to be approved and signed *before* purchases were entered into.
- [490] On January 13, 2011, Mr. Horsley advised Chan in an email most source documents for Q4 2010 purchases were still outstanding. Ten minutes later, Chan forwarded Mr. Horsley's email to Ip and Hung without adding any commentary,

which indicates to the Panel Chan was aware of the Deceitful Documentation Process. Had Chan not been aware of the Deceitful Documentation Process, it is reasonable to assume he would have added some commentary asking why there was a delay before forwarding the email to Ip and Hung. As we discuss further below, we find Chan was involved in the Deceitful Documentation Process. Although Hung had the unsigned versions of purchase requisition forms, purchase contracts and Survey Reports at the time of Horsley's email, he did not forward them to Horsley.

[491] Purchase contracts remained unsigned as late as February 1, 2011. Chan signed all purchase requisition forms for Q4 2010 between January 17 and February 1, 2011.

[492] A February 24, 2011 email indicates three sets of contracts needed to be replaced “[a]ccording to the instruction of the leaders” and that Survey Reports and the relevant timber acquisition documents also needed to be replaced to reflect locations which had been changed. Hung agreed changing the location of standing timber is a significant change in a contract (particularly for these contracts, which represented RMB 436 million of assets) and is a matter that would have been reported to him. When asked if this error would have been discovered during the Forestry Bureau's due diligence process for determining ownership, Hung replied:

The details as to what the forestry bureau base on, I do not know. From my knowledge, they would have to confirm that the ownership of the plantation had been transferred.

...

I really do not know about the details and specifics regarding this.

(Hearing Transcript, October 28, 2015 at 29:6-14)

This discrepancy, which went undiscovered by the Forestry Bureau during the due diligence of RMB 436 million of standing timber assets, casts further doubt on the authenticity and value of Forestry Bureau Confirmations in establishing ownership.

[493] Changes were made to these Survey Reports in the quarter after purchase contracts were signed and settled and two quarters after the oral agreements so as to ensure the details in the Survey Reports aligned with those in the purchase contracts. Four out of 17 Survey Reports were revised after January 24, 2011 and another three were revised after April 8, 2011, which is several weeks after the filing on SEDAR on March 15, 2011 of Sino-Forest's financial statements as at and for the year ended December 31, 2010. Changes in the Survey Reports included the afforestation year, average height and stock volume. These revisions are also discussed below in our analysis of the Dacheng allegations where we find the location descriptions and other information in Survey Reports continued to change into April 2011.

[494] For the three Survey Reports revised after April 8, 2011, reflecting a value of RMB 436 million, the change in locations could not have been reflected in the 2010 year-end financial statements filed in March 2011. The change in standing timber assets does not indicate the asset value is equivalent. The Forestry Bureau confirmed a purchase of assets, which were not ultimately purchased by Sino-Forest. This calls into question the proof of ownership of the asset when the underlying Forestry Bureau Confirmation proving ownership is wrong.

[495] The Panel finds at least some Survey Reports were reverse-engineered to match the purchase contracts. Survey Reports were created at the same time as purchase contracts although the purchase contracts indicate the survey has verified details such as area and stock volume. The process for preparing Survey Reports in Q4 2010 was not independent of Sino-Forest, as discussed below in our analysis of the Dacheng allegations. This example of the Q4 2010 BVI documentation process supports Staff's position the BVI Model was opaque and malleable.

*iii.* Q3 2009

[496] The evidence related to the Q3 2009 purchase documentation process focuses on two purchases from a company called Yongzhou City Maoxiang Forestry Development Co. Ltd. (**Maoxiang**). The documentation indicates the dates of these two purchase contracts for just under RMB 400 million were changed from July 24 and July 30, 2009, to dates on or after August 7, 2009, because Maoxiang was not incorporated until August 7, 2009. An attachment to an email dated October 6, 2009 indicates purchase contracts were initially dated July 24 and July 30, 2009 and were settled through set-offs with full payments to Maoxiang between July 27 and August 7, 2009. Maoxiang confirmed receipt of these payments between July 31 and August 11, 2009. Five of the set-off payments were recorded as received before Maoxiang was even incorporated on August 7, 2009. Maoxiang could not have had a bank account to receive payment before that date. In another attachment to an email dated October 13, 2009, the contract dates and the set-off settlement dates of the two purchase contracts were changed to dates either on or after August 7, 2009, Maoxiang's incorporation date.

[497] Upon discovering Maoxiang was not yet established, Ip asked Hung to have the payments rescinded. Ip's understanding of this process was that it would involve a third company Maoxiang directed to receive payments on its behalf. This third company may, in turn, have directed a fourth or fifth company to receive payments; this has been referred to as the "daisy chain of cash". When questioned about this process, Ip testified, "[t]here are things that I do not know concerning the actual operation of the arrangements" (Hearing Transcript, September 14, 2015 at 58:10-12). When asked if he would know who would be accepting payment on behalf of a supplier, as he was responsible for all purchases in the BVI Model, Ip responded, "I really didn't know the identities" (Hearing Transcript, September 14, 2015 at 59:4-5). Ip's response is not credible.

[498] When Hung was asked how Sino-Forest retrieved the funds paid in July before Maoxiang was incorporated, he first said the funds were "recovered subsequently, and then paid again to Maoxiang" (Hearing Transcript, October 26, 2015 at 81:15-16). The recovery of the full amount is consistent with the information recorded on the revised spreadsheet. The following day, Hung changed his testimony to indicate that only part of the payments may have been recovered because the "payment process was a very dynamic one":

The AIs only told me that they will ask Maoxiang to return the money. As to when they were able to recover all of the money, they didn't tell me. They only told me that they have paid a certain company, into certain accounts, and that the money should come back from this company. That's all they said.

(Hearing Transcript, October 27, 2015 at 11:12-19)

[499] Hung did not mention the intricate "daisy chain of cash," which would have required rescission of payments. When Staff suggested to Hung he was making up evidence as he went along regarding the dates of payment and receipt, Hung denied this. We reject Hung's evidence regarding the payment chronology as not credible.

[500] Emails indicate Survey Reports were prepared at the same time as the purchase contracts and after Hung's spreadsheet of purchase details was finalized. Purchase requisition forms were backdated to before the date of the purchase contracts to give the impression the purchases were approved before entering into the contracts. The Forestry Bureau Confirmations were backdated to the date of the purchase contract, which purportedly was the date of the oral agreement. The Q3 2009 documentation process was similar to the Q4 2010 process described above. This example also supports Staff's position the BVI Model was opaque and malleable.

*iv. Process Documents*

[501] Staff submits that Sino-Forest's formal process descriptions failed to accurately describe the purchase, sales and the AR/AP Set-Off processes for standing timber in the BVI Model. These documents were associated with an internal control certification project required to comply with NI 52-109. Mr. Maradin had a major role in working with Sino-Forest management to create the process descriptions. E&Y was retained to implement NI 52-109 requirements and also helped to create the process descriptions.

[502] The process documentation described the processes purportedly followed by Sino-Forest to document the purchases, sales and set-off payments for standing timber in the BVI Model, and described the segregation of duties. Both Ip and Hung were process owners for the standing timber purchase process and Hung was the process owner for the sale and set-off processes.

[503] The process owners were the sources for the detailed step-by-step description of each process. E&Y would create the document; the process owners would review the process narrative for accuracy and consistency with how they operated the business. Ms. Man testified she spoke with Hung and Mr. Maradin to gather the information for these descriptions. Hung acknowledged in his testimony it was his responsibility to ensure these were complete and accurate.

[504] E&Y made any revisions received from the process owners. The final versions were sent to Mr. Maradin. After he consulted with the process owners annually these documents were updated by Mr. Maradin.

[505] Initial versions of these documents were finalized in February 2009; subsequent versions were substantially similar.

[506] E&Y used these process descriptions as input for their audit process and to identify internal controls, or lack thereof. Mr. Clifford testified that as part of the audit process, these documents helped E&Y gain an understanding of Sino-Forest processes, and the internal control environment and infrastructure. They informed E&Y's foundational knowledge of the operations of Sino-Forest.

[507] The Audit Committee reviewed the process documents as part of their oversight role. The process descriptions helped the Committee to understand what management was doing, and to ensure management had sufficient resources to meet the requirements of NI 52-109. Mr. Hyde indicated these documents were also used to identify gaps in internal controls and provided a full picture of who did what.

[508] The evidence, as described throughout these Reasons, shows the process documentation for purchases, sales and set-off payments for standing timber in the BVI Model was almost entirely inaccurate.

[509] The purchase process document described a chronological process, initiated by the Resource Department, which began with a preliminary survey of the identified plantation, followed by the preparation of the purchase requisition form, which was signed by Ip and approved by Chan. The Resource Department then prepared an application for a full scale survey, which was approved by Ip. Ip would have received approval from Chan to perform a full scale survey of the target standing timber plantation. The BVI purchase process document describes a process whereby Sino-Forest would have already obtained a signed purchase agreement and a signed Forestry Bureau Confirmation by the time a purchase is recorded in the books of Sino-Forest. This did not occur in practice.

[510] Hung was asked about the purchase process description:

Q. And I believe you've told us earlier that during this purchase process you would receive information from Mr. Ip that an oral agreement or handshake agreement had taken place with a supplier.

Do you recall that as a step in the purchase of BVI standing timber?

A. Yes.

Q. I'm going to suggest to you, sir, that we don't see any reference to oral agreements or handshake agreements within this process description for the purchases of plantations.

A. We don't see it here.

Q. But you would agree with me this would be a very important part of the purchase of standing timber plantations; correct?

A. I agree.

Q. Because that is the date, I believe, that you thought the purchase agreement would be effective; correct?

A. Yes.

Q. Can you provide any explanation as to why there was no mention of this oral agreement or handshake in this process control?

A. First of all, the draft of this process description was not prepared by me. I told Tom [Maradin] everything I knew about this process. And after that, I also told Josephine Man of E&Y, and they did the first draft. After that, the finalized process document was completed and put into use.

And after that, every year I would go back to the process description to find out whether there were any changes or differences, and I do not know what is relatively more important in the process description. I would leave this decision to Tom and Josephine Man.

Q. But weren't Tom and Josephine Man looking to you to describe the process of purchasing standing timber and the details, the important details of that process?

A. Well, I had told them about the process, and there were others who had told them about the process.

(Hearing Transcript, October 23, 2015 at 9:21-11:12)

[511] We find the actual purchase process did not occur as set out in the process documents. We have received overwhelming evidence showing virtually all steps in the purchase process began after the period in which the purchases were recorded. Thus, the purchase process description was incorrect. As well, it was incomplete. It did not address how confirmations were prepared, it did not mention sticky notes, batching, oral agreements, handshake

agreements or the post-quarter process in which substantially all documentation was prepared, including, for example, the initial purchase requisition form. In reality, this requisition form was prepared at the same time as the purchase contract, which was based on an oral agreement. In effect, the approval to purchase was signed after the oral agreement.

- [512] Ip and Hung were the process owners for the process descriptions in the BVI Model and annually confirmed their accuracy. Chan reviewed at least first versions of these process descriptions. E&Y relied on the process descriptions during their audits of Sino-Forest and assumed they were a true reflection of what actually occurred.

*v. Backdating of Purchase Documentation*

- [513] The Respondents submit the timing of contract preparation was well known within Sino-Forest and it was simply a more efficient way of getting the paperwork done. Ip testified Lu Qiding and his staff of the Resource Department travelled a great deal throughout the quarter and dedicated the last couple weeks of each quarter to complete the necessary documentation, a task which they found frustrating. Ip described Lu Qiding in the following way:

Lu Qiding, well, I would liken him to a monkey running around in the mountains looking for forests, and he and his team at quarter end will have to come back to the office in time to prepare the paperwork.

(Hearing Transcript, September 11, 2015 at 51:15-19)

- [514] The Respondents submit although the written purchase contracts were backdated, they reflected oral agreements entered into on the date reflected in the final written contract. The legal enforceability of oral contracts in Mainland China was an issue raised in the hearing. Gavin Hao, an expert in the Chinese forestry industry, testified, based on his experience, "a contract with a villager is not very much different from a piece of blank paper" (Hearing Transcript, April 28, 2015 at 89:5-6). He explained private companies or state-owned enterprises are often helpless when it comes to contract disputes with villagers. Many courts will support the villagers, even when written contracts exist, and, even if penalties are imposed on villagers for breach of contract, enforcement can be very difficult. Although contracts were technically enforceable between the parties to the contract, Mr. Hao's evidence about the practical enforceability of contractual obligations regarding the transfer of standing timber rights in Mainland China demonstrates the importance of additional proof of ownership.
- [515] Assuming one accepts the Respondents' submission that an oral agreement was a valid contract for revenue recognition at the time of the handshake, significant changes to the original terms would invalidate the original oral agreement, according to the expert evidence on Chinese law.
- [516] Jinrong Liu testified that under Chinese law, oral agreements are valid and enforceable, but a written contract is required to register the transfer of ownership and obtain a PRC. To be valid, an oral contract would generally include the names of the parties, the targeted matter, quantity, quality, price or remuneration, time, place and mode of fulfillment, liability for breach of contract and dispute mechanism.
- [517] As we discuss elsewhere in these Reasons, we saw evidence of changes to names of the parties, the location of the timber, quantity, quality (tree species), and price from the time of the oral agreement to the time of the executed written contract. Thus, the oral agreement would not be valid and recording the assets based on the oral agreement would be misleading.
- [518] Mr. Liu explained that a buyer with a written contract, but no registration (a PRC) would not defeat a claim of a purchase from a registered owner; a buyer who has not registered cannot mortgage the standing timber, nor can the buyer obtain a harvesting permit without the assistance of the registered owner. And while legally a buyer who has not registered cannot transfer the standing timber, in practice this can be done, as long as the registered owner accompanies the non-registered owner to the Forestry Bureau to transfer the ownership to the third party.
- [519] A written contract without registration allows the buyer to enforce his or her rights against the other contracting party, but not against third parties, whereas a contract and registration allows a buyer to enforce his or her rights against all parties. Registration demonstrates ownership.
- [520] Mr. Liu stated in his expert report a purchase agreement may become effective when duly entered into by the parties. Upon cross-examination, he agreed that the effectiveness of a contract can also be impacted by the parties attaching a condition or conditions. A contract is not necessarily effective on the date it is entered into as there may be conditions attached which go to its effectiveness.

[521] He further testified parties to an oral agreement cannot back out of the deal just because the agreement has not yet been put in writing. He clarified, however, this is not true in cases where the oral agreement and the written agreement differ – for example, if the parties or the terms of the agreement change.

[522] Even if they were based on earlier oral agreements, Sino-Forest's written purchase contracts raise additional concerns. According to Ip: "The date of the handshake deal would be the date on which Sino-Forest and the supplier confirmed the transaction. And when I say 'confirmed the transaction', I mean when the area and the unit price is fixed" (Hearing Transcript, September 11, 2015 at 23:9-13). Yet, we saw emails and heard testimony that areas, stock volumes and prices changed well after the date of the purchase contract, which was the date of the handshake agreement. Ip testified "What is most important in the contract is the price. So once we agree on the price of them there is nothing to change except perhaps the location or some detailed information" (Hearing Transcript, May 6, 2015 at 63:21-24). Ip's testimony further convinces us whatever oral discussions may have occurred between Sino-Forest and a supplier, these discussions would not necessarily reflect the economic and legal reality expressed in the written contracts, as the Respondents claim.

[523] The Respondents submit the practice of backdating written contracts to the date of the oral agreement was in fact appropriate because it reflected the date of the actual contractual obligation to purchase. Oral agreements may be an accepted practice in China; however, if volumes and locations, among other key contract terms, changed well into the subsequent quarter, then the original handshake agreement would no longer be valid. It follows, then, those contracts would reflect terms and details that differ from those which had been agreed to at the time of the handshake deal.

**(f) Conclusion on Purchase Documentation**

[524] The Respondents' description of the purchase process, based on handshakes, phone calls and sticky notes involving billions of renminbi, is simply not believable.

[525] We find the purchase contracts and their three key attachments were fundamentally flawed. The Forestry Bureau Confirmations do not establish Sino-Forest's ownership of standing timber in the BVI Model. Standing timber locations could not be located based on the contract, Forestry Bureau Confirmation or Survey Report. The Survey Reports were prepared by one survey company in the quarter after the purchase took place, and we saw examples of Sino-Forest employees reverse-engineering them. Finally, although the purchase contracts referred to Villagers' Resolutions and PRCs as attachments, there were never any such attachments to BVI contracts. We find there is no evidence that ownership of standing timber was ever transferred to Sino-Forest in the BVI Model. We find Sino-Forest employed a deceitful documentation process whereby Sino-Forest drafted and executed purchase contracts and Forestry Bureau Confirmations in the quarter after they were dated and the subject assets were recorded. We also find that the purchase documentation does not establish proof of ownership and does not identify the location of the standing timber such that its existence can be readily and independently verified. We find the purchase documentation process was deceitful.

**3. BVI Sales Documentation**

**(a) Sales Contracts**

[526] The sales contracts and sales process are described in the *Second IC Report*:

- the BVIs sold standing timber through sales contracts. These contracts were signed between BVIs and AIs, Mainland Chinese-incorporated companies that engage in timber trading. Under a typical sales contract, the AI is entrusted by the BVI to sell the BVIs' standing timber assets located in Mainland China on its behalf;
- notwithstanding its role as "agent," the sales contracts stipulate that the AI is directly liable for paying Sino-Forest. The AI's obligation to make payment to Sino-Forest is not conditional upon the AI selling the standing timber to its customers. For this, the AI receives no commission or fee from Sino-Forest; and
- in reality the sales contracts are principal-to-principal contracts and do not involve an actual "agency" arrangement. The Independent Committee understood, for revenue recognition purposes, management treated BVI sales transactions as being complete upon the sale to the AIs.

(*Second IC Report* at 51)

[527] The documentation process for the BVI sales contracts was generally unchanged during the Material Time. To illustrate the documentation process, we have reviewed the evidence Staff submitted for Q4 2010 and highlight certain noteworthy facts. These examples provide clear evidence Sino-Forest's post-quarter documentation process was not merely an exercise of transcribing oral agreements entered into during the previous quarter.

[528] The initial document evidencing Sino-Forest's revenue in the BVI Model was the sales contract.

**(b) Timing and Scope of the Sales Documentation Process**

[529] Similar to the purchase documentation, Sino-Forest prepared, approved and revised the sales documentation after the end of each quarter. Sino-Forest relied on its sales contracts to determine revenue; however, as discussed in greater detail below, Sino-Forest recorded revenue prior to executing the sales contracts.

*i. Q4 2010*

[530] Sino-Forest began to prepare documentation for Q4 2010 sales on January 3, 2011.

[531] Similar to the purchase process, Hung testified he received the details of sales transactions throughout the quarter and would record them on sticky notes, which he then transferred to a spreadsheet. Hung began the sales documentation process for Q4 2010 by sending a spreadsheet containing information necessary to prepare the sales contracts to Kenny Wong in an email dated January 3, 2011. The attached sales summary lists 73 sales in three provinces with a stock volume of 6,608,265.25 m<sup>3</sup> and a total sales price of RMB 3,604,252,380. Of that total, RMB 2,978,388,099 (or 83%) represented sales of logs, which we now know to be simply uncut trees. The original purchase dates, purchase contract numbers, locations (province level), species, area, and yields are identified for each sale. The sales contract dates, prices and customers are identified for each sale; however, no sales contract numbers are indicated. No sales contracts had yet been prepared as at January 3, 2011.

[532] None of the sales contracts included a village name, which means the plantation location could not be sufficiently identified. For example, in a sales contract between Suri-Wood and Nanchang City Tongdasheng Industry Co., Ltd, the place of delivery is the "forest site of [Suri-Wood] where Such Timber is located", which was Rongshui County, Guangxi Province. No more specific location description is provided.

[533] On January 13, 2011, Mr. Horsley advised Chan most source documentation for the BVI and WFOE Q4 2010 period was outstanding, including sales contracts and acknowledgment of receipts of logs. Mr. Horsley requested Chan ask Hung, Ip and Albert Zhao "to get the info in asap". Ten minutes later, Chan forwarded Mr. Horsley's request to Ip and Hung (but notably not to Mr. Zhao, who was responsible for BVI standing timber sales), without adding any commentary. Similar to the purchase documentation process, Chan was clearly aware that the sales documentation process was batched and backdated.

[534] On January 14, 2011, Hung produced a revised sales summary, which was identical to the sales summary from January 3, except for the addition of the contract numbers and revised contract dates. Hung testified contract numbers are meaningful, as they show the order of contracts according to the dates of the contracts. This is consistent with Mr. Maradin's testimony. Therefore, this reordering to reflect revised dates with corresponding contract numbers destroys any relevance of the sequential ordering. Kenny Wong's transcript evidence shows he would drop the information from the spreadsheet into standard template sales contracts by doing a "mail merge", similar to the purchase process.

[535] On January 18, 2011, the dates of the Confirmations of Sales Situations (documents provided to Sino-Forest by customers which confirm the execution of the sales contract and purport to indicate the actual harvested volume of, and yield of, the standing timber sold) were revised to post-date each respective sales contract (previous versions of confirmations were all dated September 30, 2010). For example, in the contract noted above (between Suri-Wood and City Tongdasheng Industry Co., Ltd.), the contract is dated October 6, 2010, whereas the Confirmation of Sales Situation, which states harvesting is complete, is dated September 30, 2010. This Confirmation of Sales Situation states, "... we confirm ... the actual sales quantity" and indicates harvesting is complete with quantity of 108,443.61 m<sup>3</sup>. This statement is misleading as the trees remained uncut, but it implies, with a precision to two decimal places, that timber has been harvested.

[536] Kenny Wong emailed Hung regarding this date problem on October 14, 2010. He stated: "For the log sales contract[s], since I still havent confirm [sic] the date for the 'confirmation' w/ you, I have just put 9/30 ... ." Mistakenly, they had all been sent to the Finance Department. He goes on to state that he "can still 're-do' the 'confirmation'" (so as not to raise E&Y's concern) but that later contracts should "be changed to standing timber sales contracts to avoid the issue with the 'confirmation'". When asked why "re-do" was in quotation marks, Hung stated that he found it to be "strange" (Hearing Transcript, October 23, 2015 at 51), but the Finance Department suggested the term "re-do" included "something of impropriety" (Hearing Transcript, October 23, 2015 at 53). When asked why the word "confirmation" was also in quotation marks, Hung stated it corresponded to the same word in the previous paragraph (which did not explain why the previous "confirmation" was in quotation marks) and he did not think it was related to the suggested impropriety surrounding the word "re-do". We reject Hung's evidence on this point.

[537] The October 14, 2010 email also raises the issue of dating Confirmations of Sales Situation late in August 2010 such that E&Y would not accept them for the cut-off date of August 31 (the cut-off date referred to a proposed financing). The problem arose because, logistically, the customer could not harvest the timber in such a short time period, which would be a red flag to E&Y. Kenny Wong notes in the email another employee suggested changing the contracts dated close to the end of August to be standing timber sales contracts, thus avoiding the problems with the "confirmation". The casual ease with which Sino-Forest employees suggest altering contracts post-quarter-end further supports our finding below that the sales documentation process was deceitful. Further email correspondence indicates Chan signed all 73 Q4 2010 contracts on or shortly before February 1, 2011.

*ii. Sales Documentation Process*

[538] Evidence shows all of the documentation to substantiate sales transactions actually took place were prepared by Sino-Forest. All sales contracts and supporting documents were batched, backdated and signed after quarter-end. Contract numbers were assigned sequentially after the initial draft of the spreadsheet was prepared, thus rendering the chronological numbering irrelevant. Any changes to such documentation were made after the transactions were reported to have occurred. There is no evidence Sino-Forest applied for revised Forestry Bureau Confirmations for partial sales of standing timber plantations, although this step is outlined in the process description. As with the purchase process, Chan was aware the sales contracts were prepared in batches and backdated. Similar to the purchase process, what actually took place did not match the process description whatsoever, the accuracy of which was Hung's responsibility and which he confirmed annually was a true reflection of what actually occurred.

[539] Hung knew the sales contracts were prepared and signed after the end of the quarter, and, as a member of Sino-Forest's Disclosure Committee, he knew Sino-Forest's revenue recognition policy did not disclose this practice.

[540] Sino-Forest included in each BVI purchase contract a clause which gave Sino-Forest the right of first refusal to acquire the land use rights after harvesting of the plantation purchased by the BVI, or equivalent forest land use rights, for up to 50 years. The contracts also included a clause which allowed those rights to be transferred to other companies within Sino-Forest. According to Ip, since a BVI could not hold land use rights, a WFOE would acquire them. Ip agreed Sino-Forest was acquiring a valuable right but testified Sino-Forest never exercised this right. He explained in Yunnan Province, there was no need to because the plan was to start planting forests in Hunan and Guangxi Provinces. Earlier that day, however, Ip testified he recalled two occasions when Sino-Forest exercised this right for property in Guangxi Province and Yunnan Province. Although Ip's evidence is conflicting, overall it appears, except for these two instances, Sino-Forest never exercised these rights in any province in which it operated or planted trees.

[541] Mr. Hyde testified Chan explained the company never ascribed any value to the right of first refusal as the legal regime had not changed to permit a BVI to lease land. This explanation contradicts Ip's testimony, that the right could be transferred to a WFOE. Mr. Hyde further testified Chan explained, in many cases, Sino-Forest had no intention of ever exercising the option because the land was not consistent with land on which they wanted to enter into long-term leases. Yet, Sino-Forest did enter into long-term leases wherever it planted trees. Moreover, the right of first refusal allowed Sino-Forest to require the supplier to swap the land for equivalent land elsewhere, such as in Hunan and Guangxi, where Sino-Forest planted trees.

[542] Both Ip and Hung stated they did not keep track of any harvesting done by Sino-Forest or its customers. Sino-Forest itself never harvested a single tree in the BVI Model from 2007 through 2010. When asked if Sino-Forest ever hired sub-contractors over this time period to carry out the harvesting, Ip stated, "I don't recall".

[543] If Sino-Forest never tracked harvesting, then it could not exercise this right of first refusal, which Ip agreed was valuable. We find it unbelievable Sino-Forest, a for-profit enterprise, would ignore this right which it explicitly wrote into every purchase contract since at least 2004. We find Ip's and Chan's explanations not credible.

*iii. Process Documents*

[544] The sales process description, for which Hung was a process owner, described a chronological process in which sales contracts, harvesting agreements and Confirmations of Sales Situation were signed. It stated that by the end of each quarter, the accounting department would obtain from Hung all the sequential indexed sales contracts. This did not occur: for the quarter ended December 31, 2010, for example, evidence shows an email dated January 3, 2011 from Hung to Kenny Wong, attaching a spreadsheet for Q4 2010 timber sales. The spreadsheet lists 73 sales but no contract numbers have been assigned. The sequential numbering of contracts had not occurred by mid-January 2011 and sales contracts had not been prepared.

[545] Hung admitted the sales process description made no reference to the preparation of contracts in a batch.



[546] We find the sales process documents were inaccurate, incomplete and did not represent what actually occurred. There is no mention of batching or oral agreements. There is no mention Hung recorded on sticky notes sales information he received via phone calls from Sino-Forest employees in remote regions in China. When asked why information was not relayed to him through emails for written confirmation, Hung responded: "... I think my colleagues wanted to tell me as soon as possible after they have done their work to inform me of the information **so I could start preparing the contracts ...**" [emphasis added]. (Hearing Transcript, October 23, 2015 at 28:15-18) and "... I would write (the information) down on sticky notes ... I tried my best to have them stay in place. I admit over the years there have been certain notes which have fallen and had been moved inadvertently to one side" (Hearing Transcript, October 23, 2015 at 29:10-11 and 29:14-17).

[547] Hung's response is not credible: he did not start preparing contracts during the quarter but prepared them in batches after the quarter.

**(c) Misleading the Commission Regarding Revenue Recognition**

[548] Staff alleges, during the Material Time, in its correspondence to Staff, Sino-Forest misled the Commission about its revenue recognition practice.

[549] In November 2005, prior to the Material Time, the Commission sent Sino-Forest a letter regarding its financial disclosure, as part of a Continuous Disclosure Review. In his written response, Mr. Horsley confirmed:

Revenue from the sale of standing timber is recognized when the significant risks and reward of ownership have been transferred to the buyer which occurs when the contract is entered into ... The Corporation confirms that it believes the significant risks and rewards of ownership to be transferred to the customer at the time the relevant sales agreement is signed ... The Corporation does not recognize revenue from standing timber sales unless a sales agreement has been executed by both parties.

...

If requested, we assist the buyer in applying for logging and transportation permits ... the Corporation has not historically experienced any difficulty with its buyers' ability to secure the necessary permits.

[550] The Commission made another enquiry regarding Sino-Forest's financial disclosure in May 2008, during the Material Time. In his written response, Mr. Horsley confirmed:

The Corporation confirms that it believes the significant risks and rewards of ownership are considered to be transferred to the customer at the time the relevant sales agreement is signed ... The Corporation does not recognize revenue from standing timber unless a sales agreement has been executed by both the Corporation and the buyer.

[551] Sino-Forest reiterated it had minimal involvement following the sale but would assist the buyer in obtaining necessary permits to complete harvesting, which it historically had not experienced any difficulty with its buyers' ability to secure.

[552] Mr. Horsley, as CFO, signed both letters.

[553] We have previously found sales contracts were signed by Chan in the quarter following the dates on the BVI sales contracts, contrary to the statements made to the Commission, as illustrated above. Moreover, the statement regarding the absence of difficulty in securing harvesting permits is misleading. Evidence shows Sino-Forest could not obtain harvesting permits with only a Forestry Bureau Confirmation, which was the document obtained by Sino-Forest from the Forestry Bureau in lieu of a PRC; the holder of the PRC would also have to attend at the Forestry Bureau in order to secure the harvesting permit. Therefore, if there was any difficulty in post-sale delivery and performance in obtaining the permits, this would impede or delay the recognition of revenue.

[554] Both statements in 2005 and 2008 to the Commission were misleading: revenue was recognized in the quarter before a sales contract was executed and harvesting permits would have been impossible to obtain with only a Forestry Bureau Confirmation.

[555] Mr. Maradin testified he was responsible for drafting this section of the letters responding to the Commission in 2005 and 2008. He testified these sections of both letters were substantially the same. Mr. Maradin had reached out to others in Sino-Forest to gather this information. Particularly with respect to the 2005 letter, he relied on others, as he had only been involved with Sino-Forest for one month when tasked with preparing the response to the OSC. Mr.

Maradin emailed the 2005 Sino-Forest response to those who had advised him, including Chan, to ensure its accuracy, prior to sending the letter to the OSC. Mr. Maradin stated: "I remember him [Chan] confirming that he was fine with the draft ... He would know that the OSC letter was important, as a public company" (Hearing Transcript, October 31, 2014 at 98).

[556] The Panel finds Chan read the 2005 Sino-Forest response to the OSC; he understood its importance and was aware that it was misleading. There is no evidence Chan read the 2008 letter. It is reasonable to assume, however, following the practice of the 2005 letter, Chan would have been aware of the contents of the 2008 letter to the OSC regarding revenue recognition. As Mr. Maradin stated, a letter to the OSC was important. The Audit Committee, E&Y and Sino-Forest's legal counsel were aware of these responses. As such, the Panel finds Chan, as a hands-on CEO, would have been aware of the 2008 letter and its contents.

[557] The Panel finds Sino-Forest misled the Commission about its revenue recognition practices in 2008, during the Material Time.

**(d) Conclusion on Sales Documentation**

[558] The sales contract process was fundamentally flawed. We find Sino-Forest employed a deceitful documentation process whereby Sino-Forest drafted and executed sales contracts in the quarter after they were dated and the revenue was recognized. We find this resulted in Sino-Forest recognizing revenue in the BVI Model in a manner that was deceitful. In addition, we find Sino-Forest misled the Commission regarding its revenue recognition process.

**4. The Set-Off Process**

[559] In the BVI Model, because BVI subsidiaries could not have bank accounts in Mainland China, Sino-Forest's accounts receivable and accounts payable were recorded as settled through the AR/AP Set-Off Process, whereby Sino-Forest customers (or AIs) were directed to make payments to its suppliers rather than to Sino-Forest directly. The process description for the AR/AP Set-Off Process indicates AIs made payments directly to Sino-Forest suppliers. Audit Confirmation Letters provided to E&Y were also designed to confirm direct payment from a Sino-Forest AI to a Sino-Forest supplier. However, both AIs and suppliers often utilized three, four, five or more layers of parties in making payments, a process which Mr. Clifford referred to as the "daisy chain of cash". In effect, Sino-Forest had no way of knowing who ultimately settled the accounts payable and receivable, assuming they were settled at all. The process description was also deficient in mentioning that payments were made on the basis of oral agreements.

[560] The *Second IC Report* describes the AR/AP Set-Off Process as follows:

Set-off arrangements are not stipulated in the Entrusted Sale Agreements [sales contracts] themselves but rather are stipulated in separate documents which SF refers to as "Set-off Documents." The set-off documents are organized into sets and use standard wording and formatting, with each set containing the following documents:

- written instructions from a BVI with accounts receivable from an AI for that AI to make payment to a particular Supplier as payment for a new timber purchase by that same BVI or another BVI. These written instructions feature the name of the BVI at the top and are dated, signed and stamped and set out the amount to be paid;
- written notification from SF to the Supplier that payment is being made through the AI via set-off on behalf of the purchasing BVI. This written notification features the name of the BVI at the top and is dated, signed and stamped and set out the amount to be paid;
- written confirmation from the AI that payment has been made to the Supplier as requested by the instructing BVI. This written confirmation features the name of the AI and is undated and stamped and sets out the amount and date of payment; and
- written confirmation from the Supplier to the instructing BVI and paying AI that payment has been received from the AI. This written confirmation features the name of the Supplier and is dated, stamped and sets out the amount and date of payment received.

The set-off documents are only produced after the Company enters into a new BVI Timber Purchase Contract and therefore reflect the payment of the consideration for this new BVI Timber Purchase Contract using proceeds from earlier Entrusted Sale Contracts held by the AIs on behalf of the Company. **The set-off documents do not explicitly relate to any particular Entrusted Sale Contract and are not a record of BVI sales transactions. Apart from the Entrusted Sale Contract itself, and until set-off documents are produced pursuant to a new BVI timber purchase, there is no other document produced dealing with payment or settlement of BVI timber sales.**

The IC Advisors have received copies of the Set-off Documents related to all the BVI standing timber purchase transactions between the first fiscal quarter of 2006 and the first fiscal quarter of 2011. However, **the IC Advisors have not been provided with any documents showing movement of money to confirm that such set-off arrangements have been carried out.** During meetings of the IC Advisors with AIs and Suppliers, representatives from the AIs and Suppliers declined to produce such documents showing movements of money. Common reasons cited for declining to produce documents included “tax reasons” and sensitivity towards the MW allegations and the resultant publicity. Further, some AIs visited stated that they may not in fact make payment themselves as instructed by SF but would instead arrange for other parties (“fourth parties”) to make payment on their behalf. Those fourth parties may then instruct “fifth” or “sixth” parties to make payment. [emphasis added]

(Second IC Report at 52-53)

[561] Sino-Forest prepared all of the documentation, which purportedly showed customers paid suppliers the amounts on the dates indicated. As discussed elsewhere in these Reasons in our analysis of the undisclosed control allegations, E&Y sent Audit Confirmation Letters to obtain independent confirmation of these set-off arrangements. Evidence shows that Sino-Forest was directing responses to E&Y from suppliers and AIs which rendered these supposedly independent Confirmations worthless.

[562] It is significant a receivable was only settled through the purchase of more standing timber rather than with the receipt of cash, which is how revenue is ultimately realized. It is the payment to a supplier for yet more standing timber that triggers any movement of money, which, as described above, the Independent Committee advisors were unable to trace or confirm. This is the feedback loop which trapped any BVI money in Mainland China and forced Sino-Forest to continually buy more trees in its BVI Model in order to show E&Y that accounts receivable from sales were ever settled.

[563] As we have seen in the Q3 2009 analysis of Sino-Forest's purchase transactions with Maoxiang, documentation was altered to adjust for the fact that contracts were recorded and set-off payments were recognized as received before Maoxiang was incorporated. We find the preparation and dating of documents used in the AR/AP Set-Off Process was as flawed and as deceitful as every other aspect of the BVI purchase and sales documentation process.

[564] Staff reviewed Sino-Forest's records of settlement of payables arising from all of the standing timber purchases recorded by Sino-Forest in 2010. Staff's review showed:

- total purchases amounted to RMB 7.98 billion and were settled through set-offs; and
- RMB 7.48 billion of these payables were settled before the corresponding standing timber purchase contracts were prepared.

Therefore, Sino-Forest directed payment for purchases for which they did not yet have written contracts, but instead, RMB 7.48 billion was paid simply on the basis of a handshake agreement.

[565] Staff prepared a chronological summary of the Q4 2010 set-off process. It shows the process commenced on January 7, 2011, after the quarter-end. The evidence indicates all payables arising from standing timber purchases recorded in Q4 2010 were settled within the same quarter as the purchase, notwithstanding that contracts only required Sino-Forest to make payments within 30 days. Purchases totalling approximately RMB 886 million were made in December 2010 and settled that month, including same-day settlements as of the date of the purchase, which is the date of the oral agreement, according to the Respondents. Further, all documentation purporting to evidence the settlement of the standing timber purchases in Q4 2010 was prepared by Sino-Forest, including the four set-off documents, two of which should have been prepared by the supplier and AI who received and paid amounts, respectively, as instructed by Sino-Forest. This documentation was not prepared at the time of the settlement but prepared in batches after quarter-end and backdated.

- [566] Hung orchestrated and oversaw the entire AR/AP Set-Off Process. He could alter the set-off schedules and had sole control. This control weakness is discussed in greater detail elsewhere in these Reasons in our analysis of the internal control weakness allegations. The accounting department used Hung's records as data input into the accounting process which ultimately produced the financial statements upon which investors relied. Hung knew about the "daisy chain of cash"; he testified he heard about this from Chan. He testified he did not know the actual route of payments, despite being the process owner for the AR/AP Set-Off Process. If true, it is clear Hung took no interest in discovering what actually occurred.
- [567] Hung's Affidavit evidence states he asked Chan about Sino-Forest's practice of paying suppliers before a written contract was prepared and "Chan told [him] that it was fine to do so and that [he] should continue doing so". Hung further states Chan explained to him counterparties sometimes preferred the payments to be structured in this way so as to avoid taxes.
- [568] Ip contradicts the evidence he provided during his examinations in August 2011. At that time, he stated Hung would release payments to suppliers after the agreement to purchase was signed. During the hearing, Ip testified he asked Hung to arrange payments to suppliers before having a written purchase contract in place, much less a signed contract.
- [569] Ip testified the risk associated with making payments in the absence of a signed contract was not great: "[W]hat was most important in doing a deal was the handshake, the credibility. So even if you have a signed contract, the person can very well go back on his word on the contract" (Hearing Transcript, September 14, 2015 at 25:12-16). As discussed elsewhere in these Reasons, this comment reflects on the efficacy of contracts in China.
- [570] Ip emphasized the importance of relationships and trust. This also contradicts the Respondents' evidence the monitoring of suppliers' bank accounts was a necessary means in which to effect some leverage over them.
- [571] Hung could not explain why customers were willing to pay the full amount owing before the 270 days allowed under the contract terms. In the BVI Model during the Material Time, Sino-Forest had a perfect receivables collection record, which is in stark contrast with Mainland China's general business climate, where Chinese businesses often experienced severe cash flow problems. This perfect record also contrasts sharply with Sino-Forest's complete failure to collect any receivables after June 2, 2011. As at March 30, 2012, US \$887.4 million was owing and remained unpaid to BVI subsidiaries of Sino-Forest from AIs for standing timber sales.
- [572] The AR/AP Off-Set process documentation, for which Hung was responsible, indicated that AIs made payments directly to suppliers. There was no mention of third, fourth or fifth parties involved in the "daisy chain of cash". There was no mention that payments of hundreds of millions of RMB were made on the basis of oral agreements, without signed contracts.
- [573] We find the AR/AP Set-Off process descriptions to be inaccurate, incomplete and deceitful.
- [574] We find the AR/AP Set-Off Process in the BVI Model was used to facilitate Sino-Forest's overstatement of assets and revenues.

## **5. Who Knew What When**

- [575] The Respondents submit they disclosed their process accurately to Mr. Maradin, Horsley, the Board and the Audit Committee, and it was up to them to decide how to characterize the facts they were given. The Respondents submit it was not up to them to second-guess Canadian experts.
- [576] The Respondents submit, although Horsley denies any knowledge of the contracts being signed after the quarter-end, he should have been aware of this practice. He had received emails plainly indicating contracts had not been signed during the quarter in which the transactions were recorded. As well, Horsley admitted Hung and Ip would have reasonably relied on him, as a chartered accountant, for revenue recognition issues. Based on email evidence and testimony, we find Horsley was aware contracts were signed after the quarter-end.
- [577] The Respondents also submit Mr. Maradin and the members of the Audit Committee were aware, or should have been aware, of this practice. There is no evidence the Audit Committee was aware of this. Mr. Hyde testified it was "new news" to them (and Mr. Maradin) after the Muddy Waters Report.
- [578] Mr. Hyde testified, prior to the Muddy Waters Report, he understood changes in land reform meant PRCs could be issued to BVIs, but not all levels of government had implemented the reforms. As a result, Sino-Forest continued to rely on Forestry Bureau Confirmations. Mr. Hyde testified Chan and Horsley told him "as they had the ability to apply for [PRCs] they were applying for them" in the BVI Model (Hearing Transcript, November 5, 2014 at 128:14-16). Mr. Ardell

testified that prior to June 2, 2011, he knew nothing about Forestry Bureau Confirmations. After the Muddy Waters Report, Mr. Hyde and the Independent Committee learned “it was next to impossible to get [PRCs] for the BVI timber contracts because they just had never been issued” (Hearing Transcript, November 5, 2014 at 174:13-15). We find Chan knew BVIs could not obtain PRCs yet he deliberately told Mr. Hyde otherwise.

[579] Mr. Hyde testified, before the Muddy Waters Report, he was unaware a key attachment (Villagers’ Resolutions) to purchase contracts was never attached. Subsequently, Chan and Horsley told him Villagers’ Resolutions were reviewed, but not retained, as part of the due diligence process. The missing attachment had not been reported to the Audit Committee before the Muddy Waters Report by the auditors or by lawyers during the due diligence process for underwritings.

[580] Mr. Hyde testified, before the Muddy Waters Report, Chan explained the lack of maps to him as due to “Beijing secrecy requirements” (Hearing Transcript, November 5, 2014 at 178:11). The *Second IC Report* notes there was no centralized system to connect compartment numbers on maps to specific locations. Mr. Hyde testified that level of detail was not available to the Audit Committee, as the Committee did not review source documents. He said the Audit Committee relied on advisors who were doing site visits, and legal and accounting advisors who were reviewing contracts. No concerns related to the lack of location specificity were brought to the Audit Committee’s attention.

[581] Regarding Sino-Forest’s revenue recognition policy, Mr. Hyde testified, during the course of the Independent Committee Investigation, he and the rest of the Independent Committee learned that contracts were signed following quarter-end. This was inconsistent with the information the Board and Audit Committee had pre-Muddy Waters. Mr. Hyde described his reaction to learning this as:

Absolute shock. It was completely inconsistent with the understanding we had ... I know the OSC had asked on two different occasions about revenue recognition ... and the information that was responded to the Commission was that contracts were signed – well, revenue was recognized when the contracts were signed, so it was completely inconsistent with the concept of signing contracts after the quarter-end.

(Hearing Transcript, November 6, 2014 at 117:5-15)

[582] The Audit Committee, as a matter of practice during their *in camera* sessions with E&Y, asked if E&Y had any concerns with Sino-Forest management. Hyde stated E&Y never raised any concerns.

[583] Mr. Ardell, who was also on the Audit Committee, testified he was unaware, before the Muddy Waters Report, there was no internal audit function at Sino-Forest or that Chan signed all sales contracts.

[584] There is evidence the Audit Committee was aware contracts were batched and signed once a quarter. It appears to us the Committee assumed the contracts were signed during the quarter in which revenue was recognized. It further appears to us, however, from Mr. Hyde’s testimony as Chair of the Audit Committee and his role on the Independent Committee, the Audit Committee was not aware of the scope of the post-quarter-end documentation process. There is no evidence the Audit Committee was aware virtually the entire documentation process began after the quarter-end, or that any documents were signed after quarter-end.

[585] While the Respondents may be entitled to rely on those at Sino-Forest who have greater Canadian financial disclosure expertise, this reliance must be premised on accurate and complete communication of the relevant facts by the Respondents to those with greater expertise. The Respondents did not do this. We reject the Respondents’ submission that Mr. Maradin, the Audit Committee and the Board were aware of the actual purchase, sale and set-off process. Chan, Ip and Hung knew the process documents relied on by E&Y in its audit of Sino-Forest’s financial statements were inaccurate, incomplete and did not represent what actually occurred.

## 6. The Roles of Chan, Ip, Hung and Ho

[586] Chan submits there were no red flags for Chan that should have alerted him to potential issues in Sino-Forest’s business, and cites the expert evidence of Dr. Peerenboom in support thereof.

[587] Dr. Peerenboom testified the following, among other practices, are generally-accepted business practices. He later clarified, on cross-examination, he meant business practices that are accepted or permissible in China:

- the use of multiple BVI companies;
- the absence of attachments referenced in the contract;

- the use of contracts which did not identify the specific location of the purchased timber; and
- the reliance on comfort letters (in the case of Sino-Forest, Forestry Bureau Confirmations).

[588] In Dr. Peerenboom's opinion, a reasonably competent CEO, born and educated in Hong Kong with a deep knowledge of Chinese culture and business practices, would not view these business practices as red flags.

[589] Under cross-examination, Dr. Peerenboom qualified significant areas of his testimony in chief. The Panel's impression is the scope of his review of Sino-Forest's business practices and the BVI and WFOE Models was limited. For example, he was not aware whether BVIs could have bank accounts in Mainland China, nor was he aware whether Sino-Forest BVIs were paying taxes. When asked about his expert opinion that BVIs were restricted from selling in China, despite the fact Sino-Forest disclosed in its public documents it was selling to AIs, he stated "I'm a bit confused as to what's going on" (Hearing Transcript, April 2, 2015 at 103:24).

[590] While his expert opinion was the use of BVIs is common in Mainland China, he was not aware of any other company using the BVI model in the manner Sino-Forest used it. He then explained the use of BVIs is common as holding companies for investment purposes but he was not aware of any other company using the BVI structure as an operating company, as Sino-Forest did.

[591] Dr. Peerenboom testified as a general rule, comfort letters (here, Forestry Bureau Confirmations) are difficult to obtain. In rural areas, where Sino-Forest operated, the administrative regulatory structures are weaker and more inefficient than in urban areas, resulting in longer delays for these letters. He stated although there was no law expressly authorizing the issuance of Forestry Bureau Confirmations, there was no law expressly prohibiting their issuance. We find this opinion to be of little value.

[592] Regarding missing attachments to contracts, Dr. Peerenboom stated it was very common in practice. He then went on to say common is not necessarily the same thing as generally accepted and Staff's questioning had forced him "to think more carefully about what is the relationship between 'generally accepted' and 'common'" and he would have to go back and be more specific which practices were generally acceptable (Hearing Transcript, April 8, 2015 at 124:16-18).

[593] He then went on to state "generally accepted" practices are those accepted or permissible within the relevant context, but did not necessarily mean they are common or frequent: "So in that context, there's a distinction between absolute or even relative frequency and a practice being generally accepted" (Hearing Transcript, November 8, 2014 at 123:10-12). Dr. Peerenboom agreed "generally accepted" does not necessarily mean legal or in compliance with regulations.

[594] Dr. Peerenboom testified the significance of a missing attachment depends on further contextualization and the determination of what type of significance:

Q. So sticking with that same point, you would agree that if the missing attachment is intended to identify the asset being purchased, that is a significant issue if it's missing?

A. I'm unable to answer that question.

...

Q. You would agree that if the missing attachment is intended to demonstrate that the seller of the asset owns the asset being sold, that is a significant issue?

A. Again, I'm unable to answer that.

(Hearing Transcript, April 8, 2015 at 131:20-25 and 132:6-10)

[595] With so many qualifications to the term "generally accepted" and the blurred distinction among the terms "common", "permissible" and "accepted", the Panel finds Dr. Peerenboom's evidence of little value.

[596] We find there were many red flags at Sino-Forest, which included:

- the use of multiple BVI companies, not just as holding companies, but as operating companies in Mainland China;
- the absence of key attachments referenced in the contract which would evidence ownership;

- the use of contracts that did not identify the specific location of the purchased timber, and which were not supported by any additional documentation enabling one to locate the plantations; and
- the reliance on Forestry Bureau Confirmations, which contained incorrect information about future issuances of PRCs.

We find Chan, a reasonably competent CEO, born and educated in an advanced modern financial centre such as Hong Kong, was aware or should have been aware these were red flags.

[597] Chan and Hung were educated in Hong Kong and Ip was educated in Canada. Hong Kong is an advanced modern financial centre and the quality of its corporate governance regime is regarded as on par with, or above, Canada's.

[598] When asked to clarify Chan's role in the BVI purchase process, Ip replied:

Allen Chan would be the person to give the final approval in forest purchase. As for K.K. Poon, he would follow up upon the final approval; that is, he [Poon] would follow up. After the final approval had been given by Allen Chan, he [Poon] would go through the documents and sign on the contract.

(Hearing Transcript, September 11, 2015 at 53:12-17)

[599] Chan submits he relied on K.K. Poon's review of purchase contracts and survey reports because Chan was not a forestry expert. This is inconsistent with Chan's conduct. He pre-approved the purchases, knew which forests to purchase, and identified the provinces where Sino-Forest was going to purchase additional assets.

[600] Chan indicated to Mr. Clifford, in managing fraud risk, he was seeing all the purchase and sale contracts, was signing off on the contracts, decided which entity would acquire the standing timber, was signing cheques and was seeing each transaction. As noted previously, a March 2011 internal E&Y memorandum notes "Allen [Chan] is very involved in the day to day operations. He reviews cheques and key transactions as they occur. He also has an intimate knowledge of the business and would be able to spot anomalies as they occur". Mr. Clifford described Chan as having "a great degree of visibility around what the company was doing at any moment in time", and testified Chan took "great comfort from the fact that he was seeing these transactions one by one and could spot something that was an anomaly" (Hearing Transcript, November 17, 2014 at 61:1-5).

[601] Chan and Ip had weekly meetings, at which Chan would indicate whether he had any objections to proposed purchases. Chan had final say on every purchase at the time the contract was signed. Chan knew when changes were made to purchase contracts in the quarter following the quarter in which they were recorded. Hung testified he would need to obtain a new purchase requisition form, which required Chan's approval. Hung checked with Chan for authorization to pay suppliers when there was no written contract in place. Chan understood the documentation process and Horsley contacted him directly when documentation was late. He was a knowledgeable, experienced, sophisticated and hands-on CEO. He was also involved in the late December 2010 initiation of purchase documentation for Q4 2010. Chan therefore knew the purchase documentation process only started at the end of the quarter.

[602] Xu Ni stated in her interview she discussed the deficiencies in the purchase contract templates with Chan; he was aware of the deficiencies in the purchase contract templates, specifically that contracts listed Villagers' Resolutions and PRCs as attachments although these documents were never attached to the purchase contracts. Chan knew Sino-Forest BVIs could not obtain PRCs.

[603] Chan submits he relied on the Board of Directors, the Audit Committee, Horsley, Mr. Maradin and financial and legal advisors, who were all far more sophisticated than he was in the public disclosure obligations required by Ontario securities laws. The Panel agrees Chan was entitled to rely on these individuals, but reliance on others must be reasonable and must start with honest and complete disclosure of the facts. Chan did not truthfully or completely disclose the facts to those parties on whom he claimed to rely.

[604] Chan submits his "frontline" role at Sino-Forest was largely ceremonial, and as CEO, his role was to set the strategy for the company. However, we find Chan was deeply involved in the operations of Sino-Forest. As the "ultimate and compensating control" over transactions, the approver of all purchase contracts and the signatory on all sales contracts, Chan's frontline role was much more than ceremonial.

[605] Because Sino-Forest BVIs could not obtain PRCs, Sino-Forest was never the legal or registered owner of the standing timber in the BVI Model. Chan and Ip knew failure to disclose these crucial facts would result in a risk of deprivation to Investors.

- [606] Ip, as head of Sino-Panel, approved all purchases and, from the second quarter of 2010, signed all purchase contracts. He was responsible for the Sino-Panel Group, which included 48 subsidiaries and over 1,000 employees. He oversaw the Resource Department, which sourced all the standing timber for the BVI subsidiaries.
- [607] Both Chan and Ip knew Sino-Forest's BVIs could not obtain PRCs and Sino-Forest was not even applying for them, contrary to its financial statement disclosure. Chan and Ip knew the purchase contracts and Survey Reports did not provide location details and Sino-Forest's BVIs did not retain maps. Further, without PRCs, there is no record of the location of the standing timber Sino-Forest's BVIs purchased. Based on Sino-Forest's documentation, there is no way to locate the standing timber assets held in the BVI Model. Both Chan and Ip knew this.
- [608] Chan and Hung knew that receivables and payables were settled prior to the existence of written signed contracts. Chan, Ip and Hung knew documents were prepared in batches and backdated and that process documents, relied upon by E&Y, were deceitful.
- [609] Hung, Vice-President, Corporate Planning and Banking for Sino-Forest, was a Chartered Financial Analyst. In order to become a CFA, he had to complete a minimum three year self-study program, which included an accounting component, and successfully pass three six-hour exams. He had to certify annually his adherence to the CFA Code of Ethics, which emphasized integrity, professionalism and competence. As a professional with a CFA designation, he would have understood Sino-Forest's revenue recognition policy was misleading. Yet throughout his testimony, Hung was evasive about his knowledge of the revenue recognition policy and testified he would need an accountant to help him understand the policy. The Panel finds Hung had sufficient education to understand Sino-Forest's revenue recognition policy and to know it was misleading.
- [610] Hung was a member of the Disclosure Committee since 2005. Sino-Forest's Disclosure Policy states the Disclosure Committee was established "to assist the Senior Officers in fulfilling their responsibility for oversight of the completeness, accuracy and timeliness of the disclosures made by the Corporation [Sino-Forest]". Further, the Disclosure Committee's policy statement states: "The Corporation [Sino-Forest] is committed to a policy of **full, true and plain public disclosure of all material information in a timely manner**, in order to keep shareholders and all members of the investing public equally informed about the Corporation's operations" [emphasis added].
- [611] Hung signed sub-certifications in relation to Sino-Forest's public disclosure each quarter and at year-end. As an example, in one such sub-certification, Hung certified no covered report "contained an untrue statement of a material fact" or "omitted to state a material fact necessary to make the statements in the covered report ... not misleading". Such covered reports included 2010 year-end financial statements, AIFs, a press release and a Management's Discussion and Analysis (**MD&A**), as well as any amendments to these documents. Hung knew these reports were misleading.
- [612] In addition to his CFA designation, Hung obtained an undergraduate degree in mathematics from the University of Hong Kong, a Master of Finance from the City University of Hong Kong and a Master of Business Administration from Hong Kong Chinese University. We reject Hung's submission he did not understand Sino-Forest's disclosure on revenue recognition. Hung insisted an accountant's qualification would be needed to understand the concepts of revenue recognition and related party transactions. His evasiveness and continuous denial of responsibility under cross-examination undermine his credibility significantly.
- [613] Hung was the central figure in, and controlled, the Deceitful Documentation Process. He knew payments were made before written contracts were prepared. He knew at a minimum to check with Mr. Horsley as to whether the documentation process and practices were acceptable; with Hung's education and experience, questions to Mr. Horsley, Mr. Maradin or the Audit Committee would have been the minimum expected of him, as a senior officer of Sino-Forest.
- [614] We find Chan, Ip and Hung are all accountable for their roles in the Deceitful Documentation Process.

## 7. Conclusion

- [615] Sino-Forest's documentation process in the BVI Model involved preparing documents in batches and using manual systems which allowed for the backdating of contracts and post-quarter-end revisions. All documentation originated with Sino-Forest – there was no independent record. The Forestry Bureau Confirmations, which could not be disclosed to anyone outside of Sino-Forest, do not confirm Sino-Forest's legal ownership of standing timber. It was not possible to locate the specific standing timber plantations from the purchase contracts, Survey Reports or Forestry Bureau Confirmations. There was no record of payments by multiple AIs to multiple suppliers on behalf of Sino-Forest, and payments were often made prior to the preparation of purchase contracts. Sino-Forest did not keep track of harvesting and no new Forestry Bureau Confirmations were requested from the Forestry Bureaus when partial areas of standing timber plantations were sold.



[616] The process documents described a very different process. Transactions were described as being processed during the quarter sequentially and chronologically. There was no mention of batching and backdating or payments in advance of contracts being prepared or signed. Although, according to the Respondents' description of the process, oral agreements were the most critical event that initiated the entire purchase transaction, there was no mention of oral agreements or handshakes in the process documents. There was also no mention the AR/AP Set-Off Process involved three, four, five or more parties on both the supplier and the AI sides, which implied up to 12 parties could be involved in one settlement.

[617] We have found:

- PRCs could not and would not be issued to Sino-Forest's BVIs during the Material Time for two reasons: they only traded in standing timber, and they were foreign offshore companies.
- PRCs and Forestry Bureau Confirmations are not equivalent.
- Forestry Bureau Confirmations were not official documents, were not issued pursuant to a legislative mandate or published policy and were not documents of title that could be relied upon in the event of a dispute in a court of law. They are of no use in establishing Sino-Forest's ownership in the event of any dispute with third parties over ownership of forestry rights, a frequent occurrence in Mainland China. Forestry Bureau Confirmations do not establish Sino-Forest's legal ownership of standing timber in the BVI Model. Sino-Forest's stated reliance on Forestry Bureau Confirmations as proof of legal ownership was deceitful.
- The geographic distances, the many steps involved to get the contracts prepared and signed, and the Forestry Bureau Confirmations issued, make it more likely than not that the Forestry Bureau's process for confirming ownership simply did not happen.
- When new form Confirmations were issued by Forestry Bureaus during the Independent Committee investigation, they only confirmed the existence of a purchase contract and not ownership of the standing timber. The fact that these differed from the original Forestry Bureau Confirmations, which confirmed additional rights, calls into question what due diligence the Forestry Bureau conducted before chopping the original Confirmations.
- Sino-Forest never registered ownership of its standing timber in the BVI Model.
- Chan, Ip and Sino-Forest did not disclose that Sino-Forest's BVI subsidiaries could not obtain PRCs and thus could have no ownership claim to the BVI standing timber assets because those rights had not been registered.
- Neither the Survey Reports nor maps provided sufficient information to locate the trees owned by Sino-Forest. This failure to demonstrate specific locations for BVI standing timber assets contributes to our finding that Investors' pecuniary interests were put at risk.
- The BVI Model was opaque and malleable and enabled the Respondents to perpetrate fraud, as we find elsewhere in these Reasons.
- Hung was the central and crucial figure in the Deceitful Documentation Process.
- Changes to fundamental aspects of purchase contracts and supporting documents occurred long after the dates of the oral agreements and after the quarter in which Sino-Forest recorded the acquisition of the asset.
- The process descriptions failed to accurately describe the processes for the purchase, sale and set off process for Standing Timber in the BVI Model. They were almost entirely inaccurate. Ip and Hung were the process owners for these process descriptions and annually confirmed their accuracy.
- Virtually all steps in the purchase process began after the quarter in which the purchases were recorded.
- The purchase contracts and their three key attachments were fundamentally flawed:
  - As noted above, Forestry Bureau Confirmations do not establish Sino-Forest's ownership of standing timber;
  - Villagers' Resolutions and PRCs were never attached to BVI purchase contracts.

- Survey Reports were prepared in the quarter after Sino-Forest recorded the purchase and were in some cases reverse-engineered by Sino-Forest employees; and
- Standing timber locations could not be located based on these documents.
- Sino-Forest's post-quarter documentation process was not merely an exercise of transcribing oral contracts entered into during the previous quarter.
- The sales process documents were inaccurate, incomplete and did not represent what actually occurred.
- Sino-Forest misled the Commission about its revenue recognition practices in its 2008 letter to the Commission. Chan was aware of the letter and the misleading statements.
- The dating of documents used in the AR/AP Set-Off Process was inaccurate.
- The AR/AP Set-Off descriptions were inaccurate, incomplete and deceitful.
- The AR/AP Set-Off Process in the BVI Model was used to engage in a scheme to overstate Sino-Forest's assets and revenues.
- There were many red flags that Chan, a reasonably competent CEO, born and educated in an advanced modern financial center such as Hong Kong, should have been aware of.

[618] The process actually followed by Sino-Forest in documenting its BVI purchases and sales was fundamentally flawed and put Investors' pecuniary interests at risk. On the purchase side, Sino-Forest had inadequate proof of ownership for the assets it purportedly purchased and recorded under the BVI Model:

- Sino-Forest's BVI subsidiaries did not obtain official proof of ownership through PRCs;
- Sino-Forest's BVIs did not obtain the requisite Villagers' Resolutions;
- Locations of the assets purportedly purchased could not be ascertained; and
- Forestry Bureau Confirmations were not legal proof of ownership.

As a result, Sino-Forest deceived Investors by disclosing to them that it owned standing timber for which it could not prove ownership.

[619] Virtually all purchase, sales and set-off documentation were created after the end of the quarter in which Sino-Forest claims the transactions occurred. The result of the flawed sales documentation is that Sino-Forest recognized revenue in the BVI Model before sales were executed (and, in addition, misled the Commission about how and when revenue was recognized). Among other evidence discussed elsewhere in these Reasons, changes to fundamental aspects of transactions post-quarter-end provide sufficient evidence for us to find Sino-Forest's regular quarterly and annual disclosure of its assets and revenue was misleading and could not be relied upon by Investors.

[620] We find Sino-Forest falsified evidence of ownership of assets and recognized revenue in a manner that was deceitful.

[621] The Panel finds Sino-Forest's documentation process was deceitful and this process underpinned the BVI Model and facilitated fraud, as we find elsewhere in these Reasons. We find Chan, Ip and Hung controlled the BVI Model, created the actual documentation process, and knew this process was deceitful.

[622] We do not find Ho authorized, permitted or acquiesced in the Deceitful Documentation Process. The evidence does not support a finding that he was involved.

**D. Undisclosed Internal Control Weaknesses or Failures Allegations**

[623] The third element of the Standing Timber Fraud alleged by Staff is undisclosed internal control weaknesses or failures at Sino-Forest.

**1. Positions of the Parties**

**(a) Staff**

- [624] Staff alleges Sino-Forest dishonestly concealed internal control weaknesses or failures which obscured the true nature of transactions conducted within the BVI Model and prevented the detection of the Deceitful Documentation Process. Staff submits Sino-Forest failed to disclose the extent of the concentration of duties in a small group of senior management (including Ip, Hung and Chan), who completely controlled the operation of the BVI Model. This included the fraudulent creation and execution of the BVI purchase and sales contracts and their key attachments, and the AR/AP Set-Off Process. Staff alleges this concentration of control facilitated the fraudulent course of conduct perpetrated in the BVI Model. Staff further alleges the undisclosed control weaknesses and deficiencies facilitated and concealed the fraudulent conduct within the BVI Network and the Deceitful Documentation Process.
- [625] Staff also alleges Sino-Forest's statements in its public disclosure record regarding the extent of its internal control weaknesses were wholly inadequate and misleading.
- [626] Staff submits Sino-Forest's failure to properly disclose one of its material weaknesses – the lack of segregation of duties – was a key pillar of the Standing Timber Fraud. Staff submits Hung was in complete control of the deceitful documentation of the transactions in the BVI Model, including the documentation of the AR/AP Set-Off Process and the preparation of the purchase and revenue data for entry in the books and records by Sino-Forest's accounting department. Staff submits this material weakness permitted the Deceitful Documentation Process. Staff further submits Chan could have, but did not remedy, this material weakness, which, if remedied, would have risked exposing the Standing Timber Fraud, particularly the Deceitful Documentation Process.
- [627] Staff submits, as the leader and prime mover of Sino-Forest, Chan could have split up Hung's duties with ease. Staff submits, through his failure to address this material weakness, Chan ensured Hung's control remained. Staff submits people other than Hung can answer the phone, write on sticky notes and enter data in spreadsheets. However not everyone could be trusted by Chan to reverse engineer purchases and sales and churn the paper required to keep the Standing Timber Fraud alive.
- [628] Staff submits Chan and Sino-Forest are directly responsible for the facilitation of fraud as a result of the internal control deficiencies and that Hung authorized, permitted or acquiesced in Sino-Forest's conduct.

**(b) Chan**

- [629] Chan submits Sino-Forest disclosed material weaknesses with its internal controls. He submits the evidence establishes that the Respondents, including Chan, did not conceal Hung's role or the extent of the off-book cash flow.
- [630] Chan specifically submits Sino-Forest disclosed the concentration of authority, or a lack of segregation of duties, was a material weakness in its internal controls public disclosure. Chan submits Sino-Forest devoted significant financial and human resources to its internal controls project.
- [631] Chan also submits the Respondents did not conceal the size of the BVI Model. In Chan's submission, the facts that Sino-Forest's core business was the standing timber business and that it was transacted through BVI subsidiaries, which could not have bank accounts in China, and therefore engaged in a set-off process, were in plain view at all times.

**(c) Hung**

- [632] Hung submits the Audit Committee was given material dealing with internal control deficiencies which indicated that the ultimate compensating control on sales contracts was Chan, who signed all sales contracts. Hung submits Mr. Maradin, who was the Vice-President of Risk Management at Sino-Forest, had spent 15 years at E&Y and was a senior consultant to several multinational companies, where his responsibilities included internal control and regulatory compliance. Mr. Maradin was responsible for risk management, internal controls and financial reporting at Sino-Forest and was particularly aware of Chan's role in signing and approving contracts
- [633] Hung submits the remediation of significant deficiencies in internal controls was arguably a matter which warranted close attention by the Audit Committee. Hung further submits the Audit Committee had received a series of reports from Mr. Maradin about the nature of the significant deficiencies including ways of correcting them, and this was an issue of some focus for the Audit Committee.
- [634] Hung submits Mr. Maradin prepared internal control reports for the Audit Committee, which highlighted the oral nature of communications with respect to the notification of customers and suppliers about setoff payment arrangements.

Hung submits the Respondents were transparent with Mr. Maradin and others in Sino-Forest about the nature of the AR/AP Set-Off Process. Nevertheless, the Audit Committee, Mr. Maradin and Mr. Horsley were all content to allow the oral notification process to continue.

- [635] Hung submits his method of recording information by hand, then transferring the information into an Excel spreadsheet was substantially faster, more respectful to the person who was providing the information over the phone and more service-oriented. He submits nothing in the circumstances made his approach unreasonable.
- [636] Hung submits the only evidence about training the Respondents on issues in Ontario capital markets involved mention of a manual Mr. Maradin had prepared about internal controls and a one-day training session in the Fall of 2007, which included some discussion about internal controls but was not about training on Ontario regulatory standards.
- [637] Hung also submits it would be unrealistic to expect him to correct the control deficiency arising from the concentration of duties, because he was carrying out duties asked of him by his superiors. Hung submits a change in his job functions was a decision to be made by his superiors and Sino-Forest's Board of Directors.

## 2. Disclosure Requirements under NI 52-109 for Internal Control Weaknesses

- [638] In order to fully understand and appreciate the importance of undisclosed internal control weaknesses by a reporting issuer, it is useful to look at the requirements under Ontario securities law, which give direction and guidance to reporting issuers on how to structure and disclose their internal controls.
- [639] NI 52-109 sets out disclosure and filing requirements for all reporting issuers, other than investment funds. The objective of these requirements, as set out in Companion Policy 52-109 (**52-109 CP**), is to improve the quality, reliability and transparency of annual filings, interim filings and other materials that issuers file under securities legislation. We view this objective as critical to the protection of investors and maintaining the integrity of the capital markets.
- [640] Under Part 3 of NI 52-109, Sino-Forest was required to disclose any material weaknesses in its disclosure controls and procedures or its internal controls over financial reporting (**ICFR**) in its MD&A, a disclosure document that is required to be filed by a reporting issuer such as Sino-Forest under Part 5 of NI 51-102.
- [641] Section 3.2 of NI 52-109 provides:
- ... if a non-venture issuer determines that it has a material weakness which exists as at the end of the period covered by its annual or interim filings, as the case may be, it must disclose in its annual or interim MD&A for each material weakness
- (a) a description of the material weakness;
- (b) the impact of the material weakness on the issuer's financial reporting and its ICFR; and
- (c) the issuer's current plans, if any, or any actions already undertaken, for remediating the material weakness.
- [642] In 52-109 CP, guidance is provided on the interpretation and application of provisions in NI 52-109, including with respect to disclosure controls and procedures and ICFR. In particular, subparagraph 6.3 states that the definition of ICFR includes reference to reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with accounting standards. 52-109 CP indicates reasonable assurance is a high level of assurance but does not represent absolute assurance.
- [643] In identifying risks, 52-109 CP calls for a top-down, risk-based approach whereby certifying officers focus their resources on the areas of greatest risk and avoid expending unnecessary resources on areas with little or no risk, considering the size and nature of the issuer's business, and the structure and complexity of business operations.
- [644] Subparagraph 6.6(3) of 52-109 CP specifically focuses on fraud risk and calls for certifying officers to explicitly consider the vulnerability of the entity to fraudulent activity, citing as examples fraudulent financial reporting and misappropriation of assets. That provision requires certifying officers to be concerned with fraud that could cause a material misstatement in the issuer's annual filings, interim filings or other reports filed or submitted under securities legislation.
- [645] Paragraph 6.7 of 52-109 CP discusses the importance of a control environment which includes having the appropriate tone at the top, which can help develop a culture of integrity and accountability at all levels of an organization.

[646] Subparagraph 6.11(a) of 52-109 CP provides for segregation of duties to act as a check and balance on the activities of the entity so that no one individual has control over all steps of processing a transaction or other activity. Subparagraph 6.11(c) of 52-109 CP lists instances where an issuer might be dominated by a founder or other strong leader who exercises a great deal of discretion and provides personal direction to other employees, and warns of the danger this concentration of knowledge and authority could allow the individual an opportunity to override established policies or procedures or otherwise reduce the likelihood of an effective control environment. As will be discussed below, the lack of segregation of Hung's duties and Chan's role at the top strike at the heart of the danger that NI 52-109 seeks to remedy.

### 3. Were there Undisclosed Internal Control Weakness?

#### (a) Identification of Weaknesses

[647] In Sino-Forest's 2006 MD&A, it disclosed four material weaknesses in its ICFR. Sino-Forest described these material weaknesses as follows:

- a. "segregation of duties,"
- b. "[Sino-Forest] does not have the optimum complement of financial personnel with the technical accounting knowledge in the foreign subsidiaries to address all complex and non-routine transactions that may arise,"
- c. "completeness and accuracy and timeliness of the period close process including reviewing and monitoring recording of reoccurring and non-reoccurring of journal entries and translation of foreign currency transactions and subsidiary company results," and
- d. "information systems are subject to general control deficiencies including lack of effective controls over spreadsheets"

[648] These four material weaknesses were also disclosed in each of its first three quarterly MD&A 2007 interim filings. In its 2007 annual MD&A, Sino-Forest disclosed it "made improvements to its financial processes and information systems" and as a result, in Sino-Forest's view, "two of the four material weaknesses ... [had] been effectively remedied". In particular, Sino-Forest disclosed it implemented compensating review and monitoring controls by corporate accounting staff on a quarterly basis; added qualified senior financial resources with oversight responsibility for the financial statement close process; and implemented changes in the roles and responsibilities within the senior finance group. In its 2007 annual MD&A, Sino-Forest indicated two material control weaknesses – the lack of segregation of duties and control deficiencies in information systems – continued to exist.

[649] In its 2008 annual MD&A, Sino-Forest addressed the internal control weakness relating to information systems, and indicated it "implemented further changes in roles and responsibilities within the information technology department", which together with other changes effectively remediated this internal control weakness. This left the lack of segregation of duties as the only remaining material weakness.

#### (b) The Lack of Segregation of Duties

[650] Sino-Forest disclosed the material weakness of the lack of segregation of duties as follows in its 2008 annual MD&A:

The success of the Company's vision and strategy of acquiring and selling forestry plantations and access to a long-term supply of wood fibre in the PRC [People's Republic of China] is dependent on senior management. As such, senior management plays a significant role in maintaining customer relationships, negotiating and finalizing the purchase and sale of plantation fibre contracts and the settlement of accounts receivable and accounts payable associated with plantation fibre contracts. This concentration of authority, or lack of segregation of duties, creates risk in terms of measurement and completeness of transactions as well as the possibility of non-compliance with existing controls, either of which may lead to the possibility of inaccurate financial reporting.

Horsley testified the "senior management" being referred to here was Chan, Albert Ip, Albert Zhao and Hung.

[651] The same description of the lack of segregation of duties material weakness appears in both Sino-Forest's 2009 and 2010 annual MD&A.

[652] Notwithstanding this was the only remaining material internal control weakness not remediated, Mr. Maradin testified it was "the most important" (Hearing Transcript, October 29, 2014 at 68:16). Mr. Maradin testified he received "very little

support” from senior management with respect to remediating this material weakness (Hearing Transcript, October 29, 2014 at 68:2).

- [653] Mr. Maradin testified he had limited support from the Audit Committee in 2008. Mr. Maradin testified this lack of support from the Audit Committee changed by 2010, by which time the Audit Committee had become more concerned.
- [654] In an email dated November 18, 2007, Horsley writes to Chan about the importance of being able to certify that the processes, systems and internal controls of Sino-Forest are operating effectively. Horsley warns Chan “[i]f we do not get to that position, the market cap of the Company will be reduced significantly (you heard Jud [Martin] say cut in half)”.
- [655] Mr. Martin testified, in reference to his comment, it was important for a company to demonstrate it could meet regulatory guidelines; this was “top of mind after the Enron days” (Hearing Transcript, December 1, 2014 at 34:4-5). This was the “first question I received when I was visiting shareholders in my previous life.” (Mr. Martin had previously been a Senior Vice President and CFO of a reporting issuer, where he had oversight over internal control matters.) Mr. Martin described Chan’s role in relation to the implementation of NI 52-109. Chan was seen as a “very strong leader, a very respected leader, and it was up to Allen ... to try and get results” (Hearing Transcript, December 1, 2014 at 36:9-11). Chan’s role was to set the tone at the top.
- [656] Mr. Maradin testified the lack of segregation of duties was identified in 2006 and 2007 during the creation of process documentation for BVI transactions. He explained the lack of segregation of duties consisted of Hung managing the documentation for the purchase and sale of standing timber and the AR/AP Set-Off Process. Mr. Maradin testified Hung had a significant role in terms of recording BVI timber purchases and sales, reporting the information to the Sino-Forest accounting department, and providing all supporting documentation. Mr. Maradin also testified Hung was the individual responsible for the settlement of accounts payable and receivable in the BVI Model.
- [657] The failure to segregate duties was the most important material weakness and was identified as the concentration of duties with Hung. Mr. Hyde testified this material weakness was related to “the settlement agreements, on one person being responsible for many aspects of producing the settlement agreements among the AIs and suppliers” and that person was Hung (Hearing Transcript, November 5, 2014 at 99:2-17). Mr. Hyde testified, in his experience with businesses, there is not as much concentration in one person related to significant transactions.
- [658] Hung submits the Respondents were transparent with Mr. Maradin and others in Sino-Forest about the oral nature of the communications with respect to the AR/AP Set-Off Process and submits the Audit Committee, Mr. Maradin and Mr. Horsley were all content to allow the oral notification process to continue. However, the crux of the issue with respect to this internal control weakness is not the oral nature of the communications but, more important, the concentration of duties in one individual, Hung.
- [659] We find the concentration of duties in Hung was neither reflected in Sino-Forest’s MD&A disclosure nor otherwise adequately disclosed for the following reasons. The MD&A disclosure provided by Sino-Forest in respect of 2008, 2009 and 2010 spoke in broad terms of the role of “senior management” but did not disclose that the concentration of duties rested on one individual (Hung), nor the scope of the BVI Model. Sino-Forest Investors were not aware that this material weakness related to approximately 70% of Sino-Forest’s revenue every year from 2007 to 2010. The same person – Hung – was responsible for recording purchases and sales and for the AR/AP Set-Off Process in the BVI Model.
- [660] Mr. Clifford of E&Y testified that the problem with the lack of segregation of duties was that “it’s a small group of individuals that are involved in the contract negotiation and settlement process. So more specifically, it’s Allen, and Allen Chan and Albert Ip and Alfred Hung in terms of that process by which they purchase, they sell, and they net settle” (Hearing Transcript, November 17, 2014 at 107:23-108:3).
- [661] In a letter dated October 28, 2010 from E&Y to the Audit Committee, E&Y indicated that “all information for the settlement arrangement is solely kept by one senior member of management in the Hong Kong office”, whom Mr. Martin confirmed was Hung.
- [662] Sino-Forest’s repeated disclosure in its MD&As for 2008, 2009 and 2010 in respect of the lack of segregation of duties material weakness indicates that “senior management plays a significant role in maintaining customer relationships, negotiating and finalizing the purchase and sale of planation fibre contracts and the settlement of accounts”. The real significance of the lack of segregation of duties weakness was also concealed given that the scope of the BVI Model, which accounted for approximately 70% of Sino-Forest’s revenue between 2007 and 2010 was also not disclosed. Accordingly, the danger emanating from this internal weakness was heightened, given the size of transactions booked through the BVI Model. We find this disclosure is incomplete because as the evidence demonstrated, all of these

duties, specifically the recording of the purchase and sale of standing timber contracts and the settlement of accounts, rested on the shoulders of a single member of senior management: Hung.

[663] Hung submits even someone not mathematically astute would have been able to determine the approximate revenue in the BVI Model fairly easily. He submits one could do this by working from the increase in Sino-Forest's provision for tax relating to profits from the sale of standing timber in the BVI business from 2009 to 2010 multiplied by a factor that includes the PRC enterprise tax rate of 25% and the PRC income tax based on a deemed profit of 15%. We disagree. We find the computation and the elements of it are neither straightforward nor easily determinable and find that this information ought to have been fully and clearly disclosed to Investors.

**(c) *The failure to remediate the lack of segregation of duties***

[664] Throughout the Material Time, efforts were made to remediate this internal control weakness. In 2005, Sino-Forest hired Mr. Maradin as an internal control expert for the NI 52-109 internal controls project. Chan submits he supported the internal controls project, adding Sino-Forest personnel and external consultants to support the internal controls project.

[665] Hung submits the only evidence about any training for the Respondents in Ontario public markets issues involved mention of a manual that Mr. Maradin prepared about internal controls, which was not entered into evidence, and one day of training in the fall of 2007 at the Gold Coast Hotel in Hong Kong. Mr. Maradin testified his first task when he went to Hong Kong was "understanding the company more" and "doing a training manual because I thought it was very important to make sure that people understood what was required, what was required from a 52-109 perspective, but also what was also required from being a public company" (Hearing Transcript, October 29, 2014 at 35:4-12). Mr. Maradin also testified this training manual provided "a person understanding of what the regulatory requirements were as they applied to disclosure controls and procedures, internal controls or financial reporting" (Hearing Transcript, October 29, 2014 at 50:21-25) and "it was relevant to educate and train and give people guidance as far as the regulatory requirements" (Hearing Transcript, October 29, 2014 at 51:9-11). Mr. Maradin testified this training manual was also translated into Chinese. Mr. Maradin testified certain Sino-Forest people in Hong Kong and Mainland China were designated to help him build process documentation and the training manual would help those people in that process. Mr. Maradin also testified he held training sessions in 2006 in Hong Kong and Guangzhou with certain Sino-Forest personnel, including Ip, and, prior to that, held a separate session with Chan, among others, regarding the training manual.

[666] Chan submits Sino-Forest made significant improvements to its internal controls by 2011 and devoted significant financial and human resources to its internal controls project, including several independent expert advisors. Chan further submits he spoke of the importance of internal controls at a management workshop off-site at the Gold Coast Hotel in Hong Kong in 2007 which, in his submission, set the tone at the top for internal controls. Maradin testified Chan spoke to senior management at the Gold Coast Hotel about internal controls. However, we find Chan did not follow through and remediate the most significant internal control deficiency – the lack of segregation of duties.

[667] Mr. Maradin testified, by March 2007, he had drafted policies and procedures in respect of internal controls, and asked Chan, Horsley, Ip and Hung for comments on these policies and procedures.

[668] Mr. Maradin testified E&Y became auditors of Sino-Forest in Q3 of 2007 and at that time, Mr. Maradin "provided them all the documentation, whether it was financial reporting or internal controls" (Hearing Transcript, October 29, 2014 at 71:13-14).

[669] He testified he was frustrated with the lack of progress in remediation and in documenting the processes. He was also frustrated with the lack of assistance from staff. Staff that had been assigned to him in Hong Kong would be assigned to do other things when he returned to Canada. This would slow down the documentation of processes.

[670] Chan submits Sino-Forest hired E&Y in 2008 to help Mr. Maradin draft the process descriptions, which identified the internal control weakness of the lack of segregation of duties. Chan further notes Sino-Forest hired an external consultant, Control Solutions, in 2009 to work with Sino-Forest on internal controls and risk management. Mr. Maradin testified this consultant, however, was hired to work with Sino-Forest's WFOE subsidiaries and did not address any weakness in the BVI Model.

[671] An email dated May 8, 2008 from Mr. Hyde to Mr. Martin, which was then forwarded to Horsley, indicates "I don't have a sense of moving forward from a financial reporting perspective" and "[i]nternal control remains behind. We expressed concern and need for better and more frequent reporting. It did not happen. We have a new report but my sense is we should have a third party conduct a review of the state of affairs. We need to turn the heat way up ... " Mr. Maradin continued to raise this internal control weakness. It was never remediated.

- [672] Mr. Hyde and Mr. Martin testified Horsley and Chan told them one of the problems in remediating this material weakness, namely Hung's role, was that Hung was a senior member of management and dividing up his role was going to cause challenges in dealing with some of the suppliers and AIs due to the nature of the relationships. They were told Horsley and Chan were working to figure out a way to divide Hung's role that would not jeopardize those relationships or Hung's position in Sino-Forest. We reject the explanation on the part of Horsley and Chan to Mr. Hyde and Mr. Martin. Hung confirmed he had no role in maintaining relationships with suppliers or customers in the BVI Model.
- [673] At a March 15, 2009 Audit Committee meeting, Mr. Maradin presented his *Report on 2008 Internal Control Certification Project* (referred previously in these Reasons in our discussion of Allen Chan's role at Sino-Forest as the March 15 Report). Chan, among others, attended this meeting. In the March 15 Report, Mr. Maradin proposed a realignment of Hung's responsibilities relating to the AR/AP Set-Off Process as a means of remediating the internal control weakness. Mr. Maradin testified he recommended that Hung's responsibilities needed to be broken up and reassigned to separate individuals. He testified there needed to be a realignment or restricting of responsibilities, however, "at some point in time [he] realized that that wasn't going to change" (Hearing Transcript, October 29, 2014 at 161:16-17) and he was "told [by Horsley] that that won't happen" (Hearing Transcript, October 29, 2014 at 163:5). Mr. Maradin testified he assumed Horsley was told this in conversations with Chan.
- [674] Chan could have easily adopted Mr. Maradin's suggestion to break up Hung's responsibility among separate individuals. Mr. Maradin proposed an alternative compensating control of having Eric Chan, the Assistant Vice-President of Sino-Forest, prepare quarterly reconciliations of all transactions, and then have Horsley review the work and sign off on it, independently of Hung. Chan failed to direct the adoption of this alternative.
- [675] Mr. Maradin testified he had a high level of frustration in 2009. Cooperation from senior management in Hong Kong regarding remediation of this internal control weakness was low.
- [676] Mr. Hyde testified the Audit Committee did not push the remediation of this weakness from 2007 to 2009 for two reasons: first, they discussed it with E&Y, which was familiar with this weakness yet could provide an audit opinion; second, the Audit Committee was told by Horsley that Chan was a compensating control in that he reviewed all the settlement agreements and signed the purchase and sale agreements (we note that Chan did not sign all purchase contracts, but approved all purchases). Mr. Hyde testified Chan confirmed he was the compensating control for the whole process. Mr. Martin testified ultimately "reliance is placed upon [Chan's] signature as ultimate approval and knowledge of all of the transactions" (Hearing Transcript, December 1, 2014 at 51:18-20). Mr. Martin testified as a member of the Audit Committee and the Board, "It gave us great comfort, therefore, that he [Chan] was reviewing and approving. That's a great compensation, or excuse me, compensating control in my opinion and in our opinion" (Hearing Transcript, December 5, 2014 at 54:24-55:5). As a result of this misplaced comfort, the Board appears to have tolerated this lack of remediation longer than they should have.
- [677] The internal controls over financial reporting formed part of the objectives in determining the bonus criteria at Sino-Forest for 2008 and 2009. Remediating the segregation of duties component was removed as a measurement in determining bonuses for 2010.
- [678] In a letter dated August 6, 2009, included in the materials for an Audit Committee meeting held on August 9, 2009 as well as in a similar letter dated October 28, 2010 that was included in the materials for an Audit Committee meeting held on November 9, 2010, E&Y indicates, although they are not able to provide assurance on internal controls or to identify any or all weaknesses that may exist, they nevertheless identified and summarized certain suggestions to improve Sino-Forest procedures and controls. In particular, E&Y indicates all information for settlement arrangements with respect to the BVI subsidiaries was solely kept by one senior member of management in the Hong Kong office (Hung). As a result, there is no assurance all settlement records have been completely submitted to the accounting department and recorded in the general ledger. E&Y recommended a written internal control policy be formulated and implemented to ensure the completeness of the accounting records and that the control procedure should include monthly reconciliation and confirmation with AIs of settlements made, and outstanding balances of amounts owed, to BVI subsidiaries. There is no evidence E&Y's recommendations were implemented.
- [679] Mr. Maradin testified in 2010 he was managing the internal controls group, among other management tasks.
- [680] Materials provided for an Audit Committee meeting held on March 14, 2011, as part of an update by Mr. Maradin on remediation of significant deficiencies, indicate there is no evidence of review in the entire AR/AP Set-Off Process, there is no CFO review of the setting-off schedule, and there is no assurance on completeness of recording of all setting-off arrangements. These materials include a chart, which describes a number of control deficiencies and suggests changes as a means of remediation, and recommends Albert Zhao and Ip sign-off for each set-off transaction as evidence of review and approval. There is no evidence this recommendation was implemented.



[681] Chan submits Sino-Forest's business was transacted through BVI subsidiaries, the BVI subsidiaries could not have bank accounts in China, and the BVI subsidiaries engaged in the AR/AP Set-Off Process were in plain view at all times. While process descriptions state that direct payments were made between customers and suppliers in the AR/AP Set-Off Process, in reality, these payments were not direct but involved third, fourth or more parties, as discussed elsewhere in these Reasons. We agree the AR/AP Set-Off Process was in plain view, but what was not in plain view was the fact payments were not direct between customers and suppliers.

#### 4. The Roles of Chan and Hung

[682] We find the concentration of duties in Hung could have been easily remedied. Mr. Maradin testified, during one meeting of the Audit Committee "in the later stages", Chan acknowledged to the Audit Committee he had not been as supportive in terms of Mr. Maradin getting his job done. We find, as the CEO who should set the tone at the top, Chan did not address the lack of segregation of duties. We find Chan was aware of this internal control weakness and its significance as early as 2006, was reminded of it every quarter at every Audit Committee meeting and yet failed to remediate it in the following years.

[683] In relation to NI 52-109, Mr. Martin testified:

... Mr. Chan's role was the tone at the top, the trickle-down theory that I kind of call it. It's important to – for the leader, and Allen was seen as a very strong leader, a very respected leader, and it was up to Allen, and David relied on Allen for this, I came to know, to try and get results from people that he had – that his – that the board needed, that he needed, that the company needed, including 52-109

(Hearing Transcript, December 1, 2014 at 36:5-13)

Mr. Martin testified the implementation of NI 52-109 was important to demonstrate to shareholders and stakeholders that the company can meet the regulatory guidelines. Chan was also informed in November 2007 by Mr. Martin and Horsley of the need for improved internal controls but ultimately he failed to set the tone at the top.

[684] As a result of the decision by the Audit Committee that more was required to remediate the internal control issues that were outstanding, Mr. Ardell sent the following email to Chan on April 3, 2011:

Good morning Allen

I am including with this note copies of the Internal Controls – Certification status for your review.

During the recent year end audit committee meeting as well as the 'closed session', there was discussion concerning the fact that there are still a number of outstanding areas that require attention and resolution. There is recognition and appreciation that significant improvements have been achieved, however with the ever increasing impact of governance requirements the company needs to be focused on further reduction of the outstanding shortfalls. In particular we do not want the value of the shares affected by 'perceived weaknesses'.

There are a number of initiatives identified for 2011 which will further improve the overall internal controls and reduce the number outstanding certification issues which if achieved will improve our overall position

In my experience the success of achieving these objectives only occurs when the CEO makes it clear to various constituencies that these improvements must occur. I have also found it to be effective when tied in to performance bonuses.

In any case would like to talk to you about it sometime in the **next few days** so I can report back to the committee. [emphasis added]

Chan never responded to Mr. Ardell.

[685] Chan submits the Respondents did not conceal Hung's role or the extent of the off-book cash flow. The Panel finds the evidence establishes that Chan and Sino-Forest did not disclose the extent of the concentration of duties in Hung, nor the extent of the AR/AP Set-Off Process.

- [686] Chan submits the concentration of authority in Hung's role in the AR/AP Set-Off Process was a feature of doing business in China and points us to Dr. Peerenboom's evidence in support of that submission. We reject Chan's submission for reasons discussed below.
- [687] Dr. Peerenboom testified it is typical in Chinese companies to have concentration of authority and it is one of the features of the way Chinese companies do business. However, he was not aware of the specifics of the concentration of duties at Sino-Forest; his comment was merely a generalization. For example, Dr. Peerenboom was not aware of the AR/AP Set-Off Process and Hung's role in this process. Even though it may be a common feature of doing business in China, Chan had the authority and ability to remediate the weakness to reduce the risk. Finally, our concern is whether the Respondents' conduct was or was not in compliance with Ontario securities law, not Chinese business practices.
- [688] We find that Chan could easily have remediated the lack of segregation of duties, but did not. Chan lied to Mr. Martin and Mr. Hyde when he claimed remediating the concentration of control would jeopardize relationships with suppliers and AIs. The lack of segregation of duties and the concentration of control facilitated the course of conduct and operation of the BVI Model.
- [689] Hung was a member of the Disclosure Committee, which was formed at Sino-Forest as part of its disclosure controls and procedures to assist senior officers in fulfilling their responsibility for oversight of the completeness, accuracy and timeliness of the disclosures made by Sino-Forest.
- [690] We find Hung knew the significance of this internal control weakness, specifically the concentration of duties and lack of segregation. However, Chan, and not Hung, had the ability to easily remediate this weakness. Although Hung cannot be held responsible for Chan's failure to remediate the weakness that resulted from his position, Hung went along with Chan's failure to remediate the segregation of duties issue.

## 5. Conclusion

- [689] We find Sino-Forest and Chan dishonestly concealed the lack of segregation of duties. They failed to disclose the extent of the concentration of duties in Hung, and this concealment and non-disclosure obscured the true nature of transactions conducted within the BVI Model and prevented the detection of the Deceitful Documentation Process. Chan was directly responsible for the failure to remediate the internal control deficiency and the inadequate disclosure. Hung went along with Chan's failure to remediate the internal control deficiency.
- [692] We find Sino-Forest's disclosure in its MD&A regarding its internal control weakness was wholly inadequate.

## E. Four Examples of Alleged Fraudulent Transactions

- [693] Staff alleges during the Material Time, the Respondents engaged in significant fraudulent transactions related to Sino-Forest's purchase of standing timber, which had the effect of overstating Sino-Forest's assets and revenue during the Material Time. Staff relies on four illustrative examples of alleged fraudulent conduct within the Standing Timber Fraud Allegations:
- a. transactions involving the Sino-Forest supplier Dacheng (the **Dacheng Transactions**);
  - b. transactions involving the purchase and sale of approximately 450,000 m<sup>3</sup> of standing timber (the **450 Transactions**);
  - c. the purported purchase and sale of a plantation in Gengma County, Yunnan Province (the **Gengma #1 Transactions**); and
  - d. the purported purchase and sale of a second plantation in Gengma County, Yunnan Province (the **Gengma #2 Transactions**).
- [694] Staff alleges, in these transactions, Sino-Forest used certain suppliers, AIs and other nominee companies it controlled to falsify the financial disclosure of Sino-Forest, including the value of its standing timber assets and revenue.

### 1. Dacheng Transactions

- [695] The first example of alleged fraudulent conduct is the Dacheng Transactions.
- [696] These allegations involve the reported purchase of the same 58,920.3 mu of standing timber consisting of areas of 9,100.5 mu, 33,093.3 mu and 16,780.5 mu in Hezhou City, Guangxi Province from three suppliers by Suri-Wood, a Sino-Forest BVI subsidiary, and from Dacheng by Sino-Forest (Hezhou), a Sino-Forest WFOE subsidiary.

- [697] There are five sets of executed and unexecuted purchase contracts associated with the Dacheng Transactions. The first is Dacheng's purchase from Yuangao for RMB 13.68 million on November 17, 2008. The second, third and fourth sets reflect the purchase by Sino-Panel (Hezhou) from Dacheng on October 25, 2008 for RMB 13.68 million in the second set and for RMB 47.7 million in the third and fourth sets. The fifth set involves the purchase by Suri-Wood from three different suppliers for a total purchase price of RMB 205 million in April to September 2008.
- [698] Suri-Wood purportedly sold the 58,920.3 mu of standing timber to three customers for RMB 325.99 million on July 22, 2009.
- [699] These purchase and sale transactions are collectively referred to as the Dacheng Transactions.

**(a) Positions of the Parties**

*i. Staff*

- [700] Staff alleges through the Dacheng Transactions, Sino-Forest overstated the value of certain standing timber assets in its financial statements for 2008 by approximately US \$30 million. Staff alleges it did so by duplicating the same assets in the records of two Sino-Forest subsidiaries, once in the BVI Model and once in the WFOE Model. Staff further alleges Sino-Forest overstated revenue derived from the sale of those assets held in the BVI Model in Q3 2009 by approximately US \$48 million, or 13% of Q3 2009 revenue.
- [701] Staff also submits Sino-Forest overstated the value of the assets recorded in the WFOE Model. Staff submits Sino-Forest actually acquired these assets for RMB 13.68 million, and not for the RMB 47.7 million price recorded by Sino-Forest.
- [702] Staff alleges Sino-Forest, Chan, Ip and Ho committed fraud as a result of their involvement in the Dacheng Transactions.

*ii. Respondents*

- [703] The Respondents submit Sino-Forest did not duplicate assets in its financial statements. Rather, the contracts in the BVI and WFOE Models were for different stands of trees in the same general location; when there were issues with the suitability of the standing timber in the WFOE Model, Sino-Forest obtained replacement plantations for those assets, which were in entirely different locations from the assets in the BVI Model.
- [704] The Respondents claim Staff raised a new allegation in their closing submissions – that the value of the assets held in the WFOE Model was overstated. We address this issue in our analysis below.

**(b) The BVI Purchase and Sale**

- [705] Between April and September 2008, Suri-Wood, a Sino-Forest BVI subsidiary, recorded the purchase of standing timber in Hezhou City, Guangxi Province in three separate contracts with three different suppliers, for an area totalling 58,920.3 mu, with a stock volume of 539,516.37 m<sup>3</sup>, for a total purchase price of RMB 205,016,220.60 (approximately US \$30 million). Survey Reports were prepared by Zhanjiang Southern, a company in which Lu Qiding, the head of the Sino-Panel Resource Department, had a 10% ownership. The Survey Reports were dated between April and September 2008.
- [706] The first contract for 9,100.5 mu in Qingshui Village, Gonghui Town, Pinggui District, is dated April 18, 2008 but was prepared sometime after July 16, 2008. This practice of backdating contracts to the date of the oral agreement is discussed elsewhere in these Reasons in our discussion of the Deceitful Documentation Process. The second contract for 33,039.3 mu in Hejie Town, Babu District is dated July 18, 2008, and the third contract for 16,780.5 mu in Sanqi and Dujiang Villages, Huangdong Township, Babu District, is dated September 11, 2008. The latter two contracts were prepared sometime after October 6, 2008. These three location descriptions will be referred to as **Dacheng Location A**.<sup>12</sup>

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<sup>12</sup> The Respondents submit not all sets of standing timber that have the same general location description are the same assets. Rather, they submit the same descriptors were used to identify different stands of trees in the same general area. For ease of reference, we use "Dacheng Location A" to refer to all standing timber with the same general location descriptions. We deal with the Respondents' submissions about whether these refer to the same or different locations in our analysis that follows.

[707] The details of the three recorded BVI contracts at Dacheng Location A are set out in the chart below:

Recorded BVI Contracts – Dacheng Location A						
Contract Date	Purchaser	Supplier	Area (mu)	Stock Volume (m <sup>3</sup> )	Purchase Price (RMB)	Location Description
April 18, 2008	Suri-Wood	Ji'nan Hongjuyan Tradings Co., Ltd.	9,100.5	84,634.65	32,161,167.00	Qingshui Village, Gonghui Town, Pinggui District, Hezhou City
July 18, 2008	Suri-Wood	Zhanjiang Bohu Wood Co., Ltd.	33,039.3	310,569.42	118,016,379.60	Hejie Town, Babu District
September 11, 2008	Suri-Wood	Taizhou City Gaogang District Jeilin Tradings Co., Ltd.	16,780.5	144,312.30	54,838,674.00	Sanqi & Dujiang Villages, Huangdong Township, Babu District
			58,920.3	539,516.37	205,016,220.60	

[708] Accounts payable arising from the three contracts were all settled through the AR/AP Set-Off Process; no cash payments were made from Sino-Forest to the three purported suppliers. All three contracts were settled on the same dates as the purchase contract dates although the terms of the contracts allowed up to one month for payment. This implies Sino-Forest paid its suppliers before there was any written corroboration Sino-Forest owned the standing timber; there were no written contracts, let alone any Forestry Bureau Confirmations, that could verify the transfer of ownership to Sino-Forest until the quarter following the date of each purchase contract, well past the date of the payments.

[709] On July 22, 2009, Suri-Wood purportedly sold the 58,920.3 mu of standing timber to three customers for RMB 325,989,327.18 (or US \$48 million) – a 59% increase in approximately one year. This sale contradicts Sino-Forest's stated strategy of holding standing timber for two to three years before selling it. A similar contradiction with its stated strategy was also seen in the 450 Transactions when the purchase and sale both took place within the same quarter, as discussed elsewhere in these Reasons.

[710] In 2010, Sino-Forest employees indicated this sale by Suri-Wood resolved outstanding issues regarding duplication of assets in the BVI and WFOE Models, as we discuss below.

[711] Following the Muddy Waters Report, the Independent Committee advisors attempted to visit two of the three customers in these BVI sales transactions who purportedly purchased the standing timber. Neither customer could be located.

[712] The receivables arising from this sale were purportedly settled between August 12 and 18, 2009 by payments from customers to two Sino-Forest suppliers, Maoxiang, a company involved in the 450 Transactions, and Kun'an, a company we found was related to Sino-Forest.

**(c) The WFOE Contracts**

[713] In addition to the BVI contracts described above, the Dacheng allegations involve two sets of three separate purchase contracts that Sino-Forest entered into using the WFOE Model. Both sets of three purchase contracts are between the WFOE subsidiary Sino-Panel (Hezhou) Co., Ltd. (**Sino-Panel (Hezhou)**) and the supplier Dacheng. We refer to the first set of WFOE contracts, not recorded in Sino-Forest's books, as the **Executed Original WFOE Contracts** and the second set, which Sino-Forest recorded in its books, as the **Recorded WFOE Contracts**.

[714] The dates, parties, area, stock volume and purchase price are identical in the two sets of WFOE contracts, but the description of their locations differ. In the Executed Original WFOE Contracts, the location descriptions are identical to those in the BVI contracts (Dacheng Location A). The Recorded WFOE Contracts contain different location descriptions, described below as Dacheng Location B.

[715] Staff submits both sets of WFOE contracts deal with the same assets as the BVI contracts, notwithstanding their differences in stock volume and purchase price, and, in the case of the Recorded WFOE Contracts, location descriptions. Staff submits the blatant duplication of assets in the BVI contracts and the Executed Original WFOE Contracts was discovered by Sino-Forest employees, which led Ip and Ho to create a scheme to hide the duplication. The result was the replacement of the Executed Original WFOE Contracts with the Recorded WFOE Contracts. The Respondents submit there is no duplication of assets, and all three sets of contracts deal with different plantations. The Respondents further submit that even if the area of the BVI contracts and the Executed Original WFOE Contracts were

the same, the error was corrected by replacing the Executed Original WFOE Contracts with the Recorded WFOE Contracts.

*i. The Original WFOE Contracts – Dacheng Location A*

[716] The Executed Original WFOE Contracts were executed, but never recorded by Sino-Forest in its books. The details of these contracts are:

Executed Original WFOE Contracts – Dacheng Location A						
Contract Date	Purchaser	Supplier	Area (mu)	Stock Volume (m <sup>3</sup> )	Purchase Price (RMB)	Location Description
October 25, 2008	Sino-Panel (Hezhou)	Dacheng	9,100.5	57,961.2	22,025,256	Qingshui Village, Gonghui Town, Hezhou City
October 25, 2008	Sino-Panel (Hezhou)	Dacheng	33,039.3	42,371.2	16,101,056	Hejie Town, Babu District
October 25, 2008	Sino-Panel (Hezhou)	Dacheng	16,780.5	25,225.2	9,585,576	Sanqi & Dujiang Villages, Huangdong Township, Babu District
			58,920.3	125,557.6	47,711,888	

[717] Three internal survey reports were prepared (for plantations at Dacheng Location A) by the Sino-Panel Resource Department, one dated July 10, 2008 and two dated September 20, 2008. They highlight several major problems including: partially harvested timber, weather damage and a lack of proof of timber rights and ownership.

[718] While both the BVI contracts and the Executed Original WFOE Contracts describe an area of 58,920.30 mu, it is noteworthy to contrast the stock volume in the BVI contracts with that in the Executed Original WFOE Contracts; the BVI contracts state the stock volume as 539,516.37 m<sup>3</sup> and the Original WFOE Contracts state it as 125,557.6 m<sup>3</sup>. The resulting purchase costs were RMB 205,016,220.60 in the BVI contracts and RMB 47,711,888.00 in the Executed Original WFOE Contracts. The Respondents submit the substantial difference in stock volume is a reflection of the fact that the properties in the Executed Original WFOE Contracts, though in the same general area as those in the BVI contracts, are different plantations. In Staff's submission, these locations were in fact the same.

*Draft Purchase Contract between Sino-Panel (Jianghua) and Yuangao*

[719] Staff submits the counterparty to the WFOE purchase transaction was originally supposed to be a different supplier, Yuangao, which we found was related to Sino-Forest, but Sino-Forest interposed Dacheng in order to inflate the price of the standing timber assets on Sino-Forest's books. The Respondents claim this allegation of asset inflation is new. We address the Respondents' claim below at paragraph [725].

[720] In an email dated August 22, 2008 regarding the planned purchase of 9,100.5 mu of China fir timber at Qingshui Village, Gonghui Town, Pinggui District (the same as one of the three plantations at Dacheng Location A), Ip was asked for instruction on whether Yuangao should sign a contract with Yuda Wood (a supplier we found was controlled by Sino-Forest) or sign directly with the WFOE subsidiary Sino-Panel (Jianghua) Co., Ltd. (**Sino-Panel (Jianghua)**). Ip was then asked if the registration should be transferred to Yuda Wood, Sino-Panel (Jianghua) or Sino-Panel (Hezhou). It appears the structure of the purchase transaction had yet to fully evolve.

[721] The draft contract between Sino-Panel (Jianghua) and Yuangao for the purchase of 9,100.5 mu of China fir timber with stock volume of 57,961.2 m<sup>3</sup>, as discussed in the abovementioned email, states a price of RMB 7,680,000. The particulars of this contract correspond exactly to those in the BVI contract for 9,100.5 mu dated April 18, 2008, except for the stock volume and price, which are 84,634.65 m<sup>3</sup> and RMB 32,161,167, respectively. The BVI contract price was more than four times higher than in this draft contract between Sino-Panel (Jianghua) and Yuangao. The particulars of the draft Sino-Panel (Jianghua) – Yuangao contract correspond exactly to the Executed Original WFOE Contracts, except for the purchase price: RMB 7,680,000 versus RMB 22,025,256, respectively. The purchase price for the 9,100.5 mu contract in the Executed Original WFOE Contracts is approximately three times higher than that in the draft contract between Sino-Panel (Jianghua) and Yuangao that was not executed.

[722] In his testimony, Ip explained the initial proposed low price of RMB 7,680,000 in the contract between Sino-Panel (Jianghua) and Yuangao for 9,100.5 mu was because Sino-Forest had contemplated jointly developing the forestland

with Yuangao. Ip admitted there is no reference in this contract to any joint development. Although Ip’s explanation seems plausible on its own, it must be considered in light of the sale of the same standing timber from Yuangao to Dacheng. We saw evidence Yuangao actually sold the timber to Dacheng first, at this same price of RMB 7,680,000, yet Dacheng did not jointly develop the forestland or harvest with Yuangao. Neither of these contracts (between Sino-Panel (Jianghua) and Yuangao and between Dacheng and Yuangao) reference joint development.

Dacheng’s Purchase from Yuangao

- [723] A Sino-Forest document created during the 2011 SAFE investigation shows payments made by Sino-Panel (Hezhou) to Dacheng in connection with the three Executed Original WFOE Contracts at Dacheng Location A. This document, created by Sino-Forest, also indicates Dacheng obtained these forest assets from Yuangao for a total purchase price of RMB 13,680,000 (which includes the purchase price of RMB 7,680,000 for the 9,100.5 mu property, as discussed above in paragraph [722]). The Respondents submit the price at which Dacheng recorded this purchase cannot be relied upon since Chinese companies routinely underreport transaction prices to avoid paying higher taxes. The purchase price of RMB 7,860,000 negotiated between Dacheng and Yuangao is identical to the initial draft purchase price contemplated between Sino-Panel (Jianghua) and Yuangao; the Panel does not accept this was a coincidence. The price at which Dacheng purchased the timber from Yuangao could not be based on any agreement to jointly harvest or develop the land since Dacheng sold the same assets as standing timber to Sino-Panel (Hezhou). Ip did not explain how Dacheng could purchase the 9,100.5 mu of timber from Yuangao for the price of RMB 7,680,000 and then turn around and sell the same timber to Sino-Forest for RMB 22,025,256. Ip’s testimony lacks credibility.
- [724] A funds flow analysis using Dacheng’s accounting records created by Sino-Forest in 2011 during the SAFE investigation<sup>13</sup> shows Dacheng recorded three contracts with Yuangao at Dacheng Location A in its books for a total area of 58,918.8 mu, stock volume of 125,557.6 m<sup>3</sup> (virtually the same as the Executed Original WFOE contract) and a purchase price of RMB 13,680,000. The date on the three contracts between Yuangao and Dacheng is November 17, 2008, which is after the Executed Original WFOE Contracts dated October 25, 2008, in which Sino-Panel (Hezhou) purportedly purchased the same assets from Dacheng for RMB 47,711,888.
- [725] Staff submits this two-step transaction (Yuangao to Dacheng and then Dacheng to Sino-Panel (Hezhou)) allowed Sino-Forest to inflate the value of the assets on its books in the WFOE Model. The Respondents submit that this allegation is new and is not addressed in the Statement of Allegations. We agree. Staff’s allegation in the Statement of Allegations that assets were overstated by RMB 205,000,000 relates only to asset inflation resulting from the BVI contracts. Staff makes no allegation the RMB 47,711,888 recorded for the WFOE purchases was inflated. The Panel makes no finding with respect to this aspect of Staff’s submission.

Draft Original WFOE Contracts between Dacheng and Sino-Panel (Hezhou)

- [726] The first drafts of the Original WFOE Contracts with Dacheng were prepared around November 24, 2008, and show a total purchase price of RMB 13,680,000. This indicates Sino-Forest originally planned to purchase the standing timber at the price Dacheng paid Yuangao. We refer to these as the **Draft Original WFOE Contracts**. In contrast, the Executed Original WFOE Contracts at Dacheng Location A show a total price of RMB 47,711,888 and were prepared after November 24, 2008, but dated October 25, 2008. The details of Draft Original WFOE Contracts are set out in the following chart:

Draft Original WFOE Contracts – Dacheng Location A						
Contract Date	Purchaser	Supplier	Area (mu)	Stock Volume (m <sup>3</sup> )	Purchase Price (RMB)	Location Description
[unexecuted]	[not stated]	Dacheng	9,100.5	57,961.2	7,680,000	Qingshui Village, Gonghui Town, Hezhou City
[unexecuted]	[not stated]	Dacheng	33,039.3	42,371.2	3,500,000	Rongshu Village, Hejie Township,
[unexecuted]	[not stated]	Dacheng	16,780.5	25,225.2	2,500,000	Sanqi & Dujiang Villages, Huangdong Township
			58,920.3	125,557.6	13,680,000	

<sup>13</sup> Further discussion of the discrepancies in this document are addressed below.

- [727] Ip testified the Sino-Forest employee who prepared the Draft Original WFOE Contracts simply made an error by using the lower purchase price. Ip further testified this employee “copied and pasted” the content of the Yuangao – Sino-Panel (Jianghua) contract and just changed Dacheng in lieu of Yuangao, leaving all other details the same. In comparing the two versions, the Panel finds the structure and wording of the Draft Original WFOE Contract for 9,100.5 mu differs significantly from the Yuangao – Sino-Panel (Jianghua) contract, notwithstanding the key details of the contracts were the same. We do not believe this was simply an error resulting from copying and pasting. We reject Ip’s explanation for the lower purchase price in the Draft Original WFOE Contracts.
- [728] Further evidence supporting Staff’s submission Sino-Forest truly bought the standing timber from Yuangao, but interposed Dacheng, is an email from a Sino-Forest employee dated January 13, 2009, in which he refers to the “forest land sold recently by Gu [Yuangao] to our company ...”.
- [729] An attachment to an email dated April 27, 2009 links Dacheng, Yuangao, Suri-Wood and Sino-Panel (Hezhou) and indicates Dacheng leased forestland from Yuangao and then subleased the forestland to Sino-Panel (Hezhou). It also states the location and tree species of the contracts between Dacheng and Yuangao were to be changed. This latter statement not only supports the link among the companies but also supports a finding that the replacing of locations was a remedy for the duplication of assets in the BVI and WFOE contracts, as discussed next.

*ii. The Recorded WFOE Contracts – Dacheng Location B*

- [730] In January 2009, the duplication of assets purchased through the BVI contracts and the Executed Original WFOE Contracts was discovered and communicated to Ip and Ho. Both Ip and Ho acknowledged in their testimony that employees in the Finance and Resource Departments believed there was a duplication of the standing timber assets and that there was some confusion with the documentation.
- [731] The Respondents submit there was no duplication of assets but rather the two sets of locations described in both the BVI contracts and Executed Original WFOE Contracts as Dacheng Location A refer to different stands of trees in the same general location. The Respondents further submit even if there had been duplication, it has no bearing because it was corrected by replacing the Executed Original WFOE Contracts, never recorded in Sino-Forest’s books, with new contracts.
- [732] Staff submits the Executed Original WFOE Contracts remained on Sino-Forest’s books until January 13, 2009 when they were replaced by the Recorded WFOE Contracts. The area and stock volume remained the same as the Executed Original WFOE Contracts; only the location description changed to Beituo Township, Zhaoping County and Daguishan Forestry, Babu District, which we refer to as **Dacheng Location B**. Both Dacheng Location A and Dacheng Location B are in Hezhou City. Sino-Forest records reflected the Recorded WFOE Contracts and were provided to E&Y for the 2008 audit.
- [733] The details of the three Recorded WFOE Contracts at Dacheng Location B are as follows:

Recorded WFOE Contracts – Dacheng Location B							
Contract Date	Purchaser	Supplier	Area (mu)	Stock Volume (m <sup>3</sup> )	Purchase Price (RMB)	Location Description	
October 25, 2008	Sino-Panel (Hezhou)	Dacheng	9,100.5	57,961.2	22,025,256	Beituo Township, Zhaoping County	
October 25, 2008	Sino-Panel (Hezhou)	Dacheng	33,039.3	67,596.4	16,101,056	Daguishan Forestry Centre, Babu District	
October 25, 2008	Sino-Panel (Hezhou)	Dacheng	16,780.5		9,585,576	Daguishan Forestry Centre, Babu District	
			58,920.3	125,557.6	47,711,888		

- [734] The Respondents submit the reason the Executed Original WFOE Contracts were replaced with the Recorded WFOE Contracts at Dacheng Location B was that Sino-Panel discovered in the first quarter of 2009 there were problems with the forestland in the Executed Original WFOE Contracts: the stock volume and timber output were lower than originally represented by Yuangao. However, all three internal survey reports (dated July 10, 2008 and September 20, 2008) highlight major problems with these assets (partially harvested timber, weather damage, lack of proof of timber rights and ownership), more than one to three months prior to the October 25, 2008 date on the Executed Original WFOE Contracts. In other words, if there were problems, they were known well in advance of the first quarter of 2009. The Panel rejects this explanation for replacing contracts and locations.
- [735] Ip testified the erroneous belief the assets were duplicated was because the Finance Department was “very irresponsible” and “did not spend the time to look deeply into the contracts”. However, Ip did not explain how his own

Resource Department made the same error regarding duplication. There was no evidence he attempted to rectify his employees' mistakes.

[736] In fact, the Resource Department took the blame for this duplication. A March 22, 2010 email to Yeung and copied to Ho and Ip (among others) includes an attachment dated January 31, 2010, in which an employee in the Resource Department states: "It is because Suri-Wood used Sino-Panel's 4 forests to prepare purchase contracts, and therefore causing the duplicate; it is our error". Despite this clear recognition of responsibility, as well as multiple emails which discuss ways to resolve the duplication, Ip provided no evidence of any attempt on his part to correct what he testified was an error. His explanation this was a result of irresponsible errors by the Finance Department is inconsistent with contemporaneous evidence and lacks credibility.

[737] Ho testified "the issue was being dealt with ... in this email by Mr. Lu and indicated that there are no additional costs to Sino-Forest. ... There are no changes to the assets on the Sino-Panel Group" (Hearing Transcript, December 7, 2015 at 24:11-15). When asked if this duplication would result in an overstatement of assets on Sino-Forest's financial statements, Ho replied, "there were no problems with the Sino-Panel assets" (Hearing Transcript, December 7, 2015 at 31:2-3). Ho was then asked if, as an officer of Sino-Forest, he would not have reference to the financial statements of Sino-Forest. He replied, "I can only, you know, be responsible to Sino-Panel Group assets, right?" (Hearing Transcript, December 7, 2015 at 31:7-9). Ho's indifference to the accuracy of the financial statements of Sino-Forest is remarkable for a senior officer of the company.

[738] In an email dated April 27, 2009 from a Sino-Panel Finance Department employee to Ho and Ip, and referencing an email from March 27, 2009, this employee reminded Ip the BVI assets were to be sold to resolve the duplication problem. When Ho was asked in cross-examination if the WFOE assets under a new location were to remain on the WFOE accounts, Ho responded: "I think the Sino-Panel WFOE assets does not have a new location. They have the same location as in the original purchase contracts". This contradicts the Respondents' submission the two locations in the WFOE and BVI Models are different.

[739] Several emails between the Resource and Finance Departments clearly indicate the forestland was duplicated. An attachment to an email to Ho dated January 5, 2009, was entitled "List of forests that must be replaced, due to duplications with the BVI forests". Included on the list are the forests at Dacheng Location A. Another attachment to an email sent to Yeung and copied to Ho and Ip on March 22, 2010, states: "The areas of Hezhou's ... forests (9,100 mu, 33,039 mu and 16,780 mu) and the areas of the Suri forests are the same ... ". The Finance and Resource Departments agreed to resolve the issue by changing the forest locations and selling the assets that were recorded by the BVI subsidiary.

[740] The new contracts between Sino-Panel (Hezhou) and Dacheng were prepared on or after January 5, 2009, and backdated to October 25, 2008. Although the tree species changed (from China fir, pine and mixed wood in Dacheng Location A to eucalyptus, pine and mixed fir in Dacheng Location B) and location descriptions changed (that is, villages, townships and districts), the areas, stock volumes and purchase prices remained exactly the same, down to the decimal place. When asked about these areas being identical to the tenth of a mu, Ip testified:

... This can be done. That is, in the mountains they can come up with exactly this amount – say, for instance, 9,100.5 mu amount – by recharting the plantation area, keeping some of the areas, not delivering to us, and delivering only the specified amount of mu; say 9,100.5. Yes, they can do that.

Q. So if I understand your explanation correctly, it is that Dacheng would carve up existing compartments to reach exactly to the tenth of a mu the area of contract set 2? Is that right?

A. It's very simple. They can put together the big and the small compartments or – sorry, they can put together the compartments and the sub-compartments and even carve up the sub-compartments in order to reach the exact amount of mu because they will not give us any more than what is specified because, after all, we requested the swapping, not them.

(Hearing Transcript, October 6, 2016 at 18:5-23)

Again, Zhanjiang Southern prepared the survey report for the purchases recorded at Dacheng Location B.

[741] Ip, in his testimony, could not credibly explain the anomaly. He further testified: "Well, I have to say that the Resources Department had done a trick here. ... [T]he Resources Department took measurement of some of the trees and said that they were more or less the same in terms of stock volume as the original one, ... [b]ut in fact they were covering up something ... ". Ip stated the Resource Department picked similar looking trees, measured them and got a close number. However, he could not then explain how a later Zhanjiang Southern survey had the exact same



measurements for the replacement WFOE locations at Dacheng Location B as the earlier internal survey report prepared for the Executed Original WFOE Contracts at Dacheng Location A. We reject Ip's explanation regarding the identical area and stock volume.

- [742] The same attachment to the March 22, 2010 email states: "Sino-Panel's forests that don't have contracts between intermediary [companies] and third party [companies], total of 440,000 mu ... because there are no contracts ... Sino-Panel cannot obtain input VAT invoices" [bracketed words are in original English translation]. The three Recorded WFOE Contracts created in January 2009 (Dacheng Location B) are included in the 440,000 mu. This absence of supporting documentation (contracts between a supplier and sub-supplier or *fapiao*) supports Staff's submission this secondary location (Dacheng Location B) did not exist. The evolution of the location descriptions from Dacheng Location A to Dacheng Location B is evidenced in a chart prepared by Sino-Forest during the 2011 SAFE investigation. A funds flow analysis indicates the source for the Dacheng plantation at Dacheng Location B was Dacheng's purchase from Yuangao at Dacheng Location A. The two purchases are compared in a chart, which notes: "The forest location per contract(s) between Sino and Dacheng is different from the forest location per contract(s) between Dacheng and Yuangao company".
- [743] Subsequent emails (originally in Chinese) in April and June 2010 relating to this duplication issue refer to *kong lin* forests, which has been translated as "non-existent forests," "empty forests" and "fake forests". Ho gave evidence that the Chinese term *kong lin* was used by Sino-Panel employees to refer to "forests with respect to which the documentation was incomplete" (*fapiao*, PRC, contract between a supplier and sub-supplier). Having reviewed this term in the context of the emails in which it appears, we find "empty", "fake" or "non-existent" forests to be the correct translation of *kong lin* in these circumstances.
- [744] A further email to Ho dated November 22, 2010 states millions of renminbi of foreign exchange conversions had not been used by Ip to buy forests in the end and "so all of the forests do not exist." The email then specifically refers to the WFOE contracts at Dacheng Location B when it states that the "47 million in forests between the Hezhou company and Dacheng company that Simon [Yeung] mentioned also do not exist".
- [745] An attachment to a May 4, 2011 email to Ho and copied to Ip states the forest locations in the Recorded WFOE Contracts (Dacheng Location B) differ from the forest locations in the contracts between Dacheng and Yuangao (Dacheng Location A), indicating there was no underlying sub-supplier contract source for the Recorded WFOE Contracts. This documentation would have been important to Sino-Forest because it was sometimes requested by SAFE in connection with foreign exchange approvals necessary for business operations in the WFOE Model. It also states the price differences were too big (RMB 13,680,000.00 versus RMB 47,711,888.00) and further, the forests were sold by Dacheng (on October 25, 2008) before Dacheng purchased them (on November 17, 2008). All three statements support Staff's submissions.
- [746] When questioned about the apparent ability of Dacheng to sell the standing timber to Sino-Panel (Hezhou) in October, before Dacheng bought the standing timber from Yuangao in November, Ip first said it did not make sense to him. He then explained the discrepancy in the date was because Yuangao wanted to show it held the plantation for more than one year in order to avoid paying VAT; Ip stated suppliers would often "move the date of the contract ...". No evidence regarding when Yuangao purchased the plantation was provided to support the latter explanation; as such, the Panel places no weight on it.
- [747] Further information provided on various charts and in tables exchanged between the Resource and Finance Departments to rectify the duplication supports the submission contracts recorded as being for Dacheng Location B reflect the actual assets Sino-Panel purchased at Dacheng Location A. Taken together, there are a significant number of emails exchanged between Sino-Forest employees in the Resource and Finance Departments over a lengthy period of time (2009 to 2011) discussing the duplicate forest contracts in the BVI and WFOE Models. Significant time and energy was expended on what, in Ip's words, was simply an error – the forests, although in the same general location, are different. Again, no evidence was provided to show Ip tried to correct what he called an error.
- [748] Unexecuted versions of Confirmations purportedly issued by the Forestry Bureau do nothing to support the Respondents' explanation. The Forestry Bureau Confirmations refer to eucalyptus, pinewood and mixed wood and number of mu. There is no reference to stock volume. There is no reference to any specific location, other than Hezhou City. They are dated October 25, 2008, but could not have been created until after January 5, 2009. They are useless in confirming ownership of any assets. Ip confirmed Sino-Forest never obtained PRCs for the assets at Dacheng Location B, although they were purchased by a WFOE subsidiary.

**(d) Pricing and Payments in the Dacheng Transactions**

[749] We have reviewed evidence of five sets of executed and unexecuted purchase contracts associated with the Dacheng Transactions. The first is Dacheng's purchase from Yuangao for RMB 13.68 million. Dacheng obtained *fapiao* from Yuangao for RMB 13.68 million. Second, we reviewed early drafts of the Executed Original WFOE Contracts (the Draft Original WFOE Contracts) which propose a purchase price of RMB 13.68 million. Third, we reviewed the Executed Original WFOE Contracts between Sino-Panel (Hezhou) and Yuangao with a total purchase price of RMB 47.7 million. The fourth set of contracts we reviewed was the Recorded WFOE Contracts, which replaced the Executed Original WFOE Contracts for the same purchase price of RMB 47.7 million. Finally, we reviewed the BVI contract between Suri-Wood and three suppliers for a purchase price of RMB 205 million.

[750] We find all five sets of contracts refer to the same plantation at Dacheng Location A.

[751] The evidence indicates Sino-Panel (Hezhou) paid RMB 47.7 million to Dacheng in connection with the Dacheng Transactions. From that, Dacheng paid Yuangao, the original supplier, RMB 13.68 million and received *fapiao* for this amount. Evidence indicates the remainder of the payment for the Recorded WFOE Contracts (approximately RMB 34 million) came back to Sino-Forest through the settlement of accounts receivable for other transactions. On November 22, 2010, Ho was sent an email from a Sino-Forest employee regarding SAFE's audit of Sino-Panel (Hezhou)'s transactions, which states:

...

The 47 million in forests between the Hezhou company and Dacheng company that Simon mentioned also do not exist; 13.68 million of this money was given to Guyuangao [Gu Yuangao, the principal of Yuangao], and the remaining 34 million was recovered as AR. ...

[752] As noted previously in these Reasons, there was never any independent confirmation of payments settled through offsets and their authenticity is therefore questionable. Better evidence of true value of transactions is provided by direct payments. The entire payment for the BVI contracts was settled through offsets. The only evidence of direct payment in the Dacheng Transactions is the RMB 47.7 million paid by the WFOE Sino-Panel (Hezhou) to Dacheng, RMB 34 million of which was returned to Sino-Forest through accounts receivable. The net payment by Sino-Forest for the Dacheng Transactions was therefore RMB 13.68 million.

[753] The Respondents submit the full RMB 47,711,888 was paid, relying on findings from SAFE's investigation that suggest there was no fraud with respect to certain foreign exchange funds for which Sino-Panel (Hezhou) did not have proper documentation. While we consider the context of documents created for the SAFE investigation, we do not rely on SAFE's findings in respect of the legitimacy of any conversion of foreign funds as a basis for our findings.

**(e) Conclusion**

[754] We find the two sets of recorded contracts (one in the BVI Model and one in the WFOE Model) deal with the same assets at Dacheng Location A and are the same assets Dacheng purchased from Yuangao. The Recorded WFOE Contracts purported to be at Dacheng Location B list different species of trees in a different location, but both the area and the stock volume remain exactly the same as those in Dacheng Location A to the tenth of a decimal place. We reject the submission these could be different plantations and tree species with exactly identical areas and yield.

[755] The only evidence before us regarding the transactions in the BVI Model, are three contracts for standing timber, all of which were settled through offset payments. The standing timber was purportedly sold to three customers; however, Independent Committee advisors could not locate two of those customers who purportedly purchased the standing timber. Settlement of the BVI accounts receivable included offset payments to Maoxiang, a player in the 450 Transactions we find were fraudulent elsewhere in these Reasons, and Kun'an, a company the Panel has found was related to Sino-Forest.

[756] Unlike the BVI Model, there is more convincing evidence of consideration in the WFOE Model. We find Sino-Forest purchased these assets through its subsidiary Sino-Panel (Hezhou) at a recorded purchase price of approximately RMB 47 million. The net amount paid by Sino-Forest for the Dacheng Transactions was RMB 13.68 million paid by the WFOE subsidiary Sino-Panel (Hezhou).

[757] We find the BVI purchase was fictitious and inflated the assets on Sino-Forest's financial statements for 2008 by RMB 205,016,220, or approximately US \$30 million. We further find the purported sale of these duplicate assets through the BVI Model for RMB 325,989,327 was likewise fictitious and resulted in the overstatement of Sino-Forest's revenue in 2009 by approximately US \$48 million.

**(f) The Roles of Chan, Ip and Ho in the Dacheng Transactions**

- [758] We find from the numerous emails we reviewed that Ip and Ho were directly and deeply involved in the Dacheng fraud from the beginning – sometime in 2008. They were clearly aware of the duplicate assets by the first quarter of 2009. Both were directly sent or copied on emails with precise details. There is no evidence either Ip or Ho tried to correct any errors or misconceptions. Rather, they participated in orchestrating a scheme which deceived investors about the value of assets held by Sino-Forest and the revenue it generated from standing timber sales.
- [759] There is insufficient evidence to find Chan was aware of the Dacheng Transactions at the time they occurred.

**2. 450 Transactions**

**(a) Introduction**

- [760] The second example of alleged fraudulent conduct perpetrated within the Standing Timber Fraud Allegations is the 450 Transactions. These allegations involve the purported purchase and sale of 450,000 m<sup>3</sup> of standing timber by three Sino-Forest WFOE subsidiaries in Q4 2009. The Sino-Forest subsidiaries involved were the Sino-Panel companies:
- Sino-Panel (Luzhai) Co., Ltd. (**Sino-Panel (Luzhai)**),
  - Sino-Panel (Jianghua), and
  - Sino-Panel (Guangxi) Development Co., Ltd. (**Sino-Panel (Guangxi)**)
- [761] These three subsidiaries purported to enter into purchase contracts with the Sino-Forest supplier Yuangao in early October 2009 for a total of RMB 182,522,797.60 (approximately US \$26 million).
- [762] This standing timber was purportedly sold through sales contracts dated later that month to three companies, Gaoyao City Xinqi Forestry Development Co, Ltd. (**Xinqi**), Guangxi Pingle Haosen Forestry Development Co., Ltd. (**Haosen**) and Meishan (discussed elsewhere in these Reasons in our analysis of the allegations of undisclosed control). These sales totalled RMB 232,716,590.82 (approximately US \$33 million) for an apparent profit of approximately RMB 50.2 million (approximately US \$7.1 million) for Sino-Forest.
- [763] These purchase and sale transactions are collectively referred to as the **450 Transactions**.

**(b) Positions of the Parties**

*i. Staff*

- [764] Staff alleges sales contracts between the Sino-Panel subsidiaries and customers Xinqi, Meishan and Haosen are fraudulent and have no economic substance. As a result, Staff alleges Sino-Forest fraudulently overstated its revenue by approximately US \$30.1 million,<sup>14</sup> or 6% of total revenue, in the fourth quarter of 2009.
- [765] The alleged fraud is premised on the submission the circular flow of funds in the 450 Transactions brings the substance of the transactions into question. Although the Sino-Forest subsidiaries involved in the 450 Transactions were WFOEs, and were therefore capable of settling accounts receivable directly through Sino-Forest accounts, the accounts receivable for the sales in the 450 Transactions were settled through an on-book off-setting process.
- [766] Staff alleges Sino-Forest, Chan, Ip, Ho and Yeung committed fraud through these transactions. Staff does not allege any involvement by Hung in the 450 Transactions.

*ii. Respondents*

- [767] The Respondents submit the 450 Transactions were valid business transactions whose structure was driven by *bona fide* business purposes and whose accounts receivable were similarly collected using a structure driven by *bona fide* business purposes. The Respondents submit despite allegations documents were fraudulently created to deceive E&Y or Horsley, no evidence was introduced to establish either was deceived.

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<sup>14</sup> Total sales revenue from the 450 Transactions was US \$33 million. However, the VAT-exclusive revenue recorded by Sino-Forest in its disclosure amounted to US \$30.1 million for the 450 Transactions.

[768] In response to Staff's allegations about the "circular flow of funds," the Respondents submit this structure captures legitimate financing transactions and ignores uncontradicted evidence about business structures commonly used in China to resolve the collection of accounts receivable.

**(c) Structuring the 450 Transactions**

[769] According to Yeung, the genesis of the 450 Transactions, as communicated to him by Ip, was Chan's desire to have a significant transaction in Q4 2009. The Panel makes no finding on whether any desire of Chan's was the catalyst for the 450 Transactions. However, as described in our analysis below, Chan was closely involved in determining the price at which the standing timber was sold, determining the target gross profit and the settlement of the receivables in the 450 Transactions.

[770] On the purchase side, the three Sino-Panel WFOE subsidiaries, Sino-Panel (Guangxi), Sino-Panel (Jianghua) and Sino-Panel (Luzhai), purportedly purchased approximately 702,000 cubic metres of standing timber in Hunan Province from Yuangao on October 4, 6 and 8, 2009 for RMB 182,522,797, inclusive of VAT. The same standing timber was supposedly sold on October 15, 2009 as approximately 456,000 cubic metres of standing logs for RMB 232,716,590 inclusive of VAT. Exclusive of VAT, Sino-Panel purchased the timber for RMB 158.8 million and sold it for RMB 205.9 million. This amounts to an increase in value of RMB 50.2 million, or 27.5%, in one week. Staff refers to the difference of RMB 50.2 million as the **Cash Flow Gap**, which is, in effect, the profit from the purported sale.

[771] Although recorded as revenue for Q4 2009, the purchase and sales contracts were not prepared nor signed until Q1 2010. As a result, Staff allege revenue was improperly recorded in Q4 2009.

[772] Internal Sino-Forest discussions about structuring the 450 Transactions took place in December 2009. The details of the transactions, including the parties involved and prices, evolved throughout December 2009 and January 2010, when the contracts and other documentation were prepared.

[773] Accounts receivable and accounts payable from the 450 Transactions were still outstanding well into 2010 and early 2011. The collection of accounts receivable and the settlement of accounts payable is the focus of the flow of funds. The Panel must decide if this circular flow of funds brought the substance of the transactions into questions, or whether it was for *bona fide* business purposes.

**(d) Documentation for the 450 Transactions**

*i. The Purchase Contracts and Supporting Documents*

[774] A series of emails sent by Yeung, dated December 19, 21 and 31, 2009, refer to a meeting which took place on December 18, 2009 in Sino-Forest's office in Zhaoqing, Mainland China with Ip, Yeung, other Sino-Forest employees and Huang Ran. This meeting began the process whereby Sino-Forest reverse-engineered the details of the transaction. Huang Ran's attendance at an internal Sino-Forest meeting supports the Panel's finding Huang Ran acted as a nominee for Sino-Forest. In a Sino-Forest email to Huang Ran, copied to Yeung, dated March 10, 2011, Maoxiang, Juncheng and Guangxi Chihui Forestry Co., Ltd. are described as "all the companies under your management which are involved in forestland business in Hunan".

[775] According to Yeung's email of December 21, 2009, the supplier to Sino-Panel in the 450 Transactions was originally to be Maoxiang. However, Sino-Forest subsequently discovered Maoxiang could not issue Sino-Forest VAT *fapiao* because it was not a registered VAT tax payer. *Fapiao* were very important to companies operating in China as they enabled companies to get SAFE approval for the conversion of foreign exchange and to deduct cost of goods sold in calculating tax on profit.

[776] After December 2009, Yuangao was substituted for Maoxiang as supplier in the purchase transaction. Emails between Sino-Forest employees in January 2010, on which Ip and Ho were copied, state, as communicated on January 4, 2010, "the initial documents such as the forest purchase contracts and survey reports ... need to be amended ... the other party to the forest purchase contract should be changed from the Maoxiang company to the Yuangao company". The Yuangao contract was "to be used for Sino's external disclosure" but the "actual forest purchase contract is still to be signed between Yuangao company and Maoxiang company" (January 5, 2010 email from A. Shi to Yeung, copied to Ho, Ip and others using non-Sino-Forest email addresses). We have found elsewhere in these Reasons that Yuangao was related to Sino-Forest.

[777] In the end, Sino-Forest recorded Yuangao as the supplier of this standing timber at a total cost of RMB 182.5 million. Maoxiang and Yuangao are connected; the principals of each are related through marriage. The Respondents submitted that because of this close relationship, the replacement of Maoxiang with Yuangao would not have caused any issues within Sino-Panel. Huang Ran was also a 39% shareholder of Yuangao.

- [778] Evidence shows changes to the purchasing parties on the Sino-Panel side also occurred after the purported purchase and sales dates of October 2009. While the three subsidiaries which ultimately purchased the standing timber were Sino-Panel (Guangxi), Sino-Panel (Jianghua) and Sino-Panel (Luzhai), there was evidence another company, Sino-Panel (Sanjiang) Co., Ltd. and not Sino-Panel (Guangxi), was one of the original proposed purchasers. This was changed pursuant to a discussion among Ip, Lu Qiding (head of the Sino-Panel Resources Department) and Gu Yuangao (principal of Yuangao) on December 21, 2009. It was noted because Sino-Panel (Sanjiang) “is not an ordinary taxpayer, it is to be replaced by Guangxi Development”.
- [779] Thus, the parties to the 450 Transactions were still in flux after mid-December, even though the oral agreements or handshake deals were purportedly done on October 4, 6 and 8, 2009.
- [780] Similarly, documentation which supported the purchase contracts was also created after the recorded dates of purchase. Although the survey reports prepared by Zhanjiang Southern (the external survey company 10% owned by Lu Qiding) were dated September 21, 23 and 24, 2009, details of stock volume and yield per species were still being finalized in January 2010.
- [781] The email chain regarding document preparation for the 450 Transactions begins on December 21, 2009 with instructions from Yeung to various Sino-Forest employees. Forest purchase documents, including a profit and risk assessment, a forest audit report, a resource survey report, a contract approval application form, a forest purchase contract and a payment application form were given a completion deadline of December 21 to 24, 2009. Similar type sales documents, including a forest audit report, wood sales list, contract terms review, contract-approval application form and wood sales contract, were due to be completed by December 28, 2009. The email of December 21, 2009 indicated forest purchase payment was to be made December 31, 2009 and the wood sales proceeds collection was to be done on the same date. The Respondents have made submissions regarding why purchase and sales contracts might only be created at the end of the quarter based on an oral agreement that happened much earlier. However, no explanation has been submitted by them regarding how a forest audit report or a resource survey report could be completed after purchase and sales handshake deals were done in October. Instead, subsequent emails contemplated changing the survey results in January 2010, well after the timber had supposedly been paid for by Sino-Forest, sold by Sino-Forest and logged by Sino-Forest customers.
- [782] The email chain supports Staff’s submission the transaction had been reverse-engineered.
- [783] Several statements within this email chain indicate Sino-Forest employees were trying to avoid raising questions from E&Y and others, such as SAFE or tax authorities. For example:
- “This can ... avoid many possible and unnecessary troubles from EY’s side”;
  - “From EY’s point of view, significant differences should not exist for the data concerned. If the difference is significant, it is necessary to think in advance how a reasonable explanation can be provided to EY”; and
  - “The suggestion is that the m3 figure is not to be included in the invoice, only the quantity of mu is to be included (as the actual m3 figure is too different from the contract figure, it is necessary to operate in this way to avoid risk)”.
- [784] The Forestry Bureau Confirmations which provide evidence of Sino-Forest’s acquisition of rights to the standing timber in the 450 Transactions also appear to have been created long after the recorded purchase dates. Two of the three Forestry Bureau Confirmations (the third was missing) were backdated to mid-October, between October 14 and 22, 2009. Because written contracts were supposedly required by the Forestry Bureaus in order to issue Confirmations, these confirmations could not have been issued until January 2010 at the earliest. We note Sino-Panel (Luzhai) therefore sold timber to Haosen that was supposedly harvested by December 28, 2009 without having received confirmation of ownership. As noted earlier in this decision, Forestry Bureau Confirmations do not confirm ownership of plantation rights, but state that “the legitimate qualification to transfer the ownership” of those rights, in accordance with the terms of the contract submitted by the supplier on Sino-Forest’s behalf to the Forestry Bureau that chopped the Confirmation.
- [785] The Forestry Bureau Confirmations in the 450 Transactions refer only to county and province level location descriptions. There is no information sufficiently specific in the Forestry Bureau Confirmations that would permit anyone to connect the contract area to a specific location.
- [786] The Forestry Bureau Confirmations stated the Forestry Bureau reviewed signed contracts between Sino-Forest and Yuangao; however, there were no signed contracts until at least January 2010. Therefore the earliest the Forestry Bureau could actually have reviewed a signed contract was in January 2010. In October 2009, the counterpart to the purchase transactions was Maoxiang, not Yuangao, yet the Confirmations dated October refer to Yuangao as a

supplier. There is no mention in the Forestry Bureau Confirmation of any oral agreement or handshake. The Panel heard no evidence regarding when the contracts were actually signed or chopped – only that they were created at the end of December.

*ii. The Sales Contracts*

- [787] As with the purchase contracts, Staff submits the terms of sale in the 450 Transactions were reverse-engineered months after the recorded date of sale. The sales contracts for the 450 Transactions were all dated October 15, 2009, within less than two weeks of the dates on which Sino-Forest claimed to have purchased the same timber.
- [788] Sino-Panel (Guangxi) sold its timber to Meishan, Sino-Panel (Jianghua) sold its timber to Xinqi and Sino-Panel (Luzhai) sold its timber to Haosen. In aggregate, Sino-Forest recorded a profit of approximately RMB 50.2 million on these sales. We found Meishan was related to Sino-Forest in our analysis of the undisclosed control allegations elsewhere in these Reasons.
- [789] The sales contracts refer to an estimated number of cubic meters of timber sold. The final sales price was to be determined later, based on the yield after harvest, as set out in the Harvesting/Sales Confirmation to be provided to Sino-Forest by the three customers. As discussed further below, there was disagreement about whether the sales contracts actually contemplated that harvesting would take place, or whether, as Ip testified, Sino-Forest sold the plantations as standing timber, but priced the sales transactions as cut logs, a process referred to during the hearing as the sale of “standing logs”.
- [790] The sales contracts and supporting documentation were prepared in late 2009 and early 2010, along the same timelines as the purchase documentation. Changes to the identities of both the seller and purchaser and the price in the sales transactions were made in tandem, as described below.

*iii. Changes to the Terms of the 450 Transactions in Late 2009 and Early 2010*

- [791] The terms of the 450 Transactions changed after the recorded purchase and sales dates in October 2009. Based on a schedule set out in an email from Yeung on December 21, 2009, purchase contracts were to be prepared by December 24, and sales contracts by December 28, 2009, all well after the dates on which the transactions were recorded by Sino-Forest. Harvesting/Sales Confirmations, while not specifically referred to in Yeung’s schedule, were dated December 28, 2009.
- [792] According to Yeung, the original plan was to have the timber yield be 65% (456,300 cubic metres) and the selling price RMB 500 per cubic metre, for a gross margin of 20%. On December 22, 2009 the original sales price was increased to RMB 510 per cubic metre so that a profit margin of 22% could be achieved based on an invoice issued by Yuangao and accumulated losses on the books of Sino-Panel (Guangxi), Sino-Panel (Luzhai) and Sino-Panel (Jianghua). This increase and the reason for it are documented in internal Sino-Forest emails and are consistent with Ip’s testimony. The decision to increase the profit margin was made by Ip, Ho and Chan at their regular Monday Sino-Forest management meeting.
- [793] Also on December 22, 2009, one of the Sino-Panel purchasing parties was changed. Sino-Forest originally contemplated that Sino-Panel (Sanjiang) Co. Ltd. would be party to a purchase transaction, but this company was replaced with Sino-Panel (Guangxi), purportedly for tax reasons.
- [794] The supplier was changed from Maoxiang to Yuangao as of January 4, 2010, months after the oral purchase agreement purportedly occurred.
- [795] Thus from the time of the purported handshake deals in October, three significant terms had changed: the supplier, from Maoxiang to Yuangao; one of the buyers, from Sino-Panel (Sanjiang) Co. Ltd. to Sino-Panel (Luzhai); and the selling price, from RMB 500 to RMB 510 per cubic metre.
- [796] As discussed elsewhere in these Reasons, significant changes to the original agreed terms, such as these, would invalidate the original oral agreement, assuming one accepts the Respondents’ submission that an oral agreement is a valid contract for revenue recognition.
- [797] On December 23, 2009 draft sales contracts were circulated to Yeung and other Sino-Forest employees. Terms included that harvesting start by October 20 and finish by December 28, 2009, with settlement of the full price of RMB 232.7 million by December 31, 2009. Ultimately, receivables were fully settled by February 2011, well over a year later.
- [798] Sino-Panel Finance Department employees raised concerns in an email sent December 25, 2009 to Ip, Ho and Yeung, including that the price increase might raise questions with E&Y. Further exchanges of emails on December 26, 2009

stated that while the average price that was "set according to the profit target" could not be changed, "we can regulate the price and proportion of individual tree species and individual timber specifications", such that they "can be made not significantly different from previous similar transactions" and thereby "avoid many ... troubles from EY's side". In his testimony, Ho was unable to explain how the proportion of tree species could be changed.

[799] In addition to changes in the contract terms, details for stock volume and yield per species in the survey reports were still being finalized in January 2010. In fact, a January 5, 2010 email to Ip, Ho, Yeung and others states: "To be consistent with the sale price of 510 Yuan/m<sup>3</sup>, the initial documents such as the contract and the survey report containing tree species, area, volume, yield and tree diameters will be adjusted accordingly ... ". When asked how the proportion of tree species or tree diameters could change, Ho could not give a credible response:

Q. But if you're selling the same forest, how do you change the percentage of pine in the forest? Can you explain that to me?

A. Well, my understanding was when they were negotiating the contract, they were – these were the estimates of the log volumes that they're going to get out at the end of the day. So I would imagine that a slight change of the volume or the species will not affect the total contract yield of the original negotiation.

So I guess that's where – you know, that's what Mr. Shi was saying here.

Q. That would also go for changing the size of the tree, right, when we talk about individual timber specifications?

A. Well, they do have, you know, suggestions here and there because they might have ideas that they want to, you know, ensure that there is some kind of a reasonable explanation to the average price that's being calculated. But like I said before, the suggestions may or may not be used, depending on the situation, so might have just put it here for discussion purposes.

Q. When you say it could be slightly changed, what do you mean by "slight change" in proportion of individual tree species?

A. Well, like I said before, there was an average price of 500 to 513 on each of the three confirmations, if I remember correctly. So moving from 500 to 510, there was a slight change of the percentage of increase of the average price as compared to the total.

...

Q. But what did you mean by a "slight change" in the proportion of tree species? Like, let's say 30 percent of a forest was pine. What would be a slight change in that proportion?

A. Well, I would not be able to answer that question because it depends on the estimate that the customer and Sino-Panel operating team is looking at.

I think what I'm just trying to answer you is in general, you know, what he's trying to suggest here as in the species. It depends on, you know, further information from Operations to come up with whether they actually looked at – you know, whether a certain percentage of pine versus fir. So those are information that needs to be confirmed or discussed with Operations.

Q. But you'd agree with me Operations can't move trees physically into one forest and out of another forest; correct?

A. Well, my understanding was these were estimates from both parties, the Sino-Panel group and the customer. So I guess, you know, they would have to discuss with the customer and say that, you know, these are some of the proposed changes. Whether it's an actual reflection of the changes in the fir to pine, I don't know the details of it.

Q. I guess my question is, again, your Operations group in Sino-Panel didn't have the capability to move trees between forests, correct, rip them out of one forest and plunk them down planted in another forest; correct?

A. Correct.

(Hearing Transcript, December 2, 2015 at 34:22-37:16)

- [800] In the Survey Report for the 63,508.7 mu plantation purchased by Sino-Panel (Guangxi), the total yield is recorded as 326,185.85 m<sup>3</sup>. Although the yield figure in the Survey Report is similar to draft sales contracts circulated on December 23, 2009, it is not identical. This figure is, however, identical to the yield on the final Harvesting/Sales Confirmation, which leads us to conclude that this Survey Report was created after the original recorded purchase date in October 2009. If the Survey Report had been done prior to October 2009, we would expect it to have yield figures similar to earlier draft contracts. Because the yield figure is identical to later documents, we find that the Survey Report was created some time after December 23, 2009, when the sales contract and the Harvesting/Sales Confirmation were drafted.
- [801] Further emails to Yeung, Ho and Ip in late December 2009 and early January 2010 suggested including the area in mu but not the volume on the invoice to “avoid risk” because the “actual m<sup>3</sup> figure is too much different from the contract figure”. Another email of January 5, 2010 suggested the contract between Yuangao and the Sino-Panel subsidiary was “to be used for Sino’s external disclosure and Yuangao’s issue of invoices” and “the actual forest purchase contract is still to be signed between Yuangao company and Maoxiang company”.
- [802] In an email dated June 23, 2010, a Sino-Forest Finance employee emailed Ip, Ho and Yeung regarding invoice issues. Invoices, or *fapiao*, were important in WFOE transactions as they were required by SAFE for foreign exchange conversions, as well as determining tax liabilities. Yeung responded the 450 Transactions were “purely an accounting manoeuvre [*sic*]” and that Yuangao did not “seem to have gained actual profit from it”. Ho suggested during cross-examination that the translation should be “transfer,” and not “manoeuvre”. Replacing “manoeuvre” with “transfer” would not change our interpretation of this email.
- [803] In early November 2010, a Sino-Panel Finance Manager made inquiries of the Sino-Panel (Luzhai) General Manager regarding an invoice (*fapiao*) for the 450 Transactions. From the General Manager’s response, it is apparent he was neither aware of, nor involved in, this transaction. The Finance Manager reminded the General Manager of his responsibilities for managing Sino-Panel (Luzhai)’s daily operations and elevated her concerns by copying Ip, Ho and Yeung. Ip instructed Ho (in English) to “stop her yelling” (referring to the Finance Manager who was making the inquiries), and told him “the integrated sales is being arrange [*sic*] by the HQ”. The Respondents submit each Sino-Panel WFOE subsidiary recorded its own revenues and expenses and details of transactions were left to accounting employees in Mainland China. However, in contrast, the 450 Transactions were arranged “by the HQ”, out of Hong Kong even though they were WFOE transactions. All BVI documentation was controlled out of Hong Kong as well.
- [804] The Respondents submit it was not surprising documentation for the 450 Transactions, based on a handshake deal in October 2009, had not been completed by December 2009, given this was the practice in the BVI Model. The Panel, however, was not provided any evidence to show this practice was standard in the WFOE Model, so the submission does not help us.

*iv. The Supplemental Purchase Agreements*

- [805] By March 3, 2010, well past the due dates for the first set of payments on the purchase and sales contracts dated in Q4 2009, no payments or receipts had been made or received, which raised issues with E&Y in an audit of 2009 financial statements. Original terms required payment in full for the purchase contracts by January 8, 2010 and full collection of receivables from the sales contracts by March 28, 2010. While aged receivables might give rise to bad debts, outstanding payables would (and did) raise questions with the auditors regarding Sino-Forest’s ability to pay.
- [806] Hence, draft Supplemental Agreements were created on March 3, 2010, dated October 19, 2009 and emailed to Ip and Ho. The reason given for these Supplemental Agreements was “EY and Eric [Chan, a Sino-Panel Accounting Manager] have been questioning closely about this issue, so it is necessary to sign several documents like supplemental agreements or letter of notice to extend the corresponding time for receiving funds or making payments”. The draft Supplemental Agreements changed the payment terms on the purchase contracts for the initial 30% from payable within 15 days (late October 2009) to seven months (May 2010), for the remaining 70% from payable within three months (mid-January 2010) to nine months (July 2010). This would result in postponement of any payables coming due to a later date after completion of the 2009 audit on March 15, 2010. Staff submits the Supplemental Agreements were prepared to deceive E&Y.
- [807] The terms of initial and final payment changed from the draft to the final versions of the Supplemental Agreements from seven and nine months, to six and eight months, respectively. The Respondents submit that the change in terms supports an arm’s length negotiation between Sino-Panel and Yuangao. The Panel finds such changes were minimal and do not support the Respondents’ submission. Rather, the whole of the evidence supports our finding the Supplemental Agreements were created by Sino-Forest management in response to questions from E&Y and were designed to deceive E&Y about the true nature of the 450 Transactions.



- [808] While Yuangao was not inserted into the 450 Transactions until after mid-December 2009, the backdated Supplemental Agreements, prepared in March 2010, named Yuangao as the supplier in October. Yeung, in cross-examination, agreed that any handshake deal on October 19, 2009 would have been between Sino-Panel and Maoxiang, not Yuangao.
- [809] Ho, in cross examination, could not explain why Supplemental Agreements were required, nor why they were dated October 19, 2009 when the issue of payment and receipt did not arise until March 3, 2010.
- [810] The facts surrounding the creation and backdating of the Supplemental Agreements lead us to find the Supplemental Agreements were not entered into as of October 19, 2009, but were created by Sino-Forest almost six months later in an effort to avoid raising further concerns with its auditors.

v. *The Harvesting/Sales Confirmations*

- [811] According to the sales contracts, all dated October 15, 2009, the customers were responsible for harvesting by December 20, 2009 and a Harvesting/Sales Confirmation had to be issued within 10 days following completion of harvesting. The Harvesting/Sales Confirmations were all dated December 28, 2009. Payment in full was required within three months of the harvesting confirmation: March 28, 2010. The Panel notes the trees were therefore harvested without any signed purchase contract, any signed sales contract, or any Forestry Bureau Confirmation, and before details of tree species, area, volume, yield and tree diameters were finalized in the survey reports.
- [812] The Harvesting/Sales Confirmations stated that 456,309.9 m<sup>3</sup> of timber were delivered to the customers in the 450 Transactions. This was the confirmed yield following purported harvesting and deviated only slightly from the expected quantity outlined in the sales contracts. The final yield volume was exactly 65% of the stocking volume stated in the survey reports (versus the 64.98% estimated in the sales contracts).
- [813] When first asked if the Harvesting/Sales Confirmation was detailed evidence of what was actually cut down and delivered to the customer, Ip responded, "Yes. True". The following week, Ip was asked specifically about the Harvesting/Sales Confirmations for the 450 Transactions. He testified again that the Harvesting/Sales Confirmation for the 39,409.7 mu sold by Sino-Panel (Luzhai) to Haosen was an indication of actual harvesting, as agreed to by both parties to the sales contract. However, he testified it did not sound right to him that the 39,409.7 mu could have been cut down in the 75 days between the dates of the sales contract and the Harvesting/Sales Confirmation. He explained, although it was priced as cut logs, what was actually sold was standing timber. Notwithstanding the terms of the sales contract and the Harvesting/Sales Confirmation, Mr. Ip testified the plantation would not have been logged, but would have been handed over to the customer in the form of standing logs. Ip completely changed his testimony. As noted elsewhere in these Reasons, standing logs is a term used to refer to standing timber priced as cut logs; in other words, uncut trees.
- [814] The Sino-Panel (Luzhai) sales contract contemplates a yield of 128,590 m<sup>3</sup> and its Harvesting/Sales Confirmation has a stated yield of 128,652.33 m<sup>3</sup>, but in fact, both were estimates and neither was the yield of timber actually harvested because no timber had actually been cut down. Ip was asked if that gave the reader the impression that harvesting had occurred. Ip replied: "I see that the two parties had agreed on this quantity but it doesn't mean that trees had been harvested" (Hearing Transcript, June 17, 2015 at 106:4-6). Ip's reply directly contradicts the initial testimony he gave a week earlier.
- [815] When Yeung was asked if the Harvesting/Sales Confirmation was misleading, he agreed it might be for those who were not in the forestry industry. He stated: "... this may be a log transaction, but the delivery is in the form of standing timber" (Hearing Transcript, November 9, 2015 at 64:16-17). He went on to give an analogy using pigs: "The transaction is one of pork, indeed, but the delivery from us was in a live running pig" (Hearing Transcript, November 9, 2015 at 64:20-21).
- [816] The sales contracts in evidence clearly state the customers were required to commence harvesting by October 20, 2009 and to complete harvesting by December 20, 2009. The Harvesting/Sales Confirmation attached to the contract between Sino-Panel (Luzhai) and Haosen clearly gave the impression of having been prepared *after* harvesting and to be proof of the *actual* quantity of cut logs delivered to customers.
- [817] We find the sales contract and the Harvesting/Sales Confirmation were meant to deceive. The wording was explicit in terms of timber being cut down. The use of 64.98% in the sales contract but 65% in the harvesting confirmation was meant to deceive the reader into thinking the former was an estimate whereas the latter was the actual yield derived from actual harvesting. We find the sales documentation in the 450 Transactions deceitful and misleading.

(e) **The Accounts Receivable and Accounts Payable Offsetting Arrangement**

- [818] By March 10, 2010, no payments had been made or received by the Sino-Panel subsidiaries. The Supplemental Agreements were created to provide Sino-Forest some additional time because “EY ... have been questioning closely about this issue” (March 3, 2010 email from Shi Aisheng to Ip and Ho). Payment term extensions would provide Sino-Forest more time to bring more foreign currency into China and prepare the “forest purchase contracts to create new AP [accounts payable]” (March 15, 2010 email from Shi Aisheng to A. Lin, Ho and W. Chen).
- [819] Emails of March 12, 2010 to Ho refer to a meeting held the previous day to review various options regarding a RMB 150 million gap, being the difference between accounts receivable of RMB 330 million and accounts payable of RMB 180 million. The accounts receivable of RMB 330 million includes the RMB 232 million for the 450 Transactions, as well as others. The accounts payable of RMB 180 million in the email is a reference to the RMB 182 million accounts payable in the 450 Transactions. The Cash Flow Gap specific to the 450 Transactions was the RMB 50.2 million of purported profit.
- [820] One of the emails discussed various ways to close the Cash Flow Gap (*i.e.* demonstrate collection of the full amount of accounts receivable). Suggestions included increasing the registered capital and making additional timber purchases. Also suggested was the creation of new accounts payable by purchasing timber through Yuda Wood (a company we find was controlled by Sino-Forest through its nominee, Huang Ran), and then having Yuda Wood pay the funds to the 450 Transactions customers so that these customers could repay Sino-Panel.
- [821] The process of having customers and suppliers exchange funds is generally referred to in the BVI Model as the AR/AP Set-Off Process, as discussed elsewhere in these Reasons. In the BVI Model, customers are instructed to pay Sino-Forest suppliers because Sino-Forest BVI’s cannot have bank accounts in Mainland China, thereby creating off-book transactions. Sino-Forest subsidiaries could not transact in cash – a fundamental element of the BVI Model which distinguishes it from the WFOE Model.
- [822] On-book offsets were more complicated in the WFOE Model because actual cash had to change hands and bank receipts were expected as proof of payment for audit purposes. Dr. Peerenboom testified accounts receivable collections were difficult because of the liquidity issues in the controlled economy of Mainland China.
- [823] Throughout June and July 2010 numerous emails and versions of charts of the offset plan were circulated among Sino-Forest employees, including Ip, Ho and Yeung. Ip and Yeung are not copied on all emails; Ho was mainly the direct recipient. Options discussed included using five Sino-Panel companies to settle accounts payable which would be repaid back to Sino-Panel via nine intermediaries. Arrangements for bank accounts were approved by Ip and were opened by Huang Ran on behalf of the suppliers and customers. One chart produced by internal Sino-Forest personnel and attached to a July 19, 2010 email made specific reference to the 450 Transactions’ accounts payable of RMB 182 million “being returned in full after being paid”. Another chart referred to the 450 Transactions’ accounts payables being “returned”.
- [824] When Ip was cross-examined about Sino-Forest’s role in arranging the opening of bank accounts for suppliers and customers, he stated Sino-Forest had no role, nor did he have any involvement. He was reminded his direct testimony contradicted this response in cross-examination. After several attempts to avoid answering Staff counsel directly, Ip agreed these accounts would not have been opened without his direction.
- [825] When Ho was cross-examined on this topic, he stated the Sino-Forest employee had made an error in treating the opening of these bank accounts as though they were Sino-Panel accounts that required approval from Ip and Ho. Ho did not recall if he corrected this error although this individual reported directly to him.
- [826] An August 13, 2010 email circulated among Sino-Forest employees including Ip and Ho, and Huang Ran, advised that the three *wai wei gong si* (variously translated as “peripheral” or “outside” companies) had opened bank accounts for purposes of completing cash flows for the 450 Transactions. As discussed elsewhere in these Reasons in our analysis of the undisclosed control allegations, the translation of *wai wei gong si* as “periphery companies” in various emails is disputed by the Respondents. For example, in an April 2011 email regarding the 450 Transactions from an Sino-Forest employee to other employees and copying Ip and Ho, it states: “Please pay attention: the term “periphery” should not appear in emails and/or document forms”.
- [827] The Respondents submit a more appropriate translation for *wai wei gong si* is “outside companies”. They submit, while “peripheral companies” can be a literal translation of the term, the idiomatic translation of the informal expression was more correctly explained by the expert witness Professor Huang who explained it in his expert report as “... an important business partner in a group of corporate entities, but one that is at arms-length to other corporate entities in that group”. As we discussed more generally earlier in these Reasons, we have taken a contextual approach to our understanding of translations from the Chinese language in cases where the parties offer competing interpretations.

We find “periphery” is the more correct translation; the alternative translation of “Pay attention: the term ‘outside’ should not appear in emails or documents/forms” simply does not make sense.

- [828] Ip confirmed the three periphery companies referred to in the August 13, 2010 email were Haosen, Meishan and Xinqi.<sup>15</sup> The email stated the previously paid funds to Yuangao would be returned to the three Sino-Panel companies via Haosen, Meishan and Xinqi, and cautioned that large inflows and outflows within a short period may attract the suspicion of the tax authorities.
- [829] An August 13, 2010 email from Huang Ran’s employee to a Sino-Forest employee, copied to Ho and Ip, informed him the periphery companies had opened bank accounts and the funds would start flowing back following the route: Yuangao – periphery companies – the three Sino-Panel companies. The Respondents submit this flow of funds was the result of a loan Yuangao provided to the three Sino-Panel customers, Xinqi, Meishan and Haosen, which enabled them to pay the outstanding accounts receivable due to the Sino-Panel subsidiaries. The Respondents likened this loan from Yuangao to a form of vendor financing and submit it was a workaround to manage cash flow problems experienced by the three customers. Cash flow problems were frequent for companies operating in the controlled economy of Mainland China.
- [830] Over the course of August 2010, further emails ensued, in which Ip, Ho and Huang Ran were updated on the progress of the flow of funds.
- [831] In an October 28, 2010 email, an individual who worked for Huang Ran, Yang Jun, asked Ip if he should return the funds of RMB 20,800,000, which had been transferred from Sino-Panel (Jianghua) specifically for the 450 Transactions to the Nanning account of Yuangao, back to Sino-Panel (Luzhai) through the Haosen account in accordance with the “original sales route diagram”. Ip responded in English “OK to transfer” (November 1, 2010 email from Ip to Yang Jun). The requirement that Ip approve the transfer indicates the flow of funds in the 450 Transactions was under Ip’s control. Moreover, if this were truly a vendor financing arrangement between Yuangao and Haosen, as the Respondents have suggested, Ip would not be involved.
- [832] Also in July 2010, the foreign exchange conversion of US dollars into renminbi began, and Ho was advised of this by Sino-Forest employees. Ho was also informed Ip recommended doing the conversion in batches and Ip would discuss the post-conversion use of funds with Chan.
- [833] By the end of 2010, the flow of funds had not been completed nor had the Cash Flow Gap of RMB 50.2 million been resolved. The balance of unpaid accounts payable was RMB 26.25 million and the balance of unpaid accounts receivable was RMB 128,717,150 million, for the 450 Transactions, which had occurred in the last quarter of 2009.
- [834] Plans to complete the offset arrangement were discussed in emails (copying Ip and Ho) and at meetings in February 2011. Charts in attachments to these emails indicated the settlement of accounts payable on one side and the corresponding collection of accounts receivable for the same amount of RMB 182 million on the other side.
- [835] Further emails included one from Ho’s assistant to Ip on February 15, 2011 with the subject “Accounts Receivable and Accounts Payable Clearing Process” that advised him in English that “George would like to inform you that the process has been started accordingly [*sic*] to the plan”. Ip, Ho and others were advised in another email later that morning that the first stage of settlement of accounts payable had been completed that day.
- [836] Once Ip learned the first stage had been completed, he instructed Yang Jun in a February 15, 2011 email to “arrange for the funds to be channelled back immediately”. It is clear that Ip was orchestrating the flow of funds for the 450 Transactions.
- [837] Further emails were exchanged among Sino-Forest employees (including Ho) from February 2011 to March 3, 2011 regarding the collection of accounts receivable, which were finally completed on February 24, 2011. The RMB 50.2-million Cash Flow Gap was resolved by purchasing more standing timber, thus generating more accounts payable.
- [838] Ip testified he reported to Chan on how he was going to resolve the accounts receivable problem with Xinqi, Meishan and Haosen. He testified he told Chan Yuangao was lending money to these three customers so they could settle the accounts receivable. Although this was a finance issue, Ip did not report it to Horsley as CFO, but went directly to Allen Chan. When asked why he did this, Ip responded:

Allen Chan and I would meet regularly at the Hong Kong meetings. It was at such meeting that I reported what I did on a day-to-day basis, and I reported on this arrangement at the meeting to

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<sup>15</sup> Although the email referred to Taiyuan, Ip confirmed that this was a typographical error and the reference to Taiyuan was meant to refer to Haosen.

Allen Chan. If Allen Chan was of the opinion that this is something that needed to be reported to David Horsley, he would have said so to me, or he would have told Dave Horsley himself.

(Hearing Transcript, September 3, 2015 at 72:25-73:7)

[839] We find the accounts receivable/accounts payable offsetting arrangement in the 450 Transactions was a circular flow of funds, orchestrated by Ip and Ho and with Chan's knowledge, to resolve the outstanding accounts receivable. We do not accept the Respondents' explanation that Yuangao provided a loan to the Sino-Panel customers. If true, it is not credible Sino-Forest would have been so closely involved in the process, to the point of opening bank accounts and directing the flow of funds for purportedly independent, arm's length companies. We accept there were liquidity issues in Mainland China's managed economy, and accept companies provided loans outside the formal banking system. Nevertheless, the chain of emails clearly established Sino-Forest was controlling the flow of funds, not Yuangao, who was purportedly providing the funds.

**(f) Horsley and the Rainy Season Memo**

[840] By July 14, 2010, Horsley, as CFO, was concerned about the outstanding accounts receivable arising from the 450 Transactions and emailed Ip and Ho, copying Yosanda Chiang, Chan's Executive Assistant, regarding their collectability. Apparently having received no reply, two weeks later on August 2, 2010, Horsley sent another email to Ip and Ho, copying Yosanda Chiang, and Chan directly, asking for a written update and an explanation for E&Y.

[841] Despite the fact Horsley's second request occurred in the middle of plans to use a set-off arrangement for the 450 Transactions, he was told nothing about such offset plans but instead received a memo from Ho, addressed to Horsley and Ip and copied to Chan, explaining the delays were mainly due to the spring rainy season and the inability of customers to get logs to market (the **Rainy Season Memo**). There was no mention of liquidity issues nor vendor financing arrangements (see below for a discussion of the vendor financing arrangements).

[842] The Rainy Season Memo stated the spring rainy season prevented the logs from being transported from the logging area down to the flatlands stations. It was authored by Ho and prepared by his Finance Department. Ho stated the information was sourced from Ip, to whom the Memo was sent.

[843] Ip testified at one point the farmers could not access the area to log; another time he said there were not enough farmers to do the logging, and it was a slow process. Both these explanations differ from the Rainy Season Memo, which stated the trees had been cut but the logs could not be transported.

[844] Ho was asked why a Sino-Forest document noted payment in full was expected by August 2010, but the Rainy Season Memo to Horsley stated the accounts receivable were expected to be paid 50% in each of the Q3 2010 and Q4 2010. He explained this was "an estimation from the operations team and the speed of the injection of the foreign capital" (Hearing Transcript, December 3, 2015 at 124:17-19), despite the fact the Memo's explanation referred to logs being transported, once the rainy condition abated. When asked about the discrepancy, Ho stated the information was from Ip, again deflecting responsibility for the accuracy of the Memo. In fact, the funds were not collected in full until February 2011.

[845] Ho also said he would have relied on Ip or Chan to either talk to Horsley or write him an explanation about the collection of accounts receivable.

[846] The Panel notes the Rainy Season Memo indicated timber had been harvested and logs were awaiting transportation to market, which differs from Ip's testimony that the Harvesting/Sales Confirmation was simply an estimate based on standing logs. Ip stated customers could not harvest because farmers could not get to the logging area to do the cutting because of the rain. Despite the fact Ip was copied on the Rainy Season Memo, he did not correct the misleading language even though he was in charge of Sino-Panel and knew that Chan, the CEO, had also been copied on the Memo. Ho, on the other hand, agreed he had written the memo but said he got the information from Ip. The Panel finds the contradictory evidence provided by Ip and Ho, coupled with the fact neither informed Horsley of the off-set plans for the 450 Transactions, not credible. Yeung testified he had never seen the Rainy Season Memo, which we accept.

[847] On February 3, 2011, Horsley emailed Chan directly regarding his concerns over the remaining accounts receivable of US \$27 million which had been outstanding for more than one year. Chan replied within 70 minutes: "All collectible. Will get A [Albert Ip] and G [George Ho] on it ...". The Panel finds Chan's immediate response indicates he was aware of the circular flow of funds in the 450 Transactions.

[848] While Ho and Ip were engaged in the offsetting arrangement, none of this information was shared with Horsley or with E&Y. On the other hand, Ip updated Chan in July 2010 with a "set of arrangement and flow for post-foreign-exchange-conversions funds", which was part of the plan for collection of accounts receivable in the 450 Transactions.

[849] The Respondents submit implicit in the memo is that customers cannot pay until they have sold harvested timber. Horsley is told by Ho that the logs had been harvested even though Ho knew no harvesting had taken place. Ip also testified harvesting had not taken place and he had reviewed Ho's Memo. We find the Rainy Season Memo was meant to deceive Horsley and E&Y, and to hide the circular flow of funds in the 450 Transactions from their view.

**(g) Vendor Financing and Nanning Bank Accounts**

[850] The Respondents submit the flow of funds arrangement was a type of vendor financing that was common practice in China, due to the lack of readily available cash, causing challenges for businesses when trying to collect accounts receivable. Ip testified Sino-Forest arranged for the supplier in the 450 Transactions, Yuangao, to lend funds to Sino-Forest customers, Xinqi, Meishan and Haosen, so that the customers' accounts receivable could be settled. Ip considered this to be a vendor financing arrangement akin to auto financing provided by car manufacturers in Canada, and, as noted above, testified he informed Chan of the plan for Yuangao to loan money to the three customers.

[851] The Panel heard expert testimony from Michael Murphy on the structural issues regarding cash liquidity in the Chinese managed economy. Murphy testified Chinese businesses were always concerned about access to liquidity; banks may not lend to certain companies, industries or regions if guidelines in the Chinese government's economic plan stipulated other industries or regions were to be the focus of investment. As a result, companies would hold on to their cash and used workarounds, such as vendor financing, to collect accounts receivable. Instead of using their own cash to pay a liability, companies could request another party to make a payment to some person or some entity that owes the company money. He also testified having customers and suppliers deal with set-offs would save the company liquidity and avoid having to deal with the credit risks of the customer. Set-offs were a common way to preserve cash and avoid credit risk.

[852] Ip could not describe any terms of the Yuangao loan. He guessed at the interest rate, at first saying it could be between 10 and 15%, then as much as 20 to 30%. He could not explain how customers could eke out any profit at that rate, nor why Yuangao would take on such credit risk, other than to say it would earn Yuangao the goodwill of Sino-Forest. No evidence of a loan or a vendor financing arrangement was offered, nor did any of the many Sino-Forest emails regarding the 450 Transactions refer to a loan or a vendor financing arrangement.

[853] The Respondents suggest it was not unusual Sino-Forest emails did not refer to vendor financing because this arrangement was between Yuangao and Sino-Forest customers. The Panel does not accept this explanation because it is clear Sino-Forest was directly involved in the process, to the point that Ip's approval was required to transfer funds and channel them immediately back to Sino-Forest.

[854] Moreover, Ho admitted under cross-examination that, although he was CFO of Sino-Panel, he never understood there to be a financing arrangement between Yuangao and Sino-Forest's three customers until he began to prepare for the hearing. Ho testified the financing arrangement was implied and presumably discussions took place between the parties involved.

[855] The Respondents submit Huang Ran was inserted as the middleman to facilitate the process and that the customers were too embarrassed to ask Sino-Forest directly. Ho thought Huang Ran knew the principal of Yuangao and was coordinating the flow of funds. Emails showed that Ip used Huang Ran to open bank accounts at a bank branch in Nanning, Guangxi Province for Yuangao and the three customers, although none of the customers was registered in Nanning.

[856] Subsequent emails establish Ip controlled the flow of funds among these bank accounts. Huang Ran provided Ip with the balances for bank accounts for various companies including Yuangao, Maoxiang, Xinqi, Haosen and Meishan, all involved in the 450 Transactions. An email of March 4, 2011 from Huang Ran to Ip provided an update on balances of bank accounts for these companies, Huang Ran specifically stated: "... the situation of funds for the periphery companies is as follows". This email was originally written in Chinese and the English word "periphery" has been provided as the translation for the Chinese term *wai wei gong si*, a translation which the Respondents contest. Of the eleven companies listed in the email, we previously found Sino-Forest controlled one of them (Taiyuan) and four others were related parties (Kun'an, Yuangao, Meishan and Juncheng). The list was not comprised entirely of "outside" companies unrelated to Sino-Forest. We also found Sino-Forest used Huang Ran as a nominee for companies controlled by, or related to, it. These facts, coupled with the content of the email, in which Huang Ran provides Ip with bank account numbers and balances relating to the eleven companies, satisfies us the translation "periphery companies" makes the most sense in the circumstances. When asked, Ip agreed it was not normal practice for one supplier (Huang Ran) to have the bank account numbers and balances of other suppliers and customers who might also be his competitors and/or customers. Ip also testified it was not beyond reason Huang Ran would know the account information for these companies because he was a shareholder in Yuangao. Irrespective of Ip's testimony, the inference we draw is that Huang Ran was updating Ip about companies associated with the circular flow of funds.

[857] The Panel finds these three customers in the sales contracts of the 450 Transactions, Xinqi, Haosen and Meishan, facilitated the flow of funds back to Sino-Forest. Ip directed the opening of bank accounts for the three customers; Ip and Ho monitored the flow of funds for the three customers; and Huang Ran through Yuangao acted as conduit for the transfer of funds between the three customers and Sino-Forest and reported to Ip.

[858] The Panel finds the vendor financing explanation is not credible, but rather is a fabrication. The Panel finds no legitimate business purpose for this circular flow of funds and, therefore, the purported transactions have no economic substance. Accordingly, we find the sales contracts between Sino-Forest and its three customers, Xinqi, Haosen, and Meishan resulted in Sino-Forest overstating its revenue by approximately US \$30 million, or 6.4%, in Q4 2009.

**(h) The Roles of Chan, Ip, Ho and Yeung**

[859] Chan was closely involved in determining the price at which the standing timber was sold, the target gross profit and the settlement of accounts receivable in the 450 Transactions. Chan was directly emailed by Horsley about the overdue outstanding accounts receivable in February 2011. Chan's response of "All collectible" indicates Chan was aware of the 450 Transactions and subsequent collection issues. Chan was copied on the Rainy Season Memo and knew Ip and Ho did not inform Horsley of the real reason accounts receivable were still outstanding. There were weekly Monday Morning Meetings with Chan, Ip and Ho, among others, at which the subject of the 450 Transactions and issues about payments and collections were discussed. Ip told Chan about the plan for settlements of the outstanding receivables and the "loan" from Yuangao.

[860] Chan submits he was included on emails simply in the ordinary course of business and that the "circular" flow of funds was a legitimate business structure that would not raise a red flag. We reject the submission this specific flow of funds was a legitimate business structure.

[861] Ip testified it was impossible for Chan to be unaware of an April 19, 2010 foreign debt application made by a Sino-Panel subsidiary to Sino-Forest, as it was impossible to raise debt without Chan's approval. These funds were then used to settle Sino-Panel (Guangxi)'s accounts payable arising from the 450 Transactions.

[862] Ip and Ho were closely involved in reverse-engineering the transaction and in the circular flow of funds arrangement. Many emails are authored by them, or are addressed to, or copied to them. These are detailed above.

[863] Ho stated repeatedly in his affidavit and in testimony that he had limited involvement in the 450 Transactions because he was busy with investigating investment opportunities in Russia. However, there are many emails in which it is clear Ho was significantly involved in the 450 Transactions. For example: he told a Sino-Forest employee to write the Rainy Season Memo in English and he "will review and amend the memo ...". In the August 3, 2010 email he sent to Horsley attaching the Rainy Season Memo, Ho tells Horsley he "will closely monitor the situation and let you [Horsley] know". In February 2011, Ho's assistant emailed Ip "George would like to inform you that the process has been started accordingly [sic] to the plan".

[864] To support Ho's submission he was very busy with the Russia project and did not therefore have much involvement with 450 Transactions, Ho submitted 16 reports produced by the consulting firm Pöyry. While the reports are voluminous, they do not speak directly to Ho's involvement in Russia, whereas the emails discussed above support the Panel's finding Ho was directly involved in the 450 Transactions, regardless of any additional obligations he may have had at the time.

[865] Ip was undeniably involved, to the point of approving the opening of bank accounts to facilitate the circular flow of funds.

[866] Yeung was closely involved in reverse-engineering the transactions by coordinating the specific details of the 450 Transactions, such as organizing the work schedule to create all the documents and allocating tasks to specific individuals.

[867] Ip, Ho and Yeung were the key decision-makers in the extensive planning for the fraudulent transaction and in creating the deceitful documents. Ip and Ho were also involved in executing the circular flow of funds.

**(i) Conclusion**

[868] The Panel finds:

- the purchase and sale transactions were reverse-engineered by Sino-Forest employees with the full knowledge and support of Chan, Ip, Ho and Yeung;

- the Forestry Bureau Confirmations were backdated and the survey reports were created and changed well after the dates on the purchase contracts;
- the Harvesting/Sales Confirmations were meant to deceive the reader into believing harvesting had occurred;
- the vendor financing argument is not believable and the circular flow of funds was created and executed by Sino-Forest to solve the accounts receivable problem; and
- the Rainy Season Memo was meant to deceive Horsley and E&Y.

Based on the totality of the evidence, the Panel finds the sales contracts between the Sino-Panel subsidiaries and Xinqi, Meishan, and Haosen have no economic substance. We find Sino-Forest overstated revenue by approximately US \$30 million in the fourth quarter of 2009. The Panel finds that Chan, Ip, Ho and Yeung orchestrated the 450 Transactions.

### 3. Gengma #1 Transactions

#### (a) Introduction

[869] The third example of alleged fraudulent conduct perpetrated in the Standing Timber Fraud Allegations is the Gengma #1 Transactions. Staff alleges Sino-Forest, Chan and Ip committed fraud relating to the standing timber assets purchased from Gengma Dai. As a result, Staff alleges this inflated the value of forestry assets on Sino-Forest's financial statements and misstated revenue from the purported sale of these assets. Staff alleges Sino-Forest recorded the purchase of assets in Gengma County, Yunnan Province (the **Gengma #1 Plantation**) in 2007 at an inflated price, purportedly sold those assets in 2010 and later offered the same assets as collateral for a bank loan in 2011.

[870] In late 2006 Sino-Forest began exploring expansion into Gengma County, Yunnan Province, in a remote area of China near the border with Myanmar. An October 25, 2006 Sino-Forest Investigation Report on Gengma Dai determined that Gengma Dai was the leading enterprise in Gengma County (Yunnan Province), had a high profile and good relationships with the local government and residents, and had been assigned almost all the harvesting quota for the county.

[871] In May 2007, Sino-Panel (Gengma) Co., Ltd. (**Sino-Panel (Gengma)**), a WFOE subsidiary, entered into two purchase contracts with Gengma Dai for the purchase of forest rights for approximately 70,609.5 and 27,000 mu at prices of RMB 1,000 per mu and RMB 980 per mu, respectively. The final area (in mu) of the Gengma #1 Plantation was to be determined by the number of mu registered in the PRCs. Ultimately, as of May 25, 2007, 105,750 mu were registered for a total cost of RMB 105,231,200 (approximately US \$14.2 million)<sup>16</sup>. These contracts were not recorded on Sino-Forest financial statements. These will be referred to as **Gengma Contract Set 1**.

[872] In a contract with Yuda Wood dated April 20, 2007, Sino-Panel (Gengma) purchased the land use rights for the same 105,750 mu as dealt with in Gengma Contract Set 1. In another contract with Yuda Wood dated September 21, 2007, Sino-Panel (Yunnan) Limited (**Sino-Panel (Yunnan)**), a BVI subsidiary, purchased the standing timber rights for the same 105,750 mu of the Gengma #1 Plantation. The Panel found elsewhere in these Reasons that Yuda Wood was controlled by Sino-Forest. The total cost for land use and standing timber rights was RMB 620,367,100 (approximately US \$79 million). These two contracts between Yuda Wood and Sino-Panel (Yunnan) will be referred to as **Gengma Contract Set 4** and, unlike Gengma Contract Set 1, were recorded on Sino-Forest's financial statements.

#### (b) Positions of the Parties

##### i. Staff

[873] Staff submits the unrecorded contracts in Gengma Contract Set 1 were for both standing timber and land use rights and are the "true" contracts. In contrast, Staff submits, the recorded Gengma Contract Set 4 contracts, for the same standing timber and land use rights at a higher total purchase price, are fictitious. Staff alleges this resulted in an overstatement of Sino-Forest's timber holdings in its financial statements in 2007, 2008 and 2009.

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<sup>16</sup> One PRC provided only standing timber rights (not land use rights) for 1,380 mu. As of May 25, 2007 Sino-Forest therefore had PRCs for the Gengma #1 Plantation that covered 105,750 mu of standing timber rights and 104,370 mu of land use rights. On June 4, 2007, Sino-Forest was issued an additional PRC for standing timber and land use rights to 1,100 mu. This brought Sino-Forest's ownership interest in the Gengma #1 Plantation to 106,850 mu of standing timber and 105,470 mu of land use rights. Later, in September 2008, two PRCs were swapped (including the PRC that included standing timber only rights), which resulted in Sino-Forest having PRCs for 110,511.8 mu.

[874] In 2010, the standing timber in Gengma Contract Set 4 was purportedly sold for RMB 1,579,153,315 (approximately US \$231 million), or more than 15 times the allegedly “true” value of both the land and timber when it was purchased pursuant to Gengma Contract Set 1 three years earlier in 2007. Staff alleges this sale was fictitious, and submits that supporting this allegation is the fact that the same standing timber was used as collateral for a bank loan in 2011. Thus, Staff alleges that Sino-Forest fraudulently overstated revenue by US \$73.5 million in Q1 2010 and US \$157.8 million in Q2 2010 in its financial statements.

[875] Staff submits Sino-Forest, Chan and Ip were participants in the alleged Gengma #1 fraud. Staff does not allege any involvement by Hung, Ho or Yeung.

*ii. Respondents*

[876] The Respondents submit the lower-priced Gengma Contract Set 1 was intended to apply to land lease rights only, and not to standing timber rights as well. They submit the contracts had to refer to both rights because the Forestry Bureau would not issue PRCs separately for land use and standing timber rights. The Respondents contend the higher price of the Gengma Contract Set 4 eventually recorded by Sino-Forest can be explained by the fact that they encompassed standing timber ownership in addition to land use rights. They submit that the confusion in the development of multiple contracts arose because of inexperience – this was Ip’s first major standing timber contract and he was assisted by a Sino-Forest employee who was a former furniture salesman and was inexperienced in purchases of standing timber and land leases.

[877] We must decide: (i) which contract set represents the actual transaction; (ii) whether Gengma Contract Set 1 deals with land only or both land and standing timber; and (iii) whether the standing timber sales occurred at all, and, if so, whether the sales price was inflated.

**(c) The Evolution of the Purchase Contracts**

*i. Sino-Forest’s Initial Involvement – Dongkou Contract*

[878] When Sino-Forest was first investigating Gengma Dai as a supplier in Yunnan Province in 2006, it engaged an external survey company, Lincang City Forest Inventory, Planning & Design Team (**Lincang**), to do a survey of a plantation owned by Gengma Dai – the Gengma #1 Plantation. The draft Lincang survey was dated July 2007 but the field work was completed on May 2, 2007. The survey took 44 days (from March until May) and employed an average of 20 persons per day. The survey states it was prepared for Sino-Panel (Gengma) and Gengma Dai for the purpose of a forest rights transfer contract signed between them in February 2007 and covered approximately 100,000 mu owned by Gengma Dai.

[879] However, the February contract referred to in the survey report actually related to a contract between Gengma Dai and Dongkou, the purportedly arm’s length company located in Hunan Province. In our analysis of the allegations of undisclosed control, we found Dongkou was not in fact an arm’s length company, but rather was controlled by Sino-Forest.

[880] The February 2007 contract referenced in the Lincang survey report was the contract between Dongkou and Gengma Dai that Sino-Forest negotiated on behalf of Dongkou during January and February 2007. Although the survey states it is in regards to a contract between Sino-Panel (Gengma) and Gengma Dai, Ip confirmed this was a reference to the Dongkou contract. There are two draft versions of the Dongkou contract in evidence. The final executed contract was not in evidence, but an email attaching the “final version” of the contract notes it was to be signed on February 7, 2007, and a Supplemental Contract refers to a contract between Dongkou and Gengma Dai signed on that date, notarized by the public notary office of Gengma County, Yunnan Province and later rescinded. The final version of the contract was for 80,410 mu at a price of RMB 1,000 per mu. While the area differs somewhat from Gengma Contract Set 1 (between Gengma Dai and Sino-Panel (Gengma)), the Dongkou contract relates to the Gengma #1 Plantation. The details of the Dongkou contract are as follows:

Dongkou Contract						
Contract Date	Contract Title	Purchaser	Supplier	Area (mu)	Unit Price (RMB)	Contract Value (RMB)
[Undated]	Contract of Transfer of Forest Rights	Dongkou	Gengma Dai	80,410	1,000 / mu	80,410,000

Staff submits the contract is for land use and standing timber rights, but Ip testified that the contract was for land use only.



[881] Sino-Forest negotiated the purchase with Gengma Dai, acting on behalf of Dongkou. When asked why he was sent a draft contract between Dongkou and Gengma Dai, Ip testified Sino-Forest had been contemplating buying Dongkou's shares and using Dongkou's staff to manage the Gengma #1 Plantation. He further testified:

Q. ... So why sign an agreement or why have an agreement in Dongkou Shuanglian's name if you don't own them? Why not use some other Sino-Forest company that you do own?

A. At that time, there was no other company that had the resources of, or the manpower to do this deal, and at that time, Gengma Dai made a request that the money should be paid to them by early February. So we were – there were no other way except to use Shuanglian to – for the acquisition.

(Hearing Transcript, May 28, 2015 at 56:18-57:2)

His further testimony did not answer the question as to why Sino-Forest had to transact through Dongkou rather than one of its existing subsidiaries:

Q. So Commissioner Leckman is asking, did you say that there was no other Sino-Forest subsidiary that had the resources to buy this forestland or these land use rights?

A. That's right. What I said was Sino-Forest did not have any subsidiaries which had adequate human resources to take over this deal.

CHAIR: Was that human resources that I heard?

MR. KOEHNEN: Yes.

THE INTERPRETER: The witness used those two words in English.

COMMISSIONER KERWIN: So if I understood the witness, he'd followed on from talking about no other manpower or human resources to do the deal. Gengma Dai wants payment by early February.

MR. KOEHNEN: Yes.

COMMISSIONER KERWIN: I wasn't certain the connection between human resources and payment.

BY MR. KOEHNEN:

Q. So Commissioner Kerwin is asking, Mr. Ip, you said that there was no other Sino-Forest subsidiary with the human resources to do this deal or manage this deal after it closed, but you also said Gengma Dai wanted payment by some time in February. Is there a connection between the need for payment in February and the human resources?

A. There was no connection. What I was saying that – what I was saying is that Gengma Dai was coming after us to finalize the deal, and if the deal was not finalized and if we did not pay by the beginning of February, then they would not sell the forest.

(Hearing Transcript, May 28, 2015 at 57:21-59:3)

We find Ip's confusing response does not assist us.

[882] Ip testified Dongkou's employees, mainly management, would have moved from Hunan Province to Yunnan Province to manage the Gengma #1 Plantation. When asked in cross-examination what these employees would be doing, Ip said: "I wanted them to manage the plantation and operations. That would include **harvesting, replanting**" [emphasis added] (Hearing Transcript, September 21, 2015 at 84:1-3). Ip insisted the contract was for land use only, even though the contract, like other template-derived contracts we have reviewed, referred to the transfer of forestland use rights, timber ownership and timber use rights. Given Ip's insistence the contract was for land use only, he would have us believe it would be possible for Dongkou's employees to harvest timber to which they had no rights. We reject Ip's explanation as not believable.

[883] On this issue, Ip testified “this contract is all mixed up”, “that is why I say there are a lot of contradictions within this contract itself” and that the contract “is a mess” (Hearing Transcript, September 21, 2015 at 88:23-24 and 92:22-23 and September 22, 2015 at 12:14). Yet, this contract had been negotiated by the very experienced Vice-President and head of Sino-Panel’s Resource Department, Lu Qiding, and another Sino-Forest Vice-President.

[884] The email that attached the “final version” of the Dongkou contract was sent to Ip on February 3, 2007 with the subject line “Final Contract Version – Yunnan Gengma Plantation Land Acquisition” states:

Dear Albert,

Attached please find the latest final version of the contract that we plan to sign on next Wednesday. This contract was negotiated among Lu Ci Deng [Sino-Panel Vice-President and head of the Resource Department], Yu Xiao Ming [a Sino-Forest Vice-President], myself [James Lau, of the Sino-Panel Resource Department] with the Gengma people. Lu agreed with the terms and conditions. Please read and advise us if you have any comments for further amendment. Please note that they have specified that before all payment is made to them, we have to get their prior agreement before we transfer the right to a third party or pledge for mortgage loan.

I would like to stress and highlight that Gengma requires RMB 25 m to be remitted to their account on or before Feb 15, otherwise the contract will be cancelled and they will not sell to us even if this money is given to them after Feb 15. It would be much appreciated if you could kindly arrange remittance of this sum of money.

[emphasis added]

[885] This email clearly indicates that Sino-Forest was signing the purchase contract on behalf of Dongkou, negotiated it on behalf of Dongkou, and planned to remit RMB 25 million before February 15, 2007 to Gengma Dai. In addition, the telephone number listed for Dongkou on the attached contract belonged to a Sino-Forest employee.

[886] The Dongkou purchase from Gengma Dai was subsequently replaced with the Sino-Panel (Gengma) purchase from Gengma Dai (Gengma Contract Set 1). No explanation was provided for this change.

ii. *Gengma Contract Set 1 – WFOE Contracts*

[887] The contracts in Gengma Contract Set 1 were contracts for the purchase of the Gengma #1 Plantation in the WFOE Model. They were executed, but never recorded on Sino-Forest’s books.

[888] Gengma Contract Set 1 specifically stipulates the transfer of forest land use rights as well as standing timber use rights. The “Subject of Transfer” in these contracts is described as the forest rights owned by Gengma Dai, being “the lawful forestland use rights, timber ownership and timber use rights”. PRCs were issued by the Forestry Bureau and conveyed registered title to Sino-Forest for land use and standing timber rights, with the exception of one PRC that only conveyed title to the standing timber (and not the land use rights) for two parcels of land totaling 1,380 mu. All of these were issued on May 25, 2007 for a total area of 105,750 mu. The contracts in Gengma Contract Set 1 were undated other than the year 2007.

[889] Gavin Hao, who was qualified as an expert in the Chinese forestry industry, provided evidence on general difficulties in obtaining PRCs in Mainland China and stated specifically in his expert report that “in some regions, when the Forestry Bureaus are registering forestry land use rights, they currently will not permit such rights to be registered to different owners” (Robert Flynn and Gavin Hao, *Report on China’s Forestry Issues* (June 2013) at 15-16). He explained that this is partially based on a rigid mentality on the part of many forestry authorities that timber ownership rights go hand-in-hand with forestry land use, based on the traditional forestry business model. Mr. Hao testified, in practice, separating standing timber and land use rights does happen, and he had seen it in his personal experience. His work experience in this respect was limited to Sichuan and Guizhou Provinces, so he could not be definitive regarding practices in Yunnan or Hunan Provinces.

[890] The Respondents submit, and Ip testified, the reason Gengma Contract Set 1 referred to the transfer of both standing timber and land use rights was that Forestry Bureaus would generally not issue PRCs with separate owners for these two types of rights. They further submit the fact that Gengma County was in a particularly remote district of China makes Ip’s explanation more reasonable. The PRCs issued to Sino-Panel (Gengma) in connection with Gengma Contract Set 1 indicate that Gengma Dai did sell both land and standing timber to Sino-Forest. These PRCs also indicate the local Gengma County Forestry Bureau would, and in this case did, issue PRCs for 1,380 mu of standing timber rights only, contrary to the Respondents’ submission. We did not hear evidence about why Sino-Forest would want to purchase the land use rights to a property, without the associated standing timber rights. If Sino-Forest had

land use but not standing timber rights, Sino-Forest would be hostage to the owner of the standing timber rights until that owner decided to harvest. Moreover, it is not clear that Sino-Forest would own the timber on land that it replanted if Sino-Forest did not have the registered standing timber rights. If this is the case, it is not logical that Sino-Forest would replant a property with trees when the rights to harvest the timber on the land were actually owned by someone else.

[891] The details of Gengma Contract Set 1 are as follows:

Gengma Contract Set 1							
Contract Date	Contract Title	Purchaser	Supplier	Area (mu)	Term of Forestland Use Rights	Unit Price (RMB)	Contract Value (RMB)
2007 [Undated]	Contract of Transfer of Forest Rights	Sino-Panel (Gengma)	Gengma Dai	79,810*	Duration determined based on PRCs	1,000 / mu	79,810,000
2007 [Undated]	Contract of Transfer of Forest Rights	Sino-Panel (Gengma)	Gengma Dai	25,940*	Duration determined based on PRCs	980 / mu	25,421,200
				105,750			105,231,200

\* The area in each of the contracts in Gengma Contract Set 1 was an estimate, to be determined based on figures from the PRCs, and the contracts were priced at RMB 1,000/mu and RMB 980/mu, respectively. The final Area and Contract Value numbers are derived from the PRCs issued on May 25, 2007.

[892] Ip agreed the Gengma Contract Set 1, on the face of it, stipulated the transfer of both land and standing timber rights; however, he testified this was a business deal for land only. Ip testified that, subsequent to the execution of the contracts, a survey would be completed by the Forestry Bureau, which would provide more information on the exact area and stock volume of the plantation, after which the total price of the contract (including standing timber) could be determined. The Respondents submit this is a nuance that is implied but not specified in the contracts, notwithstanding the fact that the terms "forestland use rights, timber ownership and timber use rights" are explicitly stated in the contracts.

[893] Ip is incorrect; the contracts in Gengma Contract Set 1 explicitly state:

Within 14 days after the completion and acceptance of the comprehensive forest survey **conducted by both parties**, Party A (Gengma Dai) shall complete the submission of all formalities for registration of change of forest rights to the authorities responsible for registering the change in forest rights.

[emphasis added]

Therefore, it was Sino-Panel (Gengma) and Gengma Dai that were responsible for conducting a survey. As noted above, the preliminary and incomplete draft survey was conducted by Lincang for Sino-Panel (Gengma) and Gengma Dai. Although Sino-Forest ultimately recorded the purchase of the Gengma #1 Plantation from Yuda Wood (and not Gengma Dai), there was no mention of Yuda Wood in the survey as a counterparty to any transaction. The contracts state that the survey would be completed within 14 days prior to the submission of application for the PRCs (which would be after the contract had been signed). Since the PRCs were issued on May 25, 2007, the survey had to have been completed at the latest by May 11, 2007. Although dated July 2007, the field work for the Lincang survey was completed on May 2, 2007. The survey company would provide Sino-Forest with data shortly after completing the on-site survey (*i.e.* before the completion of the formal report). This is consistent with Sino-Forest having the results of the survey by the required completion date of May 11. Therefore, the price for standing timber could have been calculated by May 11 with the information obtained from the survey. Ip's explanation is not credible.

[894] A May 26, 2007 email to Ip confirmed that PRCs for 105,750 mu had been obtained and noted that there were 1,380 mu without land use rights. It also attached a payment summary with two different options: (i) payment that included the 1,380 mu with rights to the standing timber only for a total amount of RMB 105,231,200, and (ii) payment that excluded this 1,380 mu for the lesser amount of RMB 103,033,600. The email concluded as follows:

PS Inside are two pieces of forestland totaling 1,380 mu, over which our company does not have the forest land use rights. It is necessary to enter into an agreement with Gengma Forestry Co. [Gengma Dai] and require them to transfer the forest land use rights to be under the name of Sino. Otherwise, our company can refuse to pay the amount for that 1,380 mu.

This email indicates the Sino-Forest employee fully expected land use rights to be transferred in addition to standing timber rights.

- [895] Between December 2007 and February 2008, Gengma Dai issued *fapiao* to Sino-Panel (Gengma) for the full amount of RMB 105,380,000. The Panel has heard evidence that *fapiao* are limited by the government and therefore valuable. Gengma Dai would not give up *fapiao* unless a valid transaction required it to do so.
- [896] Between June 2007 and January 2009, Sino-Panel (Gengma) paid Gengma Dai RMB 102,113,966 related to the amount of *fapiao* issued for RMB 105,380,000. Ip and Ho approved and signed these payments. Bank transaction slips confirm actual cash was paid to Gengma Dai. There was no evidence presented to indicate this money was returned subsequent to the recorded transaction with Yuda Wood for the same plantation in Gengma Contract Set 4, which the Respondents submit is the true contract.
- [897] The contracts in Gengma Contract Set 1 were also the contracts that were shown to the tax authorities for the issuance of *fapiao*. There is no evidence the recorded contracts (Gengma Contract Set 4) were shown to the tax authorities or any *fapiao* was issued in respect of these contracts, notwithstanding that the Respondents submit they are the true contracts.
- [898] Sino-Panel (Gengma) employees believed this Gengma Contract Set 1 included both land and standing timber rights. In a July 26, 2007 internal Sino-Panel (Gengma) memo, an employee in the Finance Department wrote that the PRCs clearly transferred land and standing timber rights to Sino-Panel (Gengma) and that “the taxes and duties to be borne by our company in the transfer of forest rights should be 5.2%”. Ip testified this tax rate was applicable to land ownership, and the Respondents submit this is evidence that Gengma Contract Set 1 does not include standing timber. Later in the memo, however, VAT is considered separately and the employees conclude that the seller, not Sino-Forest, is responsible for paying it. Ip previously testified that VAT applied to standing timber sales, and not land only sales. The employees who wrote this memo considered the tax on both standing timber and land separately because different tax rates apply to each, which provides further evidence that Gengma Contract Set 1 applied to both land and standing timber.
- [899] The Panel finds that Gengma Contract Set 1 included both standing timber and land use rights.

*iii. Gengma Contract Set 2 (WFOE Contract) and Supplementary Contracts*

- [900] Several iterations of contracts were created between Gengma Contract Set 1 and Gengma Contract Set 4, which was ultimately signed and recorded by Sino-Forest. The first contract that named Yuda Wood was attached to an August 9, 2007 email and was titled Contract of Transfer of Forest Rights between Yuda Wood and Sino-Panel (Gengma). The contract was for land and standing timber rights for the duration stated on the PRCs (which ranged from 20 to 70 years), and was valued at RMB 315,693,600. This contract was dated June 1, 2007, was signed by Chan and Huang Ran, and was provided to Sino-Forest’s auditor, which at that point in time was BDO. The contract increased the price for the 105,750 mu of Gengma forests from RMB 980-1,000 per mu (in Gengma Contract Set 1) to RMB 2,940-3,000 per mu. This contract is referred to as **Gengma Contract Set 2** and was later rescinded (see below paragraph [903]). Its details are as follows:

Gengma Contract Set 2								
Contract Date	Contract Title	Purchaser	Supplier	Area (mu)	Term of Forestland Use Rights	Unit Price (RMB)	Price	Contract Value (RMB)
June 1, 2007	Contract of Transfer of Forest Rights	Sino-Panel (Gengma)	Yuda Wood	105,750*	Duration determined based on PRCs	2,940 to 3,000 / mu		315,693,600

\* The area in Gengma Contract Set 2 was estimated to be 105,750 mu, to be finally determined based on figures from the PRCs.

- [901] A set of Supplementary Contracts to Gengma Contract Set 2 was attached to an email dated October 17, 2007 and changed the terms of the lease in Gengma Contract Set 2 from 5 years to 30 years, but was unsigned and undated. There was no previous evidence that the lease had been for a term of 5 years – in fact, the contracts stated the duration was to be the same as that stipulated on the PRCs, which ranged from 20 to 70 years. The only evidence that earlier contracts were for a term of five years was found on Sino-Forest internal documents. Ip agreed that five-year terms were rarely seen.
- [902] Staff submits these contracts were created, changing the term and increasing average yield per mu, in order to justify the increase in value of the timber assets to the value eventually recorded by Sino-Forest in Gengma Contract Set 4.

[903] Sometime after the June 1, 2007 Gengma Contract Set 2 was entered into, but before the September 21, 2007 Gengma Contract Set 4, there was an undated but signed (by Chan and Huang Ran) rescission of the June 1, 2007 contract (Gengma Contract Set 2)(during the hearing, the rescission was referred to as Gengma Contract Set 3). Since Gengma Contract Set 2 had already been provided to BDO, this rescission was required so that the auditors were not provided with two purchase contracts for the same timber assets once Gengma Contract Set 4 had been created.

iv. *Gengma Contract Set 4 – BVI and WFOE Contracts*

[904] The purchase contracts for the Gengma #1 Plantation eventually recorded on Sino-Forest’s books were Gengma Contract Set 4. On April 20, 2007, Sino-Panel (Gengma), a WFOE, entered into a purchase contract with Yuda Wood for the land use rights of the 105,750 mu Gengma #1 Plantation for RMB 111,037,500 in a Contract of Forestland Lease. On September 21, 2007, Sino-Panel (Yunnan), a BVI, purchased the standing timber rights from Yuda Wood to the same plantation area for RMB 509,329,600. The combined value for land use rights and standing timber rights was RMB 620,367,100, or more than five times the price paid in Gengma Contract Set 1. The details of Gengma Contract Set 4 are set out below:

Gengma Contract Set 4								
Contract Date	Contract Title	Purchaser	Supplier	Area (mu)	Stock Volume (m <sup>3</sup> )	Term of Forestland Use Rights	Unit Price (RMB)	Contract Value (RMB)
September 21, 2007	Timber Acquisition Contract	Sino-Panel (Yunnan), a BVI subsidiary	Yuda Wood	105,750	1,958,960	N/A	260/m <sup>3</sup>	509,329,600
[Undated] April 20, 2007*	Contract of Forestland Lease	Sino-Panel (Gengma), a WFOE subsidiary	Yuda Wood	105,750	N/A	June 2, 2007 to June 2, 2037	35/mu times 30 years	111,037,500
								620,367,100

\* The contract between Sino-Panel (Gengma) and Yuda Wood was undated. Another version of this contract was found in a loose file on Chan’s assistant’s computer, last modified June 7, 2011 (five days after the Muddy Waters Report). This version was signed by Chan and dated April 20, 2007.

[905] A second survey was prepared for Gengma Contract Set 4, and was conducted by Zhanjiang Southern. It was dated September 2007 (September 21 on the cover page and September 14 in the body of the report), was prepared for Suri-Wood, encompassed exactly 105,750 mu and took nine days to complete, from September 4 to 13, 2007. The Zhanjiang Southern survey did not state who the counterparties to the proposed transaction were, unlike the Lincang survey, which did refer to a contract between Sino-Panel (Gengma) and Gengma Dai. The Zhanjiang Southern survey covered a plantation area with a stock volume very similar to that in the Lincang survey. This survey, and not the earlier Lincang survey, was provided to E&Y for audit purposes. When asked why Sino-Forest obtained a second survey report for the same property, Ip responded that Lincang was a local survey company that Sino-Forest was using for the first time. He testified that Sino-Forest employed a second survey company to cross-check the work quality of the Lincang company. We agree with Staff’s submission that providing the Lincang survey to E&Y would be problematic because it states it was prepared for Sino-Panel (Gengma) and Gengma Dai for the purpose of a forest rights transfer for a contract signed between them in February 2007 and covers approximately 100,000 mu of forest resources owned by Gengma Dai.

[906] When questioned about the difference in the length of time it took Lincang versus Zhanjiang Southern to complete their surveys, Ip was evasive about how much time in general a survey would take, and claimed he had no knowledge about the process, despite his role as head of operations for the Sino-Panel companies, and the requirement that his approval be obtained prior to engaging a survey company to conduct a survey.

[907] There was no evidence of any agreement to rescind Gengma Contract Set 1. In contrast, there was a Rescission of Contract agreement (Gengma Contract Set 3) regarding Gengma Contract Set 2 between Sino-Panel (Gengma) and Yuda Wood for 105,750 mu, prior to Gengma Contract Set 4.

[908] Chan signed both the BVI and WFOE purchase contracts for Gengma Contract Set 4, although the usual process in 2007 was for K.K. Poon to sign all purchase contracts. When Ip was asked why Chan signed in this case, he testified: “ ... in the beginning of this contract, Sino-Panel (Gengma) was involved in the negotiations, and **Allen Chan was involved from the beginning so he was clear about the development of the negotiations on this transaction ...** ” [emphasis added] (Hearing Transcript, September 25, 2015 at 21:6-10).

- [909] Between June 6, 2007 and January 22, 2009, Sino-Panel (Gengma) paid Gengma Dai RMB 102,113,966 for the Gengma #1 Plantation, as referenced in paragraph [896]. In March 2009, Sino-Panel (Gengma) paid Yuda Wood an additional RMB 8,923,534. These payments to Gengma Dai and Yuda Wood total RMB 111,037,500, which was the total value of the WFOE contract for land use rights in Gengma Contract Set 4.
- [910] The contract for standing timber rights in Gengma Contract Set 4 was settled through both offsets and a direct payment from a BVI subsidiary. In partial settlement of the standing timber contract between Sino-Panel (Yunnan) and Yuda Wood, Sino-Panel paid RMB 150,000,000 in cash to Yuda Wood's parent company, HK Sonic Jita. The Panel previously found that Yuda Wood was controlled by Sino-Forest and Sino-Forest capitalized Yuda Wood. This RMB 150,000,000 was a payment in cash between two offshore companies and was the only evidence of a transfer of cash for settlement of accounts by a BVI subsidiary between June 30, 2006 and June 2, 2011 (the date of the Muddy Waters Report).
- [911] The BVI Sino-Panel (Yunnan)'s remaining balance of RMB 359,329,600 owing to Yuda Wood under Gengma Contract Set 4 was settled through offsets on the same date as the contract, September 21, 2007, although the terms of the contract allowed for the first payment instalment of RMB 30 million to be paid within seven days of the contract being *signed*. Assuming this contract followed the procedures for BVI transactions in general, as discussed in our analysis of the deceitful documentation allegations, this would imply that RMB 359 million was paid to Yuda Wood without a signed contract in place (BVI contracts were generally signed in the quarter following the date on the contract. In this case, a written contract would not be executed until sometime in the first quarter of 2008.).
- [912] Yuda Wood's manager and shareholder, Huang Ran, told the Independent Committee Advisors that Yuda Wood would use four or more parties to settle accounts receivable with Sino-Forest customers for reasons that included tax minimization. If that is the case, it is unclear how the offsets could have all been completed on the same day the contract was signed when at least a fourth party was involved. The logistics would have been very daunting, especially since businesses in Mainland China experienced frequent cash flow problems.
- [913] There was no indication Yuda Wood actually owned the Gengma #1 Plantation. No evidence was presented to show that Gengma Dai transferred ownership of the timber assets to Yuda Wood. Ip testified the owner of the forestry rights at the time was Gengma Dai, but Sino-Forest purchased the forests through Yuda Wood. After consulting with the Forestry Bureau, Sino-Forest and the Forestry Bureau determined that it would be very complicated to transfer the PRCs for these plantations from Gengma Dai to Yuda Wood and then to Sino-Panel (Gengma) and would take a long time. Ip said "they [the head of Sino-Panel's Resource Department, Lu Qiding, and the Forestry Bureau] came up with this solution, and that is, there would be this contract with the transferor and the transferee as such" (Hearing Transcript, September 23, 2015 at 83:14-16). Ip's testimony is the only evidence that the Forestry Bureau permitted the transfer of ownership from Gengma Dai to Yuda Wood without reregistering the PRCs in Yuda Wood's name.
- [914] Ip's explanation directly contradicts his own testimony in chief. He testified that if Sino-Forest wanted to obtain a PRC, it had to produce to the Gengma Forestry Bureau a contract with the **original owner** that transferred both land lease and standing timber rights. The Forestry Bureau required the contract be between the **current title holder** and the transferee in order to issue the PRC. We find Ip's explanation in paragraph [913] not credible. We find ownership of the Gengma #1 Plantation was never transferred to Yuda Wood via the solution Ip outlined.
- [915] In summary, the cash payments for the settlement of Gengma Contract Set 4 land use rights were distributed as follows:

- RMB 102,113,966 to Gengma Dai from Sino-Panel (Gengma); and
- RMB 8,923,534 to Yuda Wood from Sino-Panel (Gengma).

The settlement of the standing timber was:

- a cash payment of RMB 150,000,000 to HK Sonic Jita from the BVI subsidiary Sino-Panel; and
- payments by offset totalling RMB 359,329,600 purportedly paid to Yuda Wood from the customers of another Sino-Forest subsidiary.

In total, these payments amount to RMB 620,367,100, the full amount of Gengma Contract Set 4. The only direct payment to an independent third party is the payment to Gengma Dai. We reject the evidence of other payments in settlement of Gengma Contract Set 4. RMB 158.9 million was paid to Yuda Wood, a company controlled by Sino-Forest, and its parent company, HK Sonic Jita, and the remainder was settled through offsets, which we found elsewhere in these Reasons are not reliable evidence of payment.

[916] We find the contracts in Gengma Contract Set 4 between Yuda Wood and both of Sino-Panel (Gengma) and Sino-Panel (Yunnan) are fictitious. Sino-Forest recorded the value of the Gengma #1 Plantation assets at RMB 620,367,100, which is more than five times the price Sino-Forest actually paid Gengma Dai for the assets, RMB 102,113,966. We find Gengma Contract Set 4 was created to overstate the value of the forest assets on Sino-Forest's financial statements.

v. *Assignment Agreement*

[917] An unsigned agreement dated October 16, 2007 switched the purchaser of the standing timber of the Gengma #1 Plantation from Sino-Panel (Yunnan), a BVI, to Sino-Panel (Gengma), a WFOE. We find this Assignment Agreement of Timber Purchase Contract was created to explain the discrepancy between the PRCs, which listed the owner of the standing timber as Sino-Panel (Gengma) and the recorded contract, which showed the purchaser to be Sino-Panel (Yunnan). The only version of this Assignment Agreement in evidence was found on Chan's executive assistant's computer and was last modified on June 7, 2011, five days after the Muddy Waters Report. Staff found no record of this Assignment Agreement in E&Y's audit working papers.

[918] When asked if this Assignment Agreement was created to explain the discrepancy between the PRCs and the Sino-Panel (Yunnan) contract, Ip replied, "Can I put it the other way? At the time, we had to dig up this contract and this contract was pre-existing. We had to come up with a contract as back-up," and "This is about an internal transfer of rights, of ownership; that is, internal to the Sino-Forest group" (Hearing Transcript, September 25, 2015 at 47:3-6 and 19-21). Ip never showed this Assignment Agreement to the Independent Committee advisors even though Yunnan was the focus of the Independent Committee investigation.

[919] The Panel notes the apparently simple method of transferring assets from a BVI to a WFOE in this Assignment Agreement. Evidence has been provided that Sino-Forest had attempted to on-shore BVI assets but had had little success because, as described to the Panel, the process was very complex and difficult. Mr. Hyde, Chair of the Sino-Forest Audit Committee, testified that the on-shoring project was extremely complex and required consultation with external tax and legal advisors. This is consistent with evidence of internal discussions at E&Y on the on-shoring issue. Mr. Hyde testified on-shoring was a priority for Sino-Forest and was the subject of significant discussions at Sino-Forest Board of Directors and Audit Committee meetings. We draw an adverse inference about the legitimacy of the Assignment Agreement, based on the inconsistency between the evidence about the apparent ease of this document's creation and the complex process for transferring assets between a BVI and a WFOE. We find the Assignment Agreement was created to explain differences between the contract and corresponding PRCs in the aftermath of the Muddy Waters Report.

[920] The Panel notes the further inconsistencies with dates. While the contracts recorded on Sino-Forest's financial statements were dated April 20 and September 21, 2007 (Gengma Contract Set 4), significant details of the purchase transactions were changing well into October 2007. The evidence supports the fact that Sino-Forest took a somewhat fluid and flexible approach to the dating of contracts, which helps to explain the non-sequential nature of some of these iterations.

vi. *Conclusion on the Actual Purchase Contracts*

[921] Ip testified Sino-Forest wanted to use Yuda Wood as its own supplier because Sino-Forest had reservations about working with Gengma Dai, despite the fact Sino-Forest had entered into a Master Framework Agreement with Gengma Dai for the supply of standing timber in Yunnan Province. The shareholder and legal representative of Gengma Dai was described by Ip as a powerful, experienced businessman and a drug addict. Ip raised his concerns with Chan that Gengma Dai's principal, with his significant bargaining power, would not comply with the terms of the Master Framework Agreement to provide Sino-Forest with preferential access to timber. Ip testified he relied on Chan to share these concerns with Horsley. Ip also told Chan there were ways to mitigate any issues by using Huang Ran, through Yuda Wood, as a "firewall" between Sino-Forest and Gengma Dai. This firewall plan was developed in consultation with Chan, according to Ip. The Respondents submit that, with Yuda Wood as the middleman, Yuda Wood would have the contractual obligation to Sino-Forest to solve problems as they arose. The Respondents submit the increase in price from Gengma Contract Set 1 (RMB 105,231,200) and the contract with Yuda Wood for land use rights (RMB 111,037,500) can be described as the price paid to Yuda Wood to fix these potential problems.

[922] Yet in November 2007, when disputes arose between Sino-Panel (Gengma) and Gengma Dai regarding PRCs for the Gengma #1 Plantation, Yuda Wood did not play the role of problem solver. The problems were ultimately resolved by the Resources Department of Sino-Forest Head Office; Yuda Wood was not involved, even as a go-between. Ip was copied on the email which recommended this approach. There was no mention of Yuda Wood in the email.

[923] We reject Ip's explanation of Yuda Wood's role. Further, we find this dispute resolution between Sino-Forest and Gengma Dai without Yuda Wood's help supports Staff's submission that the actual transaction was between Sino-

Panel (Gengma) and Gengma Dai, that is, Gengma Contract Set 1. We find Yuda Wood was used to create false contracts in order to increase the value of the forest assets on Sino-Forest's financial statements.

[924] A draft report to the Lincang City branch of SAFE by Sino-Panel (Gengma), dated June 9, 2011 (after the Muddy Waters Report) referred to the foreign exchange conversion of US dollars to renminbi related to the transfer of forest rights from Gengma Dai to Sino-Panel (Gengma). The email to which the draft report was attached references "what we have reported to the Administration of Foreign Exchange [SAFE] at the time of the actual foreign currency conversions". This means Sino-Panel (Gengma) used Gengma Contract Set 1 (with Gengma Dai), and not Gengma Contract Set 4 (with Yuda Wood), to support its request to SAFE to convert US dollars to renminbi for the purpose of paying Gengma Dai. Sino-Forest also provided Gengma Contract Set 1 to its bank for foreign currency conversion in partial payment to Gengma Dai in January 2009.

[925] The Panel finds the contracts in Gengma Contract Set 1 were the true and valid contracts by which Sino-Forest purchased the land and standing timber rights to the Gengma #1 Plantation, based in part on the following:

- the contracts specified land use rights and standing timber rights;
- PRCs were issued for both land use rights and standing timber rights for 105,750 mu;
- Sino-Panel (Gengma) paid RMB 102,113,966 in cash to Gengma Dai in satisfaction of these contracts;
- Gengma Dai, an arms' length company, issued *fapiao* for RMB 105,380,000;
- these contracts were used for currency conversion with SAFE; and
- these contracts were also presented to the tax authorities.

The fact that three government authorities (Forestry Bureau, SAFE and the tax authorities) relied on the validity of these contracts is evidence that supports our finding. More specifically, the Forestry Bureau issued PRCs for land use rights, standing timber rights and standing timber use rights and registered this ownership to Sino-Panel (Gengma). We reject the Respondents' submission that the Forestry Bureau would not issue forestry rights separately as the reason the contract had to refer to both land use and standing timber rights.

[926] The purchase contracts of Gengma Contract Set 4 were fictitious and were created to increase the value of Sino-Forest's assets on its financial statements. We find Yuda Wood never owned the Gengma #1 Plantation. We find Sino-Forest purchased this plantation from Gengma Dai. By recording these fictitious purchase contracts with Yuda Wood at a price more than five times what it actually paid Gengma Dai, Sino-Forest inflated its assets on its financial statements in 2007, 2008 and 2009.

**(d) The BVI Sales Contracts**

[927] Between January and June 2010, Sino-Panel (Yunnan) sold the standing timber for RMB 1,579,153,315 to five customers. The sales price was more than three times the recorded purchase price of standing timber in Gengma Contract Set 4 and more than 15 times what the Panel has found to be the actual purchase price in Gengma Contract Set 1, which was for both standing timber and land use rights. The RMB 1.5 billion is also 99% of the 2006 Gengma County GDP despite the fact the 105,750 mu is less than 5% of the county's commercial forests. Although the year of sales was four years after 2006, we find this figure astounding.

[928] The Panel was provided no explanation of how Sino-Panel (Yunnan) could have sold the standing timber in the first half of 2010 when the Assignment Agreement purported to have transferred the ownership of that standing timber to Sino-Panel (Gengma) in October 2007. This inconsistency further supports Staff's submission that both these documents were falsified and the true purchase of forest assets was through Gengma Contract Set 1 for RMB 105,231,200. Chan signed all 31 sales contracts.

[929] Three of the five customers, representing 56% of the sales price, could not be located by the Independent Committee advisors following the release of the Muddy Waters Report. The accounts receivable arising from this sale were all purportedly settled through offsets; two of the five suppliers that received payments, representing 60% of the receivables, were companies in which Huang Ran had an ownership interest, Yuda Wood and Jiangxi Senchangtai Forestry Co., Ltd. The Panel has found elsewhere in these Reasons that Huang Ran acted as a nominee for Sino-Forest and Sino-Forest controlled Yuda Wood.

[930] Despite recording the sale of the standing timber in the first half of 2010, Sino-Forest pledged the Gengma #1 Plantation assets as collateral in its application for a bank loan with China Development Bank in a valuation report



dated August 12, 2010. Staff submits this confirms that Sino-Forest still owned the standing timber from the Gengma #1 Plantation, the standing timber sale was fictitious, and therefore revenue was overstated on Sino-Forest's financial statements in 2010.

[931] The Respondents submit that there is no evidence they had any role in formulating the asset list for the bank loan with China Development Bank. However, Yeung stated in his affidavit that "Negotiation of the loan and preparation of the security for the bank" were the responsibility of Ip and a Vice-President, Project Finance at Sino-Panel. Once Sino-Forest became aware the Gengma #1 Plantation assets were included as collateral, Sino-Forest proposed to the bank that those assets be replaced. The bank suggested waiting until the loan was drawn before replacing the asset. However, the Muddy Waters Report and ensuing events intervened, and the loan was never made.

[932] The Respondents submit this pledging of collateral was simply an error. While it might be plausible that one error occurs, the same "error" occurred multiple times. In addition to the Gengma #1 Plantation assets, assets from the Gengma #2 transaction were also pledged as collateral for this loan. In total, the Gengma #1 and Gengma #2 Plantation assets were purportedly sold through 38 sales contracts between March 2008 and June 2010. The explanation that this is an error involving 38 contracts executed in 10 different months over more than two years is not credible. We reject the Respondents' explanation and find the Gengma #1 Plantation assets were still on the books of Sino-Forest when pledged as collateral.

[933] Based on the following, we find the sales were fictitious:

- the reported value of the sales amounts to 99% of the GDP for Gengma County for 2006;
- 60% of the accounts receivable were settled by offsets with companies associated with Huang Ran, whom we have found acted as Sino-Forest's nominee;
- subsequent to the sale, the Gengma #1 Plantation assets were pledged by Sino-Forest as collateral for a loan; and
- three of the customers to whom the standing timber was purportedly sold could not be located when the Independent Committee advisors tried to track them down.

Therefore, we find the revenue for 2010 was overstated on Sino-Forest's financial statements by the full amount of the purported BVI sale: US \$73.5 million for Q1 2010 (29.3% of revenue) and US \$157.8 million for Q2 2010 (51.6% of revenue).

[934] Staff has also provided other data which supports their submission the sales price is inflated, however, the Panel makes no finding regarding valuation. We have found the contracts in Gengma Contract Set 1 reflected the actual and valid transaction between Sino-Panel (Gengma) and Gengma Dai. These assets were never sold. The BVI sales contracts were entirely fictitious.

**(e) Conclusion**

[935] The Panel finds:

- Gengma Contract Set 1 between Sino-Panel (Gengma) and Gengma Dai was the true, actual contract;
- Gengma Contract Set 4, which involved Yuda Wood, a company controlled by Sino-Forest, was fictitious and inflated the value of forest assets on Sino-Forest financial statements in 2007, 2008 and 2009; and
- The Gengma #1 Plantation was never sold and therefore the fictitious sale of standing timber by Sino-Panel (Yunnan) inflated the revenue of Sino-Forest in Q1 and Q2 2010 by RMB 1,579,153,315 (or US \$231.3 million).

**(f) The Roles of Chan and Ip**

[936] Chan's involvement in the Gengma #1 Transactions is clear. Although he did not sign purchase contracts in the regular course of business, Chan signed Gengma Contract Set 2; the Rescission of Contract to Gengma Contract Set 2 (Gengma Contract Set 3); and both contracts in Gengma Contract Set 4. Ip testified Chan was involved in negotiations "from the beginning". Ip testified he consulted Chan about using Yuda Wood as a supplier for the Gengma #1 Plantation.

[937] Chan signed the 31 BVI sales contracts which totalled RMB 1.5 billion. Given his involvement in day-to-day operations and his self-professed ability to detect anomalies, Chan would have known the contracts were fictitious.

[938] Ip's involvement in the Gengma #1 Transactions is also clear. Numerous emails were sent directly by him, sent directly to him, or were copied to him. He has acknowledged this was his first major standing timber contract and so would have been intimately aware of all the details. He reviewed contracts before they were signed by Chan and coordinated payments. His very detailed testimony supports this conclusion.

#### 4. Gengma #2 Transactions

[939] The fourth example of alleged fraudulent conduct perpetrated within the Standing Timber Fraud Allegations is the Gengma #2 Transactions.

##### (a) *Positions of the Parties*

###### *i. Staff*

[940] In the Gengma #2 Transactions, Staff alleges Sino-Forest purported to purchase and sell 50,815 mu of forestry plantation assets in the province of Yunnan (the **Gengma #2 Plantation**) in a series of transactions to artificially inflate its assets and revenue.

[941] Sino-Forest recorded the purchase of the Gengma #2 Plantation assets from Yuda Wood in two transactions. The first contract was for standing timber. It was between Sino-Panel (Yunnan), a BVI subsidiary, and Yuda Wood, is dated September 27, 2007, and was for a purchase price of approximately RMB 161 million (**Gengma #2 Contract 1A**). The second contract was for land use rights. It was between Sino-Panel (Gengma), a WFOE subsidiary, and Yuda Wood, is undated and was for a purchase price of approximately RMB 53 million (**Gengma #2 Contract 1B**). Together, Sino-Forest recorded the purchase of both standing timber and land use rights for the Gengma #2 Plantation at a total purchase price of approximately RMB 214.5 million (US \$28.5 million).

[942] Staff alleges Sino-Forest purportedly recorded the sale of land use rights to Kun'an for RMB 53,584,417.50 pursuant to a contract dated November 23, 2009. As has been noted elsewhere in these Reasons, Staff alleges that Kun'an was controlled by Sino-Forest through Huang Ran.

[943] Staff further alleges Sino-Forest purported to sell the standing timber in a series of transactions between March 2008 and November 2009 for approximately RMB 338 million (approximately US \$49.1 million).

[944] Staff alleges Yuda Wood, however, did not acquire the Gengma #2 Plantation until September 2008, after Sino-Forest claims to have purchased this asset from Yuda Wood and after Sino-Forest began recording sales of the Gengma #2 Plantation standing timber. As a result, Staff alleges the Gengma #2 Transactions resulted in Sino-Forest overstating its assets and, furthermore, overstating its revenue by approximately RMB 338 million (approximately US \$49.1 million) over 2008 and 2009.

[945] Staff makes these allegations against Sino-Forest, Chan, Ip and Ho.

###### *ii. Respondents*

[946] The Respondents submit Ip understood Sino-Forest acquired the Gengma #2 Plantation in September 2007. They rely on Ip's testimony that he does not know why or how this mix up about who held the plantation rights or when the transfer of rights to the Gengma #2 Plantation occurred. They submit Ip was unaware of any problems Sino-Forest had in selling the assets, and was not aware of any complaints arising from the standing timber sales.

[947] The Respondents submit the evidence of circulation of purchase agreements involving the Gengma #2 Plantation assets is not consistent with fraud, but with a mix up on the supplier's side for which they do not have a complete answer. The Respondents submit, when the problem was discovered, it was rectified when Sino-Forest obtained PRCs, which attenuated any prejudice which may have been caused by the mix-up on the supplier's side.

##### (b) *Purchases of the Gengma #2 Plantation*

###### *i. Sino-Panel and Yuda Wood Contracts – Gengma #2 Contracts 1A and 1B*

[948] Sino-Panel (Gengma) (a WFOE subsidiary) recorded the purchase of land use rights for a total area of 50,815 mu from Yuda Wood for RMB 53,355,750 (Gengma #2 Contract 1B). The contract is undated but signed by Chan. Huang Ran signed the contract as the legal representative of Yuda Wood. The Panel has previously found Huang Ran acted as

Sino-Forest's nominee and that Sino-Forest controlled Yuda Wood. Between January 2009 and April 2009, Sino-Panel (Gengma) paid Yuda Wood RMB 52,883,674, leaving the balance of the contract value unpaid. *Fapiao* and bank slips confirm these payments. Fund applications indicate that Ip and Ho approved these payments in 2009.

[949] Sino-Panel (Yunnan) (a BVI subsidiary) recorded the purchase of 50,815 mu of standing timber from Yuda Wood on September 27, 2007, for RMB 161,185,180 (Gengma #2 Contract 1A). Chan signed the purchase contract as the legal representative of Sino-Panel (Yunnan), although he did not sign BVI purchase contracts in the normal course of business. Huang Ran signed as the legal representative of Yuda Wood. A survey report was prepared by Zhanjiang Southern. The survey report was attached to the contract and referenced forestland in Gengma County: Gengma Town and Mengsa Town.

[950] The details of the Gengma #2 Contracts 1A and 1B are as follows:

Gengma #2 Contracts 1A and 1B							
Contract	Contract Date	Contract Title	Purchaser	Supplier	Area (mu)	Unit Price (RMB)	Contract Value (RMB)
1A	September 27, 2007	Timber Acquisition Contract	Sino-Panel (Yunnan)	Yuda Wood	50,815	260/m <sup>3</sup>	161,185,180
1B	Undated	Contract of Forestland Lease	Sino-Panel (Gengma)	Yuda Wood	50,815	35 * 30 years / mu	53,355,750
							214,540,930

[951] Together, the acquisition price for the standing timber and land use rights for the Gengma #2 Plantation is RMB 214,540,930 for 50,815 mu of forestland distributed across two towns of Gengma County: Gengma Town and Mengsa Town, as described in the Zhanjiang Southern survey report. The BVI contract (1A) was signed on September 27, 2007. The WFOE contract (1B) was undated, however, it stipulated that the period of lease began on September 15, 2007. Ultimately, PRCs for only 44,630.7 mu were transferred to Sino-Panel (Gengma) and not all matched the locations in the contracts. However, as of September 2007, neither Sino-Forest nor Yuda Wood owned the Gengma #2 Plantation, as discussed below.

ii. *Taiyuan and Gengma Dai Contract – Gengma #2 Contract 2*

[952] Although Sino-Forest purportedly purchased the Gengma #2 Plantation in 2007 from Yuda Wood (through Gengma #2 Contracts 1A and 1B), we find that Yuda Wood did not itself own the Gengma #2 Plantation at this time. Yuda Wood's involvement began much later in time. In fact, another company, Taiyuan, was originally in negotiations to purchase the Gengma #2 Plantation from its prior owner, Gengma Dai, in 2008. Sino-Forest was involved in the 2008 negotiations regarding a transaction for the sale of the Gengma #2 Plantation from Gengma Dai to Taiyuan. We find elsewhere in these Reasons that both Yuda Wood and Taiyuan were controlled by Sino-Forest through its nominee, Huang Ran.

[953] In July 2008, Sino-Forest negotiated a purchase contract between Taiyuan, as purchaser, and Gengma Dai, the latter being an arm's length, independent supplier (Gengma #2 Contract 2). In an email dated September 26, 2008, Ip forwarded Ho copies of contracts regarding the purchase of 58,465 mu and instructed him to handle the payment between Taiyuan and Gengma Dai.

[954] One attachment to the email is a Contract of Transfer of Forest Rights (forestland use rights, timber ownership and timber use rights) from Gengma Dai to Taiyuan for RMB 680 per mu. The total 58,465 mu of forestland that is the subject of this contract is comprised of various villages in six towns: Hepai Township, Gengma Town, Mengsa Town, Mengding Town and Mengjian Township in Gengma County and Banhong Township in Cangyuan County. The contract is dated July 9, 2008 and is signed by Huang Ran on behalf of Taiyuan as its legal representative. The Panel notes the differences in locations between this contract and the Sino-Panel (Gengma) – Yuda Gengma #2 Contracts 1A and 1B (Gengma Town and Mengsa Town).

[955] The details of Gengma #2 Contract 2 are as follows:

Gengma #2 Contract 2						
Contract Date	Contract Title	Purchaser	Supplier	Area (mu)	Unit Price (RMB)	Contract Value (RMB)
July 9, 2008	Contract of Transfer of Forest Rights	Taiyuan	Gengma Dai	Approximately 58,000 mu and not less than 55,000 mu. (The attached appendix indicates 58,465 mu)	680/mu	Unstated

[956] Another attachment entitled Notice of Change of Forest Rights is a notification from Taiyuan instructing Gengma Dai to transfer its purchase rights to Sino-Panel (Gengma); it is neither dated nor signed. Ip testified that he did not open the attached notification because it "gave ... the impression that this was to do with finance matters" (Hearing Transcript, May 22, 2015 at 20:15-16) and so simply forwarded the email to Ho to handle the payment. During his cross-examination, Ip was asked:

Q. So you would approve payments without first reviewing the underlying materials, Mr. Ip? Is that right?

A. I needed to see the supporting documents to make an approval, but here I am asking George Ho to handle the payment. If there was any need for me to give the approval, George Ho would have come back with the request.

(Hearing Transcript, September 25, 2015 at 76:12-19)

[957] We find Ip's response is not credible. We agree with Staff's submission that, as is evident from Ip's testimony, Ip sought to distance himself from the Taiyuan – Gengma Dai contract and Sino-Forest's involvement in negotiating contract terms between, and arranging payments with, two supposedly independent, arms' length companies.

[958] In a second email dated September 26, 2008, in the same email chain, a Sino-Forest employee asks Ip for direction on how to record the payment to Gengma Dai on behalf of Taiyuan: "As this is processed through signing a contract with Huang Ran, I cannot figure out how this is to be reported. Huang Ran also said that he is merely signing". Ip disagreed this email was referring to how the payments should be recorded in Sino-Forest's books. He testified that the Chinese characters in the email, *shang bao*, mean "report to" and not "record". Ip testified that the Sino-Forest employee did not know to whom he should report about settlement of the payment. Taking the email in its entirety, we find the Sino-Forest employee is asking Ip about either recording or reporting on a transaction in which Sino-Forest should have no apparent involvement. Second, Huang Ran was "merely signing" the contract. Further, in an earlier email in the chain, a Sino-Panel employee provides Huang Ran with relevant information regarding Gengma #2 Contract 2 and informs him that "As Mr. Ip has agreed to make payment to the counter-party this week, your assistance on this project is needed ... ". The contents and context of these emails support Staff's submission that Sino-Forest directed the acquisition of the Gengma #2 Plantation between Taiyuan and Gengma Dai and that Sino-Forest used Taiyuan to acquire the plantation on Sino-Forest's behalf.

[959] Ip was questioned about the September 26, 2008 email that concerned Gengma Dai, Taiyuan and Sino-Forest. In his examination in chief, when asked why Gengma Dai would be raising this payment issue with Sino-Forest, Ip responded:

A. That is because he was aware that the acquisition of forests was for Sino-Forest, and since it was not paid so that's why they went after Yuda for payment.

Q. And when you started your answer by saying "he was aware", who is the "he"?

A. Gengma Dai was aware that ultimately this forest would be sold by Yuda to Sino-Forest.

Q. So why does that lead Gengma Dai to raise the issue with Sino-Forest?

A. That is because at the time Gengma Dai did not receive payment from Yuda.

Q. So help me understand why Gengma Dai is approaching Sino-Forest about that issue. Why don't they just deal with Yuda?

A. Because they talked with Yuda, and Yuda informed them that for the time being there was not enough capital to pay them.

(Hearing Transcript, May 22, 2015 at 15:8-16:1)

Ip contradicted himself in cross-examination. He first stated, “Whether Huang Ran had enough funds, I do not know ...”. When asked to clarify his original statement that Yuda Wood did not have enough capital to pay Gengma Dai, he changed his testimony, stating “I do not know whether the Yuda [sic] indeed did not have the funds or whether Yuda wanted us to pay them first” (Hearing Transcript, September 28, 2015 at 11:6-8).

[960] When asked by his counsel why Gengma Dai was bringing Yuda Wood into the mix, Ip responded, “It’s because Gengma Dai knew that the forest would eventually be sold by Yuda to Sino-Forest” (Hearing Transcript, May 22, 2015 at 17:17-17). It is unclear to the Panel why Ip’s response referred to Yuda Wood when the contract was between Taiyuan and Gengma Dai. While Ip testified he did not open the attachment, the body of the second email clearly indicates the transaction was with Taiyuan and that “Mr. Ip has agreed to make payment”. It is not credible that Ip would not be aware the attachment referred to Taiyuan and not Yuda Wood. The Panel notes both Yuda Wood and Taiyuan were controlled by Huang Ran on behalf of Sino-Forest. Moreover, Yuda Wood purportedly sold the Gengma #2 Plantation to Sino-Forest in September 2007, a year before this email was sent.

iii. *Yuda Wood and Gengma Dai Contracts – Gengma #2 Contracts 3A and 3B*

[961] It is unclear why Taiyuan was dropped as the counterparty to the purchase from Gengma Dai, but in March 2009, Yuda Wood replaced Taiyuan as purchaser in the transaction with Gengma Dai for the Gengma #2 Plantation. While the Gengma #2 Plantation was situated in Yunnan Province, Yuda Wood’s registered office was in Hunan Province.

[962] Attached to an email dated March 5, 2009 between Sino-Forest employees, including Ho, and copying one Yuda Wood employee are two contracts. The first is a Contract of the Transfer of Forest Rights, which deals with the transfer from Gengma Dai to Yuda Wood of approximately 58,000 mu of forestland for RMB 39,440,000 (RMB 680 per mu) (**Gengma #2 Contract 3A**) (Ultimately, only 44,630.7 mu was transferred according to the PRCs, resulting in a total price of RMB 30,348,876). There is no location specified in the contract and it is unsigned but backdated to September 15, 2008. The second attachment is an undated and unsigned Agreement of Change in Contracting Parties in Regard to Contract of Transfer of Forest Rights in which Taiyuan transfers to Yuda Wood its rights and obligations with respect to a contract with Gengma Dai (**Gengma #2 Contract 3B**). The details of Gengma #2 Contracts 3A and 3B are as follows:

Gengma #2 Contract 3A						
Contract Date	Contract Title	Purchaser	Supplier	Area (mu)	Unit Price (RMB)	Contract Value (RMB)
September 15, 2008 (unsigned)	Contract of Transfer of Forest Rights	Yuda Wood	Gengma Dai	Approximately 58,000 mu and not less than 55,00 mu *	680 / mu	39,440,000**

\*According to PRCs issued for the Gengma #2 Plantation, only 44,630.7 mu was transferred.

\*\*The actual purchase price, based on the 44,630.7 mu would have been RMB 30,348,876

Gengma #2 Contract 3B				
Contract Date	Contract Title	Transferor of Purchaser Rights and Obligations	Transferee of Purchaser Rights and Obligations	Supplier
Undated and unsigned	Agreement of Change in Contracting Parties in Regard to Contract of Transfer of Forest Rights	Taiyuan	Yuda Wood	Gengma Dai

[963] In a January 16, 2009 email from Ip to a Sino-Forest employee, Ip asks for an update on the payment for the “Yunan plantation”. This led to various responses including one in which Sino-Forest employees are asked to “affix the seal on the contract between Yuda Co. and the Forest Product Co. ... and pay Yuda Co.”, which indicates that Sino-Forest held Yuda Wood’s corporate seals. Ip confirmed that the two companies referred to in this email are Yuda Wood and Gengma Dai. This remark confirms that the contract between Yuda Wood and Gengma Dai was not signed prior to

January 16, 2009 despite the fact that Sino-Forest had apparently purchased the Gengma #2 Plantation from Yuda Wood in September 2007 and purportedly started selling the standing timber in March 2008.

[964] When asked to clarify why the Sino-Forest employee should apply Yuda's chop to the contract, Ip replied:

THE WITNESS: Not at all. That's not what it means here. It is asking here May [a Sino-Forest employee] to arrange for Yuda Company and Gengma to forward to Janson Wang [another Sino-Forest employee] the contract after which they have chopped the contract.

BY MR. ROSSI:

Q. And that's your interpretation that you're giving to that sentence, correct?

A. Yes, I understand it this way.

(Hearing Transcript, September 28, 2015 at 33:9-17)

The Panel finds Ip's response not credible.

[965] Gengma #2 Contracts 1A and 1B recorded by Sino-Forest have an average unit price of RMB 4,222 per mu. In contrast, Gengma #2 Contract 3A (between Yuda Wood and Gengma Dai), for the same asset, is priced at RMB 680 per mu. Ip explained the difference was because Gengma #2 Contracts 1A and 1B were for both standing timber and land, whereas Gengma #2 Contract 3A was for land only. The email discussed below contradicts Ip's claim.

[966] In an email dated January 16, 2009, a Sino-Forest employee writes that the contract (Gengma #2 Contract 3A) must be split between land and timber since the former requires payment of sales tax whereas the latter requires payment of VAT. He states that the problem is "not yet resolved regarding the contract between Yuda and the Forest Product Company" (i.e., Yuda Wood and Gengma Dai). Both Ip and Ho are later copied on the chain of emails, although no one from Yuda Wood is copied despite the fact that the tax issue involved Yuda Wood.

[967] This email chain resolves any disputes as to whether Gengma #2 Contract 3A between Yuda Wood and Gengma Dai is for both land use and standing timber rights or simply for land use rights. It is evident from these emails that Sino-Forest employees understood this contract to be for both land use and standing timber rights. We do not believe Ip's explanation that Gengma #2 Contract 3A was for land use only. Therefore Ip's explanation does not account for the difference in price between what Sino-Forest paid Yuda Wood for the Gengma #2 Plantation (RMB 214,540,930) and what Yuda Wood paid Gengma Dai for the same plantation (RMB 30,348,876).

[968] In his testimony, Ip agreed Sino-Forest employees negotiated the price of RMB 680 per mu between Yuda Wood and Gengma Dai, further supporting our finding Sino-Forest controlled Yuda Wood.

[969] We note Sino-Forest had signed a Master Framework Agreement on March 23, 2007, under which Gengma Dai agreed to supply Sino-Forest with preferential access to timber in Yunnan Province. However, despite this agreement, Sino-Forest purchased the Gengma #2 Plantation from Yuda Wood pursuant to Gengma #2 Contracts 1A and 1B, rather than from Gengma Dai directly. Between 2007 and 2010, Sino-Forest transacted RMB 1.472 billion with Yuda Wood for standing timber in Yunnan Province (23% of the total value transacted under the Yunnan MFA) and only RMB 376 million with Gengma Dai (6% of transactions under the Yunnan MFA).

*iv. Plantation Rights Certificates for the Gengma #2 Plantation*

[970] A June 30, 2009 email circulated among Sino-Forest employees, including Ip, attaches a payment calculation schedule for the transfer of PRCs from Gengma Dai to Sino-Panel (Gengma). The attachment to this email is a table outlining PRCs for an area of 41,129 mu at a price of RMB 680 per mu, signed by Gengma Dai and Sino-Panel (Gengma) personnel. Yuda Wood was not involved because, according to Ip, "the procedures would be a lot more complicated" (Hearing Transcript, September 28, 2015 at 68:1), even though Sino-Panel (Gengma)'s contract (Gengma #2 Contract 1B) was with Yuda Wood and not with Gengma Dai. Ip does not recall any contract transferring ownership to Sino-Panel (Gengma) from Gengma Dai and none was entered into evidence. As discussed in the Gengma #1 Transactions, Ip testified Sino-Forest and the Forestry Bureau came up with a solution to the complicated problem of how to transfer PRCs from Gengma Dai to Yuda Wood and then to Sino-Panel (Gengma). Ip's testimony is the only evidence the Forestry Bureau permitted the transfer of ownership without reregistering the PRCs in Yuda Wood's name. For reasons outlined in our analysis of the Gengma #1 Transactions, we find Ip's explanation not credible.

[971] The PRCs that were transferred to Sino-Panel (Gengma) total an area of 44,630.7 mu and are distributed in the following manner:

- 12,305.5 mu in Mengsa Town;
- 12,346.9 mu in Gengma Town;
- 3,283.9 mu in Mengding Town;
- 10,417.8 mu in Hepai Township; and
- 6,276.6 mu in Banhong Township.

The first four towns are in Gengma County and the fifth town is in Cangyuan County. These PRC locations differ from both those referenced in the Zhanjiang Southern Survey Report associated with Gengma #2 Contract 1A (described below) and those contemplated in Gengma #2 Contract 2 between Taiyuan and Gengma Dai.

- [972] The Zhanjiang Southern survey dated September 27, 2007, in support of Gengma #2 Contract 1A refers to an area of 50,815 mu distributed across two towns in Gengma County: 27,180 mu in Gengma Town and 23,635 mu in Mengsa Town. This was the survey for Gengma #2 Contract 1A, which was recorded in Sino-Forest's financial statements.
- [973] Ip testified he disagrees with the assertion Sino-Forest never owned the 50,815 mu of forestland referred to in both the Zhanjiang Southern Survey Report and the land lease contract with Kun'an (discussed further below) despite the fact there is only 24,652.4 mu of overlapping area in the survey report and the PRCs (representing the areas of forestland in Gengma Town and Mengsa Town). He explained there was a possibility the farmers were resistant to relinquish the land to the suppliers, and so the suppliers "found other land to supplement and make up for the shortfall" (Hearing Transcript, September 29, 2015 at 29:10-11). When asked if both timber and land lease ownership would be swapped, Ip responded: "Not necessarily" (Hearing Transcript, September 29, 2015 at 30:13). When reminded that it had been previously established that Gengma #2 Contracts 1A and 1B dealt with the same assets, he responded that it had been the original intention to swap both rights. Ip testified he does not remember whether any issues regarding a swap of land had been brought to his attention by his subordinates. Ip's testimony is the only evidence we have seen referring to farmers being reluctant to relinquish the land to suppliers.
- [974] Ip testified that although Sino-Forest only received PRCs for 44,630.7 mu in the Gengma #2 Transactions, using extra PRCs from the Gengma #1 Transactions, Sino-Forest had sufficient PRCs to transfer the entire 50,815 mu. He explained Sino-Forest actually received 110,500 mu, rather than 105,000 mu in the Gengma #1 Transactions, and the PRCs for this additional 5,500 mu could be used for Gengma #2 Plantation sales.
- [975] Ip's response is not credible. Land is not a fungible asset. The Respondents' own counsel argued land value can vary when attempting to explain the difference in values between the assets in the Gengma #1 Plantation and the Gengma #2 Plantation (RMB 980 to 1,000 per mu and RMB 680 per mu, respectively). Counsel offered a non-exhaustive list of factors that could influence land value: access to roads, slope of a mountain, protection from wind, soil quality and rock content. Such factors would in turn affect the unit stock volume. In fact, the unit stock volume in the Gengma #1 Plantation was 18.5 m<sup>3</sup> per mu while that in the Gengma #2 Plantation was 12.2 m<sup>3</sup> per mu.
- [976] As a result, it is not possible to simply swap assets from the Gengma #1 Plantation to the Gengma #2 Plantation to make up for the shortfall, as Ip testified. Even if this was possible, there was no accounting adjustment made to the asset value of the Gengma #1 Plantation in the books of Sino-Forest. Finally, the swap would not resolve the shortfall. In the Gengma #1 Plantation, PRCs for an area of 110,511.8 mu were transferred to Sino-Forest for an area of 105,750 mu, leaving an additional 4,761.8 mu of forestland unaccounted for. In the Gengma #2 Plantation, the difference between the area in the contract and the area transferred by the PRCs is 6,184.3 mu (50,815 mu versus 44,630.7 mu). Even if Ip's explanation was plausible (which it is not), there remains a shortfall of 1,422.5 mu.
- [977] In the end, by December 8, 2009, PRCs representing 44,630.7 mu of forestland were transferred to Sino-Panel (Gengma) from Gengma Dai, for which Yuda Wood paid Gengma Dai RMB 30,348,876 between November 18, 2008 and October 12, 2010. Sino-Panel (Gengma) did not have title to the Gengma #2 Plantation on September 27, 2007 when it purportedly purchased the standing timber, nor did it have full title to the assets by the time it paid Yuda Wood 99% of the purported cost of RMB 53,355,750 between January 7, 2009 and April 2, 2009.

v. *Cash Flows, Payments and Settlements*

- [978] Between January 7, 2009 and April 2, 2009, Sino-Panel (Gengma) made cash payments to Yuda Wood totalling RMB 52,883,673.84 for the land use rights of an area of 50,815 mu, leaving an unpaid balance of RMB 472,076.16. This contract value corresponds to that in Gengma #2 Contract 1B between Sino-Panel (Gengma) and Yuda Wood. In turn, between November 2008 and October 2010, Yuda Wood paid Gengma Dai RMB 30,348,876 over six payments, which corresponds to a unit price of RMB 680 per mu for 44,630.7 mu. Sino-Panel (Gengma) (but not Yuda Wood) received

PRCs from Gengma Dai for plantations with areas equal to this exact amount. Receipt of PRCs for 44,630.7 mu corresponding to a price of RMB 680 per mu matches the values ascribed to the assets in Gengma #2 Contracts 2 and 3A, between Gengma Dai and Taiyuan, and Gengma Dai and Yuda Wood. This supports Staff's submission that this is the true value at which Sino-Forest acquired the Gengma #2 Plantation.

- [979] All six payments Yuda Wood made to Gengma Dai were from the two Yuda Wood bank accounts in Guangzhou that Sino-Forest controlled. As discussed elsewhere in these Reasons in our analysis of the undisclosed control allegations, Ho had the password to a USB key required for transfers out of these accounts. Ip and Ho approved the payments, and emails indicate Sino-Forest employees were directly involved in coordinating these payments. We agree with Staff's assertion that if Gengma #2 Contract 3A was an arms' length transaction between Yuda Wood and Gengma Dai, Sino-Forest would not have been involved in Yuda Wood's payments to Gengma Dai. Yuda Wood would not have wanted Sino-Forest to know how much Yuda Wood paid Gengma Dai for the assets; this would be commercially sensitive information. In a for-profit, competitive environment, it would be common sense for Sino-Forest to question why it was paying seven times more for the same assets. The Panel finds Contract 1B is fictitious.
- [980] Sino-Panel (Yunnan) purportedly settled its outstanding accounts payable of RMB 161,185,180 to Yuda Wood for standing timber rights acquired in Gengma #2 Contract 1A by offsets between customers of other Sino-Forest BVI subsidiaries and Yuda Wood. It is noteworthy that all eight payments from Sino-Forest customers to Yuda Wood were recorded as fully settled on the same date the contract is dated (September 27, 2007) although the contract terms did not require same-day payment. Moreover, the *Second IC Report* states Huang Ran was clear that when Sino-Forest directed third parties to settle payments with Yuda Wood, these settlements involved other fourth, fifth or even sixth parties – in offset procedures, as each player in the “daisy chain of cash” sought to avoid paying taxes. We do not find it credible all these players settled payments on the same day.
- [981] As well, as of September 27, 2007, Yuda Wood had not yet acquired the assets from Gengma Dai and no PRCs had been issued to Sino-Panel (Gengma) for the corresponding land use rights that accompanied the standing timber rights. Based on these facts we find Contract 1A is fictitious.

**(c) Sales of the Gengma #2 Plantation**

*i. Standing Timber Sales*

- [982] Between March 2008 and November 2009, Sino-Panel (Yunnan) recorded seven separate contracts for the sale of standing timber from the Gengma #2 Plantation (50,815 mu). The total sales price was RMB 338,117,795. This was more than double its purported purchase cost of RMB 161,185,180 in Gengma #2 Contract 1A. Thirty-four percent of these sales were to Dongkou for an average sales price of RMB 886.42 per m<sup>3</sup>. The Panel has found elsewhere in these Reasons that Dongkou was controlled by Sino-Forest. Both shareholders of Dongkou were on Sino-Forest's payroll up to at least July 2008. Accounts receivable from Dongkou were all settled through offsets, some of which were with suppliers the Panel has found to be under the control or influence of Sino-Forest. The remaining four sales were in 2009 to two other customers for a much lower sales price of RMB 437.1 per m<sup>3</sup>. There were no submissions or evidence these two customers were not independent arm's length customers.
- [983] The three sales by Sino-Panel (Yunnan) to Dongkou were on March 21, June 19 and September 9, 2008 and covered an area of 10,680 mu. Yet, as we found above, although Sino-Panel (Yunnan) purported to purchase the standing timber of the Gengma #2 Plantation from Yuda Wood on September 27, 2007, Yuda Wood did not purchase Gengma #2 Plantation from Gengma Dai until September 15, 2008. Further, Sino-Panel (Gengma) only received PRCs beginning on September 11, 2008. Therefore, Sino-Forest sold 10,680 mu of forestland that it did not own, supporting Staff's submission that this sale was fictitious.
- [984] Ip testified that no one raised any issues with him when Sino-Forest sold the Gengma #2 Plantation assets. The Panel finds it likely this would be the case if the sales were fictitious or made to customers controlled by and/or related to Sino-Forest. A substantial portion of the standing timber sales by dollar value were sold to Dongkou, a company controlled by Sino-Forest. In any case, the accounts receivable were all settled through offsets, so no cash changed hands and therefore there is no independent record of actual settlement. It is not surprising that Sino-Forest reported no issues in settling the accounts receivable for the purported sales of the Gengma #2 Plantation standing timber.

*ii. Land Sales*

- [985] Sino-Panel (Gengma) sold 50,815 mu of land use rights in the Gengma #2 Plantation to Kun'an on November 23, 2009, for RMB 53,584,417.50, to be settled in two equal installments in February, 2010 and May, 2010. This amount is very close to the RMB 53,355,750 Sino-Panel (Gengma) paid to Yuda Wood for land use rights pursuant to Gengma #2 Contract 1B. Sino-Panel (Gengma) recorded the sale of 50,815 mu despite the fact it only held PRCs for 44,630.7 mu for the Gengma #2 Plantation.



[986] Kun'an was previously found to be a company related to Sino-Forest. Therefore, Sino-Panel (Gengma) purchased land use rights from a company it controlled (Yuda Wood), and then sold these rights to a company it was related to.

[987] Kun'an's Statement of Operation Situation filed with SAIC (*i.e.*, its corporate filings) in April 2010 indicates that since its incorporation on January 20, 2009, Kun'an had not had any sales, expenses, liabilities or assets, except for its initial registered capital of RMB 500,000. Yet, Kun'an seemingly bought over 50,000 mu for more than RMB 50 million in November 2009. As previously noted, discrepancies between information in a company's SAIC filings and its books and records is common, so it can be problematic to rely on SAIC filings exclusively, and the Independent Committee determined no conclusions can be drawn from this information alone. However, the magnitude of this discrepancy is significant and is one more data point we consider to arrive at our finding.

[988] Staff submits Sino-Forest had to get the Gengma #2 Plantation off its books in case E&Y's audit discovered that the locations had changed. This would explain why Sino-Forest chose to sell exactly 50,815 mu when it had PRCs for only 44,630.7 mu. Staff further submits that Sino-Forest was trying to create the impression for E&Y's benefit that it had in fact acquired all the 50,815 mu they had recorded in Gengma #2 Contracts 1A and 1B. Ip strongly disagreed. He stated:

When we first abandoned our replanting programme in Yunnan we wanted to lease out the land for which we had lease contracts. And with Gengma Dai and Yuda we had a contract for 50,815 mu, and that contract was still in force. And at a certain point in time we had received PRCs for 4,400 [*sic*] mu. Well, in fact, the PRCs were still being collected. We were still obtaining the rest of the PRCs.

In fact, both Yuda and Sino wanted to complete the agreement; that is, for the entire 50,815 mu. Nobody wanted to stop the completion of the contract, no. So in leasing out the land, in our minds we were still thinking that we had 50,815 mu that we could lease out.

(Hearing Transcript, September 29, 2015 at 16:1-14)

However, according to Ip, when unable to get the balance of PRCs, they swapped in 5,000 mu from the Gengma #1 Plantation and added it to the Gengma #2 Plantation. As discussed in paragraphs [973] to [976], Ip's explanation of swapping assets is not credible.

[989] The Panel finds Staff's submission to be the more likely explanation why exactly 50,815 mu were sold to Kun'an, despite the lack of sufficient PRCs.

[990] By March 2010, no funds had been received from Kun'an although the first payment on its contract with Sino-Panel (Gengma) was due in late February. In an email dated March 3, 2010, Ip and Ho were asked to approve Supplemental Agreements to extend payment terms because E&Y had been "questioning closely about this issue". Huang Ran was also copied on this email. According to Ip, Huang Ran is copied on the email as a representative of Yuangao (the email also addresses issues relating to the 450 Transactions, to which Yuangao was a party). Staff submits he was acting as a representative of Kun'an in this instance. The Panel has found elsewhere in these Reasons Huang Ran acted as a nominee for Sino-Forest with companies it controlled or was related to, including both Kun'an and Yuangao.

[991] The settlement of the account receivable from the purported sale of the Gengma #2 Plantation to Kun'an also involved Juncheng, a supplier to Sino-Forest, and Yu Degang, a former Sino-Forest employee. Kun'an and Yu Degang were considered elsewhere in these Reasons in our analysis of the allegations of undisclosed control. Juncheng was a major supplier to Sino-Forest in 2010 although it had only been incorporated that same year. We found elsewhere in these Reasons Juncheng was related to Sino-Forest. Yu Degang owned 60% of Kun'an, was a shareholder of Maoxiang from August 7, 2009 to October 15, 2009 and was an employee of Sino-Forest from May 22, 2007 to October 31, 2008.

[992] In February 2011, Kun'an delegated its payment obligation of RMB 53,584,417.50 arising from its purchase of land use rights from Sino-Panel (Gengma) through Certificates of Delegation to Juncheng and Mr. Yu Degang:

- Juncheng was delegated to pay RMB 12,637,989.84 on behalf of Kun'an; and
- Yu Degang was delegated to pay RMB 40,946,427.66 on behalf of Kun'an.

Juncheng and Yu Degang ultimately settled this obligation on behalf of Kun'an using funds provided by Sino-Forest subsidiaries in what we find to be a circular flow of funds. Bank records indicate that RMB 12,637,989.84 was transferred from Juncheng to Sino-Panel (Gengma) on February 23, 2011 and that the RMB 40,946,427.66 was transferred from Yu Degang to Sino-Panel (Gengma) on March 3 and 4, 2011.

[993] According to internal Sino-Forest documents, the source of these funds paid by Juncheng and Yu Degang can be traced back to Sino-Forest. Juncheng received over RMB 52 million from two Sino-Panel subsidiaries as payment for timber acquisitions. From this, Juncheng made payments that included the following, which relate to the Gengma #2 sale of land use rights to Kun'an:

- RMB 6,000,000 to Sino-Panel (Gengma) on behalf of Kun'an;
- A further RMB 6,637,989.84 to Sino-Panel (Gengma) on behalf of Kun'an; and
- RMB 20,946,427.66 recorded as being provided to Sino-Panel (Gengma) by Yu Degang.

The first two payments total the RMB 12,637,989.84 payment that Kun'an delegated to Juncheng regarding the sale of the Gengma #2 land use rights. An internal Sino-Forest document titled "List of Funds that Co-operative Companies Received from Sino and that are not Easy to Explain" indicates that Juncheng transferred the amount of the third payment, RMB 20,946,427.66, to Yu Degang. For this transfer, the document notes the following:

- "Unusual Disposition Purpose": "Payment to Yu Degang for paying Gengma";
- "Solution": "Create a Loan Agreement (illustrating the purposes)"; and
- "Remarks": "Payment to Sino Gengma transferred by Yu Degang".

This indicates that RMB 33,584,417.50 out of the total RMB 53,584,417.50 owed by Kun'an to Sino-Panel (Gengma) for the sale of the Gengma #2 Plantation originated from Sino-Forest subsidiaries, in a circular flow of funds.

[994] The remaining RMB 20 million that Yu Degang paid Sino-Panel (Gengma) on behalf of Kun'an for the Gengma #2 Plantation land can also be traced back to Sino-Forest. Sino-Forest documents note that Taiyuan, a company we found was controlled by Sino-Forest, received over RMB 54 million from a Sino-Forest WFOE subsidiary. From that transfer, RMB 20 million is noted as being "Payment to Sino (Gengma) on behalf of Kunan for timber". The document referred to above entitled "List of Funds that Co-operative Companies Received from Sino and that are not Easy to Explain" shows that Taiyuan transferred RMB 20 million of the over RMB 54 million it received from the Sino-Forest WFOE subsidiary to Yu Degang.

[995] Employees in the Sino-Panel accounting department directed this flow of funds from Sino-Forest subsidiaries to the individuals and companies related to, or controlled by, Sino-Forest and back to Sino-Forest. Ip and Ho are copied on these emails from their subordinates that show the circular flow of funds was directed by Sino-Forest.

[996] Staff submits Juncheng and Yu Degang remitted these funds back to Sino-Panel (Gengma) to settle the account receivable from Kun'an, and these funds were part of the circular flow of funds in the settlement of the 450 Transactions, which is discussed in greater detail elsewhere in these Reasons. We agree with Staff's submission, and find the entire amount of the RMB 53,584,417.50 paid to Sino-Panel (Gengma) for the land sale to Kun'an originated from Sino-Forest subsidiaries and was part of a circular flow of funds directed by Sino-Forest employees for no legitimate business purpose.

[997] With respect to the sale of land use rights to Kun'an, the receivables were settled entirely through a circular flow of funds, for which we find no legitimate business purpose. The Panel finds these sales to be fictitious.

*iii. Pledge of the Gengma #2 Plantation as Collateral*

[998] Despite recording the sale of the standing timber in 2008 and 2009 and the sale of land use rights in 2009, Sino-Forest pledged the Gengma #2 Plantation assets as collateral in its application for a bank loan with China Development Bank, as indicated in a valuation report dated August 12, 2010 (previously referred to in our analysis of Gengma #1 Transactions). Staff submits this confirms that Sino-Forest still owned the Gengma #2 Plantation.

[999] The Respondents submit there is no evidence they had any role in formulating the asset list for the bank loan with China Development Bank. However, Yeung stated in his affidavit that "Negotiation of the loan and preparation of the security for the bank" were the responsibility of Ip and a Vice-President, Project Finance at Sino-Panel. The Respondents submit once Sino-Forest became aware of the fact that the Gengma #2 Plantation assets were included as collateral, Sino-Forest proposed to the bank that those assets be replaced. The bank suggested waiting until the loan was drawn before replacing the asset. However, the Muddy Waters Report and ensuing events intervened, and the loan was never made.

[1000] The Respondents submit pledging the Gengma #2 (and Gengma #1 Plantation) assets as collateral was simply an error. However, as we found in our analysis of the Gengma #1 Transactions, to have the same error recur for 38 sales contracts executed in 10 different months between March 2008 and June 2010 strains credulity. We reject the Respondents' explanation and find the assets were still owned by Sino-Forest.

**(d) Conclusion**

[1001] The Panel finds:

- the Gengma #2 Transactions involved companies that were controlled by and/or related to Sino-Forest and thus were not independent arms' length transactions;
- Sino-Forest negotiated terms, including price, for purchase contracts between purported independent third parties;
- the locations in the PRCs that Sino-Panel (Gengma) received did not match those referred to in the survey for the recorded purchase from Yuda Wood;
- the land use sales transaction with Kun'an involved a circular flow of funds and was fictitious;
- Yuda Wood did not own the Gengma #2 Plantation in September 2007 when Sino-Forest recorded the purchase of these assets from Yuda Wood; and
- Sino-Forest directed payments on behalf of purported independent third parties.

[1002] The Panel finds the recorded purchase contracts between Sino-Panel (Yunnan), Sino-Panel (Gengma) and Yuda Wood (Gengma #2 Contracts 1A and 1B) were fictitious. The evidence indicates the land and standing timber of the Gengma #2 Plantation was purchased directly from Gengma Dai, based on the following:

- Sino-Forest recorded both purchase and sales transactions before its supplier Yuda Wood purportedly purchased the plantation from Gengma Dai;
- the PRCs issued to Sino-Panel (Gengma) evidence a purchase directly from Gengma Dai;
- Sino-Panel (Gengma) received *fapiao* from Gengma Dai; and
- the cash payments from Yuda Wood to Gengma Dai came from bank accounts that were controlled by Sino-Forest.

As a result, the Panel finds that Sino-Forest inflated the value of the Gengma #2 Plantation assets on its financial statements in 2007 and 2008.

[1003] We find the recorded sales of the Gengma #2 Plantation were fictitious. We base this finding on facts that include:

- a substantial portion of the standing timber sales by dollar value were to Dongkou, a company controlled by Sino-Forest, and the accounts receivable were all settled through offsets, so no cash changed hands;
- the sale of the land use rights was made to Kun'an, a company related to Sino-Forest, and was settled as part of a circular flow of funds that originated and ended up in the accounts of Sino-Forest subsidiaries; and
- Sino-Forest still had the Gengma #2 Plantation assets on its books in 2010 when it pledged them as collateral for a bank loan.

The Panel therefore finds that Sino-Forest overstated revenue from the purported sale of the standing timber between March 2008 and November 2009 by a total of approximately RMB 338 million (approximately US \$49.1 million) on its financial statements.

**(e) The Roles of Chan, Ip and Ho**

[1004] The Panel found in Gengma #1 that Chan's involvement was clear. Gengma #2 occurred six days later. Ip testified under cross-examination that, at the time of the Gengma transactions, there was no segregation between Transaction #1 and #2, and that Sino-Forest had 155,000 mu of forestland in total. Although Ip confirmed there were two contracts which distinguished the two plantations, Ip reiterated there was no separation between them and testified that the terms

Gengma #1 and Gengma #2 only emerged at the time of the allegations. We therefore consider Ip's testimony that Chan was involved in negotiations "from the beginning" to be equally applicable in the Gengma #2 Transactions.

[1005] Therefore, the Panel finds Chan's involvement in the Gengma #2 Transactions is equally clear. He signed Gengma #2 Contracts 1A and 1B despite the fact that he did not normally sign BVI purchase contracts. Chan also signed the WFOE and BVI sales contracts. The Panel heard repeatedly that Chan was closely involved in day-to-day operations of Sino-Forest, and, as ultimate compensating control, could detect anomalies.

[1006] The Panel finds Ip's involvement is also clear. Numerous emails were either directly sent to him or were copied to him. He was intimately aware of all the details. He approved contracting Zhanjiang Southern to undertake a survey of the Gengma #2 Plantation in September 2007. He reviewed all contracts before they were signed by Chan. He coordinated payments. His very detailed testimony supports the conclusion that Ip directed the Gengma #2 Transactions.

[1007] Ho joined Sino-Forest in the fall of 2007 and would not have been involved at the outset of this transaction. Nevertheless, Ho was closely involved in the payments and settlement process in his role as Vice-President Finance, Sino-Forest and CFO and Vice-President Finance, Sino-Panel. Ho approved the six payments by Yuda Wood to Gengma Dai through the Guangzhou bank account over which he had control. While his role was secondary to that of Chan and Ip, the Panel finds he was aware of the circular flow of funds used to settle the outstanding receivables from Kun'an in 2011.

#### F. Conclusion on the Standing Timber Fraud Allegations

[1008] Staff alleges, during the Material Time, the Respondents engaged in numerous deceitful and dishonest courses of conduct that ultimately caused the assets and revenues derived from the purchase and sale of standing timber (which constituted the majority of Sino-Forest's business) to be fraudulently overstated, putting the pecuniary interests of Investors at risk contrary to Ontario securities law and contrary to the public interest.

[1009] Staff alleges the Standing Timber Fraud was comprised of three deceitful and dishonest courses of conduct in:

- a. undisclosed control of purportedly arms' length companies with which Sino-Forest did business;
- b. the Deceitful Documentation Process; and
- c. undisclosed internal control weaknesses or failures.

Staff alleges each of the above dishonest and deceitful courses of conduct by the Respondents put the pecuniary interests of Investors at risk, constituting fraud.

[1010] Staff cites four examples of alleged fraudulent courses of conduct that the Respondents perpetrated within the Standing Timber Fraud Allegations (collectively referred to as the **Four Frauds**):

- a. the Dacheng Transactions;
- b. the 450 Transactions;
- c. Gengma #1 Transactions; and
- d. Gengma #2 Transactions.

[1011] Based on their involvement in the Standing Timber Fraud Allegations, Staff alleges the Respondents engaged in deceitful or dishonest conduct related to Sino-Forest's standing timber assets and revenue they knew or ought to have known constituted fraud, contrary to subsection 126.1(b) of the *Securities Act* and the public interest.

[1012] In addition, Staff alleges, as officers of Sino-Forest (and/or its subsidiary, Sino-Panel), Chan, Ip, Hung, Ho and Yeung authorized, permitted or acquiesced in Sino-Forest's non-compliance with Ontario securities law in regards to the Standing Timber Fraud Allegations and deemed to have not complied with Ontario securities law pursuant to section 129.2 of the *Securities Act*, which was conduct contrary to the public interest.

[1013] Staff submits the failure of the Respondents to provide truthful disclosure to Investors about the issues of ownership of assets, control of parties with which Sino-Forest did business, revenue recognition and deceitful documentation, internal control weaknesses and other risks prevented Investors from making informed decisions, thus putting their pecuniary interests at risk.

[1014] The Respondents submit there was no fraud and they acted in good faith to protect the interests of Sino-Forest in what they believe was the best interests of Sino-Forest stakeholders at all times.

**1. The Law on Fraud**

[1015] Subsection 126.1(b) of the *Securities Act* prohibits fraud, and states:

A person or company shall not, directly or indirectly, engage or participate in any act, practice or course of conduct relating to securities, derivatives or the underlying interest of a derivative that the person or company knows or reasonably ought to know,

...

(b) perpetrates a fraud on any person or company.

[1016] Fraud is “one of the most egregious securities regulatory violations” and is both “an affront to the individual investors directly targeted” and something that “decreases confidence in the fairness and efficiency of the entire capital markets system” (*Re Capital Alternatives Inc*, 2007 LNBASC 47 at para 308, citing D Johnston and K D Rockwell, *Canadian Securities Regulation*, 4th ed, Markham: Lexis Nexis, 2007 at 420).

[1017] The *Securities Act* does not provide a definition of “fraud”. Since the fraud provision came into force in 2006, the Commission has considered it in light of the leading criminal case on fraud of *R v Théroux*, [1993] 2 SCR 5 (**Théroux**). In *Théroux*, the Supreme Court of Canada stated that a single precept underlies the offence of fraud: “commercial affairs are to be conducted honestly” (*Théroux* at 15, quoting J.D. Ewart, *Criminal Fraud* (Toronto: Carswell, 1986), at 9).

[1018] The Court confirmed the elements necessary to prove fraud as follows:

... the *actus reus* of the offence of fraud will be established by proof of:

1. the prohibited act, be it an act of deceit, a falsehood or some other fraudulent means; and
2. deprivation caused by the prohibited act, which may consist in actual loss or the placing of the victim's pecuniary interests at risk.

Correspondingly, the *mens rea* of fraud is established by proof of:

1. subjective knowledge of the prohibited act; and
2. subjective knowledge that the prohibited act could have as a consequence the deprivation of another (which deprivation may consist in knowledge that the victim's pecuniary interests are put at risk).

(*Théroux* at 20)

In doing so, the Court described fraud as an “offence of general scope capable of encompassing a wide range of dishonest commercial dealings” (*Théroux* at 16).

[1019] The Commission has adopted the test established by the Supreme Court in *Théroux* and applied by the British Columbia Court of Appeal in *Anderson v British Columbia (Securities Commission)*, 2004 BCCA 7 (**Anderson**). In *Re Al-tar Energy Corp* (2010), 33 OSCB 5535 (**Al-tar**), the first case in which the Commission considered subsection 126.1(b), and subsequent cases, the Commission has relied on the British Columbia Court of Appeal's interpretation in *Anderson* of the substantially identical fraud provision in that province.

**(a) Actus reus**

[1020] The *actus reus* of fraud contains two elements: (i) the respondent must have committed a dishonest act, and (ii) that act must have caused deprivation to the victim.

*i. Dishonest Act*

- [1021] The first element, a dishonest act, is established by proof of deceit, falsehood, or other fraudulent means. The first two categories, fraud by deceit or by falsehood, only require the respondent, as a matter of fact, to have represented that a situation was of a certain character, when, in reality it was not (*Théroux* at 15-16).
- [1022] The third category, fraud by “other fraudulent means”, is determined objectively, by reference to what a reasonable person would consider to be a dishonest act (*Théroux* at 16). Underlying this idea of dishonesty is the “wrongful use of something in which another person has an interest, in a manner that this other’s interest is extinguished or put at risk” (*R v Olan*, [1978] 2 SCR 1175 at 1182 (*Olan*)).
- [1023] Omission or non-disclosure of important facts can be included in “other fraudulent means”. In *R v Émond* (1997), 117 CC (3d) 275 (*Émond*), a criminal proceeding, the Quebec Court of Appeal characterized a mere omission or failure to disclose [material] facts as “a situation where, through his silence, an individual hides from the other person a fundamental and essential element ... such as would mislead a ‘reasonable person’” (at 284). The Supreme Court has also stated dishonest acts by “other fraudulent means” can include the use of corporate funds for personal purposes, non-disclosure of important facts and unauthorized diversion of funds (*R v Zlatic*, [1993] 2 SCR 29 at para 18).
- [1024] In the securities regulatory context, non-disclosure of important information to investors has been found to be a dishonest act. In *Re Capital Alternatives Inc*, 2007 LNBASC 47, the Alberta Securities Commission found that the omission of material information in an offering memorandum (including with respect to the risks of the investment) was misleading, deceitful and fraudulent (aff’d, *Alberta Securities Commission v Brost*, [2008] AJ No 1071 (CA)).

*ii. Deprivation*

- [1025] The second element of the *actus reus* of fraud, deprivation, is established by proof of detriment, prejudice, or risk of prejudice to the economic interests of the victim, caused by the dishonest act (*Théroux* at 15).
- [1026] While an economic loss may satisfy the requirements of deprivation under the *Théroux* test, the offence is not limited to those instances only. Prejudice or risk of prejudice to economic interests will also support a finding of fraud. The notion of prejudice is to be given a broad interpretation and even the mere imperilling of another’s economic interest is sufficient. In *Re Phillips*, (2015) 38 OSCB 617, the Commission found where the perpetrator of the fraud has concealed or not disclosed important facts about an investment from investors, those investors are prejudiced because their funds are exposed to risks of which they are not aware. The perpetrators of the fraud do not need to profit from their actions (*Théroux* at 17).

**(b) The Mental Element of Fraud**

- [1027] A breach of subsection 126.1(b) of the *Securities Act* requires a finding that the person or company knew or reasonably ought to have known their conduct perpetrated a fraud. The Commission has applied the test for *mens rea* articulated in *Théroux* within this statutory context.
- [1028] Subsection 126.1(b) of the Act has the identical operative language as the fraud provision in the British Columbia Act. In interpreting the fraud provision in the British Columbia Act and with respect to the mental element, the British Columbia Court of Appeal in *Anderson* stated at paragraph 26:

... [the fraud provision of the BC Act] does not dispense with proof of fraud, including proof of a guilty mind. *Peek v. Derry* (1889), 14 App. Cas. 337 (U.K. H.L.) confirmed that a dishonest intent is required for fraud. Section 57(b) [the fraud provision of the BC Act] simply widens the prohibition against participation in transactions to include participants who know or ought to know that a fraud is being perpetrated *by others*, as well as those who participate in perpetrating the fraud. It does not eliminate proof of fraud, including proof of subjective knowledge of the facts constituting the dishonest act, by someone involved in the transactions. ... [emphasis in original]

(*Anderson* at para 26)

The Commission has applied the test from *Anderson*.

- [1029] Proof of two elements must be established for the mental requirement for a finding of fraud: First, subjective knowledge of the prohibited act, and second, the subjective knowledge that the prohibited act could have as a consequence the deprivation of another. The two elements together are described in *Théroux* as the “subjective awareness that one was undertaking a prohibited act (the deceit, falsehood or some other dishonest act) which could cause deprivation in the sense of depriving another of property or putting that property at risk” (*Théroux* at 19).

[1030] The mental element for fraud under subsection 126.1(b) of the *Securities Act* still requires consideration of the subjective knowledge of the respondent. In *Anderson*, the British Columbia Court of Appeal rejected the argument that the substantially identical fraud provision in the province established an objective standard:

... The section does not offer a definition of fraud. It creates a statutory prohibition which may extend to persons who ought to be aware of the fraud even though they may not be participants in it, but it does not dispense with the requirement that there must be a fraud involved in the transaction, which requires a guilty state of mind as well as an act.

(*Anderson* at para 24)

[1031] The respondent need not have intended the consequences, nor are beliefs regarding the morality of the course of conduct relevant to the issue (*Théroux* at 18-19). As the court held in *Théroux*, “a sanguine belief that all will come out right in the end” is not a defence (at 24). While mere carelessness or mistake will not rise to the level of fraud, recklessness as to the consequences of one’s conduct will (*Théroux* at 20).

[1032] Proving subjective awareness does not require the trier of fact be provided with a mental snapshot proving exactly what was in the respondent’s mind at the time the dishonest act was committed (*Théroux* at 21). Inference of subjective knowledge of the risk can be drawn from the facts as the respondent believed them to be (*Théroux* at 21) and subjective awareness can be inferred from the act itself (*Théroux* at 18).

## 2. The Standard of Proof

[1033] The standard of proof in proceedings before this tribunal is the civil standard of proof on a balance of probabilities. The Commission has consistently applied this standard, following the direction of the Supreme Court in *F (H) v McDougall*:

... it is time to say, once and for all in Canada, there is only one civil standard of proof at common law and that is proof on a balance of probabilities. Of course, context is all important and a judge should not be unmindful, where appropriate, of inherent improbabilities or the seriousness of the allegations or consequences. However, these considerations do not change the standard of proof.

(*F (H) McDougall*, 2008 SCC 53 at para 40)

[1034] Chan submits Staff’s case has not met the high standard of proof required for securities fraud. The standard of proof for fraud under s. 126.1(b) is the same for any other allegation of a breach of Ontario securities law: proof on a balance of probabilities.

[1035] Fraud is a very serious allegation. However, the seriousness of the allegation does not elevate the standard of proof. The question we must ask ourselves is whether, based on the evidence before us, it is more likely than not that the elements of fraud have been made out (*F (H) McDougall* at para 44).

## 3. Was the Alleged Standing Timber Fraud a Fraud on Investors?

[1036] We now consider whether each of Chan, Ip, Hung, Ho, Yeung and Sino-Forest had the requisite *actus reus* and *mens rea* for fraud under the *Securities Act*.

[1037] For the reasons that follow, we find that each of Sino-Forest, Chan, Ip, Hung and Ho committed fraud through their participation in the standing timber fraud.

### (a) The Respondents’ Roles in the Three Elements of the Standing Timber Fraud

#### i. Undisclosed Control of Purportedly Arm’s Length Companies

[1038] Sino-Forest recorded assets and revenue resulting from transactions with parties that it controlled or was related to. Sino-Forest reported to Investors these assets and revenue were the result of arm’s length transactions. They were not. Through this misleading disclosure, Sino-Forest deceived Investors about the accuracy and reliability of information reported in its financial statements. As a result, Investors did not have the information they required to make informed decisions to buy, sell or hold Sino-Forest securities. As noted by Mr. Clifford, partner at Sino-Forest’s auditor, E&Y, this undisclosed control called into question whether transactions with these parties were real at all. Investors’ pecuniary interests were put at risk. Investors in reporting issuers rely on the accuracy and completeness of disclosure. These Investors relied on Sino-Forest’s statements regarding assets purchased and revenue recognized from companies that were controlled by or related to Sino-Forest.

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**Reasons: Decisions, Orders and Rulings**

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- [1039] Chan, Ip, Hung and Ho actively hid information from Sino-Forest's Audit Committee, Board and auditors about the nature of Sino-Forest's relationships with these companies.
- [1040] We find Chan knew Sino-Forest controlled its largest supplier, Yuda Wood, and hid this information from Investors and from others involved in Sino-Forest's disclosure to Investors. Examples of Chan's involvement in Sino-Forest's control of Yuda Wood included his approval of payments from Sino-Forest for property purchased in Yuda Wood's name, his approval of Sino-Forest's control of Yuda Wood bank accounts and his knowledge Sino-Forest controlled Yuda Wood. Chan knew other companies were related to or controlled by Sino-Forest. He used the Company Caretaker List to manage the companies it listed, which purported to do business with Sino-Forest, and some of which we found were related to, or controlled by, Sino-Forest.
- [1041] As Chairman and CEO of Sino-Forest, Chan was involved in and ultimately responsible for the company's disclosure. He knew the importance of providing accurate disclosure to Investors, yet he hid key information concerning undisclosed control from them that made the disclosure deceitful and put their pecuniary interests at risk.
- [1042] Ip was responsible for all purchases in the BVI Model and oversaw elements of the business and transactions of companies that were controlled by, or related to, Sino-Forest. His level of oversight of these aspects of the business of purportedly independent companies was similar to his responsibilities in overseeing the business of the Sino-Panel Group. Examples of his oversight can be seen in the evidence of his review of transaction documents on behalf of Yuda Wood and Dongkou for transactions to which Sino-Forest was not a party, his involvement in what should have been independent audit confirmation processes, his oversight of the changing shareholder structure of Yuda Wood's parent company, HK Sonic Jita, and his involvement in the oversight of bank accounts of many of the controlled or related companies.
- [1043] Ip knew Sino-Forest controlled the bank accounts of Sino-Forest's largest supplier, Yuda Wood. He was aware Sino-Forest was using Yuda Wood and other controlled or related companies – specifically, Kun'an, Taiyuan, Juncheng, Meishan, Shun'xuan and Yuangao – to perpetrate the Standing Timber Fraud. Ip signed purchase contracts on behalf of Sino-Forest with companies he knew Sino-Forest controlled or was related to. This is critical information he knew should have been disclosed to auditors and the Board of Sino-Forest.
- [1044] As a senior officer of Sino-Forest, Ip had to certify to the accuracy of Sino-Forest's disclosure. He knew the importance of accurate disclosure to Investors, and he certified the disclosure was accurate when he knew it was not. He knew the financial statements were not accurate in that they incorrectly recorded transactions with parties that were not independent of Sino-Forest. His inaction kept this key information from Investors, which we find he knew would result in risk to their pecuniary interests.
- [1045] Hung also was involved in, and had knowledge of, Sino-Forest's role in the creation of Audit Confirmation Letters, which he knew should have been independent, but were not. Audit Confirmation Letters reviewed by Hung included those on behalf of Juncheng, which was related to Sino-Forest. We are not satisfied, based on the evidence of his review of these Audit Confirmation Letters, he knew of the risk to Investors' pecuniary interests caused by Sino-Forest's relationship to Juncheng. However, Hung's role in the Standing Timber Fraud is most clearly seen in the Deceitful Documentation Process, which we discuss next.
- [1046] Like Ip, Ho was involved in Sino-Forest's control over companies with which it did business. Ho's role with respect to Yuda Wood was in many ways similar to his responsibility over Sino-Panel subsidiaries as Vice President, Finance for Sino-Panel. Ho's approval was required for applying Yuda Wood's corporate chops and making payments from Yuda Wood bank accounts. As detailed elsewhere in these Reasons, he was also involved in Shun'xuan, Kun'an and Yuangao, companies we found were related to Sino-Forest. He was also involved in the supposedly independent E&Y Audit Confirmation Letters.
- [1047] Ho knew these companies were not independent of Sino-Forest. He was CFO of Sino-Panel and had ultimate oversight of accounting for the Sino-Panel subsidiaries. He has an accounting background and knew related-party transactions would call into question the assets and revenue of Sino-Forest. He was on Sino-Forest's Disclosure Committee, whose mandate was to assist senior officers in fulfilling their responsibility for oversight of completeness, accuracy and timeliness of the disclosure made by Sino-Forest. He also signed sub-certifications in which he certified Sino-Forest's disclosure was accurate. He knew it was not. He took no steps to correct the inaccurate disclosure. We find Ho knew concealing this critical information about Sino-Forest's control and related-party relationships put Investors' pecuniary interests at risk.
- [1048] Yeung played an integral role in Sino-Forest's control of Yuda Wood. Yeung was key in registering Yuda Wood, he stated that Yuda Wood's "operating authority is 100% under our control", and he signed an agreement to purchase property on behalf of Yuda Wood. Yeung was also deeply involved in Kun'an. He instructed Huang Ran about how to organize and structure the company.



[1049] Yeung was Vice-President, Operations of Sino-Panel, the BVI parent company of the subsidiaries in the Sino-Panel Group. He was not an officer of Sino-Forest. Unlike Hung and Ho, he was not responsible for the financial aspects of Sino-Forest's business and was not on the Disclosure Committee, and he had no financial background. Notwithstanding his involvement with Yuda Wood and Kun'an, it is not clear he knew Investors' economic interests were put at risk by his conduct.

ii. *The Deceitful Documentation Process*

[1050] Sino-Forest used the Deceitful Documentation Process to obscure the truth about its ownership of assets and its revenue recognition in the BVI Model's standing timber business. Sino-Forest's Deceitful Documentation Process deceived Investors about the assets Sino-Forest purportedly owned and the revenue recognized from sales in the BVI Model. Sino-Forest told Investors it had proof of its ownership of standing timber assets to support its financial statements. As we found in our analysis of the Deceitful Documentation Process, this was not true. The Forestry Bureau Confirmations were not proof of legal ownership of standing timber assets, and the locations of these assets Sino-Forest claimed to own could not be ascertained based on purchase documentation. Sino-Forest's practice of backdating its sales documentation resulted in the company misstating its revenue from standing timber sales in the BVI Model in its public disclosure.

[1051] In addition, the AR/AP Set-Off Process through which Sino-Forest purported to settle accounts receivable and payable in the BVI Model provides no proof that transactions occurred or payments were ever made in connection with BVI purchase or sales transactions. Rather, it was a means by which the Respondents deceived its auditors, and consequently Investors, about the volume and value of transactions it was entering into in the BVI Model.

[1052] This Deceitful Documentation Process calls into question the assets and revenue Sino-Forest recorded in the BVI Model during the Material Time. This significantly put the pecuniary interests of Investors at risk. As stated elsewhere in these Reasons, approximately 70% of the total timber holdings by hectare that Investors were led to believe they owned through Sino-Forest and approximately 70% of the revenue the company recognized between 2007 and 2010 cannot be verified.

[1053] Chan, Ip and Hung were key architects of the Deceitful Documentation Process, which put Investors' pecuniary interests at risk.

[1054] We found Chan actively participated in Sino-Forest's Deceitful Documentation Process. Chan was deeply involved in the operations of Sino-Forest. He approved all the purchase and sales transactions in the BVI Model. As the "ultimate and compensating control" over transactions, and the signatory on all sales contracts in the BVI Model, Chan's frontline role was much more than ceremonial. He knew key documentation was missing from purchase contracts and knew the process descriptions relied on by E&Y did not accurately reflect the documentation process. We find he deliberately hid from the auditors the actual documentation process.

[1055] Chan instructed Hung to pay suppliers before written contracts were prepared. He also instructed that plantation locations be kept secret in documentation, which resulted in purchase documentation in the BVI Model which was not sufficient to identify plantation locations. Chan signed sales contracts in the quarter following when they were recorded. Notwithstanding this, he allowed misleading information regarding Sino-Forest's revenue recognition process to be provided to the Commission.

[1056] Chan knew Sino-Forest could not obtain PRCs, but nonetheless authorized Sino-Forest's misleading public disclosure in respect of the company's proof of ownership and efforts to obtain PRCs. Although he knew Sino-Forest's BVIs could not obtain PRCs, and Sino-Forest had not applied for PRCs for its BVI standing timber assets, he deliberately told Mr. Hyde, Chair of the Audit Committee, that Sino-Forest was applying for PRCs. Chan failed to disclose the crucial fact that, because BVIs could not obtain PRCs, Sino-Forest was never the legal or registered owner of the standing timber. He knew this would result in a risk of deprivation to Investors. Chan knew the BVI Model assets and revenue recorded in Sino-Forest's financial statements could not be relied on by investors. Chan lied to the Board of Directors, the Audit Committee and E&Y about critical information which led to Sino-Forest's inaccurate disclosure, which put Investors' pecuniary interests at risk.

[1057] Ip was intimately involved in the Deceitful Documentation Process through his role in overseeing all purchases in the BVI Model. He approved all purchases and by Q2 2010 signed all purchase contracts. He was responsible for the Sino-Panel Resource Department, which sourced the BVI standing timber. Like Chan, Ip knew BVIs could not obtain PRCs and Sino-Forest was not even applying for them in the BVI Model, but nevertheless sub-certified misleading disclosure to the contrary. Ip knew documents were prepared in batches and backdated and that the process documents relied on by E&Y in their audits of Sino-Forest's financial statements were deceitful. Further, Ip knew the locations of BVI assets purportedly purchased could not be identified based on the contracts, Survey Reports or Forestry Bureau Confirmations.

- [1058] Ip knew Sino-Forest's inability to obtain PRCs in the BVI Model, which resulted in Sino-Forest never being the legal or registered owner of this standing timber, was a critical fact that should have been disclosed to Investors. He knew not disclosing this critical fact would result in a risk of deprivation to Investors. Despite certifying to the contrary, Ip knew the BVI Model assets and revenue recorded in Sino-Forest's financial statements could not be relied upon. He knew this would put Investors' pecuniary interests at risk.
- [1059] Hung was the central figure in, and controlled, the Deceitful Documentation Process. He knew payments were made before contracts were prepared.
- [1060] Hung signed sub-certifications in relation to Sino-Forest's public disclosure each quarter and at year-end in which he certified the disclosure contained no untrue statement of a material fact or omitted facts to make them not misleading. Hung knew these reports were misleading. Hung directed the settlement of receivables and payables prior to the existence of contracts, and the preparation and backdating of purchase and sales documentation in batches. These documents and the process descriptions relied upon by E&Y, were deceitful. Hung knew this and did not correct the information provided to Sino-Forest's auditors or its Board.
- [1061] We reject Hung's submission he did not understand Sino-Forest's disclosure on revenue recognition. The Panel finds Hung had sufficient education to understand Sino-Forest's revenue recognition policy and to understand it was misleading. Hung knew the disclosure he certified as not misleading, was in fact misleading. Hung was a member of the Disclosure Committee since 2005. Its role was to ensure shareholders and the investing public were informed of Sino-Forest's operations through full, true and plain disclosure of all material information in a timely manner.
- [1062] Hung knew the BVI Model assets and revenue recorded in Sino-Forest's financial statements could not be relied on by Investors. He was Vice President, Corporate Planning and Banking of Sino-Forest. He was a CFA and knew Sino-Forest's assets and revenue from the BVI Model would be called into question as a result of the Deceitful Documentation Process. Although he was on Sino-Forest's Disclosure Committee, he took no steps to correct the inaccurate disclosure. We find Hung knew his conduct in the Deceitful Documentation Process put Investors' pecuniary interests at risk.
- [1063] As noted elsewhere in these Reasons, we find Ho was not involved in a substantial way in the Deceitful Documentation Process.

*iii. Undisclosed Internal Control Weaknesses or Failures*

- [1064] Sino-Forest's failure to accurately disclose the extent of the concentration of duties in the BVI Model as a material weakness deceived Investors. Although we find this deceitful disclosure in respect of internal control weaknesses did not, on its own, cause Investors deprivation, it was an essential element in the Standing Timber Fraud.
- [1065] The persistence of this unremediated internal control weakness facilitated the continuation of the Deceitful Documentation Process. Chan was uniquely positioned to remediate this internal control weakness. He did not.
- [1066] We find Chan's motivation in perpetuating the lack of segregation of duties was to maintain the Standing Timber Fraud. No other explanation flows from the evidence. As stated elsewhere in these Reasons, his explanation for why the weakness could not be remediated was simply untrue. There was no reason Hung's role in overseeing the purchase and sales documentation and settlements in the BVI Model could not have been broken up and redistributed. We find Chan and Hung knew Hung's role in overseeing the Deceitful Documentation Process was a key element of the Standing Timber Fraud.

*iv. The Standing Timber Fraud was an Elaborate Scheme to Defraud Investors*

- [1067] We find the Standing Timber Fraud was an elaborate scheme to defraud Investors. It consisted of three core elements:
- a. undisclosed control of purportedly arm's length parties,
  - b. a Deceitful Documentation Process, and
  - c. undisclosed internal control weaknesses.
- [1068] All three elements combined created the necessary infrastructure for the continued perpetration of the fraud in this case over the Material Time. Transactions with purportedly independent third parties that were actually controlled by or related to Sino-Forest enabled Sino-Forest to falsify purchase and sales documentation provided to its auditors. This in turn led to financial statements and other disclosure which deceitfully reported to Investors that Sino-Forest owned assets and recognized revenue in the BVI Model unsupported by the evidence.

[1069] Sino-Forest's use of controlled or related parties also enabled Sino-Forest to engage in set-off arrangements for accounts receivable and payable in the BVI Model that we found were incapable of independent verification. Hung's central role in the Deceitful Documentation Process was essential to the continuation of the Standing Timber Fraud. Had Chan remediated the internal control weakness of the concentration of these duties in Hung, the Standing Timber Fraud would have been exposed.

[1070] The cumulative impact of the Standing Timber Fraud on Investors resulted in the loss of approximately CA \$6 billion in market capitalization. Pursuant to a restructuring plan approved by the creditors of Sino-Forest, substantially all the assets of Sino-Forest were transferred into Emerald Plantation Holdings Limited. In its financial statements for the year ended December 31, 2013, Emerald ascribed a carrying value of nil to BVI standing timber assets. The value of these assets recorded by Sino-Forest as of December 31, 2010 was US \$2.9 billion.

**(b) No Bona fide Business Purpose**

[1071] Ip, Hung, Ho and Yeung submit fraud cannot be found when the impugned conduct was carried out for *bona fide* business purposes. They cite the British Columbia Court of Appeal's decision in *Anderson*, in which the Court overturned a finding of fraud on the basis the loans in dispute were carried out for a *bona fide* business purpose. They rely on the Court's finding in *Anderson* that there was no evidence the respondents in that case knowingly failed to disclose information about related-party loans or knew they were putting investors' financial interests at risk (*Anderson* at para 33).

[1072] The Supreme Court has distinguished between unwise business practices and fraud:

... The distinction is the same as the distinction between a corporate officer using corporate funds for unwise business purposes, which is not fraud, and the diversion of corporate funds to private purposes having nothing to do with business. Unwise business practices are not fraudulent. The wrongful use of money in which others have a pecuniary interest for purposes that have nothing to do with business, may however, in appropriate circumstances, constitute fraud.

(*R v Zlatic*, [1993] SCJ No. 43 at para 24)

[1073] As discussed throughout these Reasons, we find the actions of the Respondents in the three elements of the standing timber fraud and the four examples of fraud were not carried out for *bona fide* business purposes. In *Anderson*, the Court stated:

There is no evidence that the appellants made any intentionally false statements to investors, and the allegation rests on concealment of information from investors that was material to the risk to their investments. While as *R. v. Cuerrier*, 1998 CanLII 796 (SCC), [1998] 2 S.C.R. 371, 162 D.L.R. (4th) 513, 127 C.C.C. (3d) 1 confirms, dishonest concealment of material facts can amount to fraud, proof of the accused's subjective knowledge of those facts is still required.

(*Anderson* at 30)

This is not similar to the circumstances in *Anderson*. Chan, Ip, Ho and Hung dishonestly concealed key facts relating to Sino-Forest's disclosure of ownership of assets and recorded revenue. They knew their conduct put the pecuniary interests of Investors at risk.

**(c) The Respondents' Roles in the Four Frauds**

[1074] The Four Frauds provide illustrative examples of the Respondents' involvement in the Standing Timber Fraud.

[1075] The Dacheng Transactions provide an example of Ip and Ho's involvement in the perpetration of the Standing Timber Fraud. In the Dacheng Transactions, we found Sino-Forest recorded the sale of the same assets in the BVI and WFOE Models. We found the BVI purchase was fictitious and inflated the assets on Sino-Forest's financial statements for 2008 by approximately US \$30 million. The sale of these duplicate assets through the BVI Model was likewise fictitious and resulted in the overstatement of Sino-Forest's revenue in 2009 by approximately US \$48 million. This overstatement of assets and revenue clearly put the pecuniary interests of Investors at risk.

[1076] Ip was clearly aware of the duplicate assets in Dacheng by Q1 2009 but did not try to correct any errors or misconceptions. Rather, Ip, along with Ho, participated in orchestrating a fraud that deceived Investors about the value of assets held by Sino-Forest and the revenue it generated from standing timber sales. Ip knew the overstatements in Sino-Forest's financial statements which resulted from the Dacheng Transactions put Investors' pecuniary interests at risk.

- [1077] Ho similarly knew the Dacheng Transactions involved the duplication of assets in the BVI and WFOE Models. Like Ip, he was involved in these transactions from the beginning. Although he was Vice-President, Finance of Sino-Forest and was aware of its obligations to accurately disclose assets and revenue, Ho did not bother to correct the overstatement of assets on Sino-Forest's 2008 financial statements or the overstatement of revenue on the 2009 financial statements. Instead, he falsely certified these disclosure documents contained no misleading information. Ho knew, in doing so, he put Investors' pecuniary interests at risk.
- [1078] The 450 Transactions provide an example of Chan, Ip, Ho and Yeung's involvement in the Standing Timber Fraud. We found purchase and sales contracts in the 450 Transactions which were purportedly executed in the same quarter were reverse-engineered with the full knowledge and support of Chan, Ip, Ho and Yeung. Documentation to support these transactions was created to deceive Sino-Forest's CFO and auditors. The sales contracts had no economic substance and resulted in Sino-Forest's overstatement of revenue by approximately US \$30 million in Q4 2009. This revenue did not exist.
- [1079] Chan was closely involved in the 450 Transactions. He determined the profit margin, had ultimate oversight, and his approval was key in fabricating a significant transaction in Q4 2009. We found Chan would have discussed the 450 Transactions at weekly Monday Morning Meetings with Ip, Ho and others. Chan was aware of Ip and Ho's deception of Horsley, the CFO, about the reason accounts receivable were outstanding for the 450 Transactions in the Rainy Season Memo. He allowed this deception to continue and did nothing to correct it. Chan was aware of the circular flow of funds in the 450 Transactions, which we found were for no legitimate business purpose. He approved a loan, the proceeds of which were used to fund the fraudulent circular flow of funds.
- [1080] Chan knew the circular flow of funds resulted in transactions which had no economic substance, resulting in Sino-Forest overstating revenue on its financial statements in 2009, to the detriment of Investors' pecuniary interests.
- [1081] Ip was also closely involved in the fraud perpetrated through the 450 Transactions. He was one of the key decision-makers in the extensive planning for the fraudulent transactions, creating the deceitful documents, and executing the circular flow of funds. He approved the opening of bank accounts used to facilitate the circular flow of funds and monitored those bank accounts.
- [1082] Ip knew his role in creating the 450 Transactions and their circular flow of funds resulted in sales transactions which had no economic substance. He knew the resulting overstatement of revenue on Sino-Forest's financial statements deprived Investors by putting their pecuniary interests at risk.
- [1083] Ho was also significantly involved in reverse-engineering the 450 Transactions conducted using Sino-Panel subsidiaries. In addition to being a key decision-maker in the 450 Transactions, he sent Horsley the Rainy Season Memo, which was used to deceive Horsley about the real reason for outstanding accounts receivable. He assured Horsley he would "closely monitor the situation".
- [1084] As has been stated above, Ho knew the importance of ensuring accurate disclosure, and the impact of inaccurate disclosure, as resulted from the 450 Transactions, on Investors' pecuniary interests.
- [1085] Along with Ip and Ho, Yeung was closely involved in reverse-engineering the 450 Transactions. He authored, was sent or was copied on numerous emails detailing the structuring of these transactions. He was involved in coordinating the specific details of the 450 Transactions, including organizing the work schedule to create all the documents and allocating tasks to specific individuals. Although this work facilitated the fraudulent 450 Transactions, he was not involved in the circular flow of funds, which resulted in sales transactions with no economic substance. We find his involvement in the 450 Transactions did not rise to the level of fraud.
- [1086] The Gengma #1 Transactions provide an example of Chan's and Ip's involvement in the perpetration of the Standing Timber Fraud. In the Gengma #1 Transactions, we found Sino-Forest created fictitious purchase contracts in the BVI Model in order to inflate the value of forest assets on its financial statements in 2007, 2008 and 2009 in purchases it recorded for a total of RMB 620,367,100. The true purchase of that plantation was done in the WFOE Model, in contracts Sino-Forest entered into at a stated price of RMB 105,231,200. We also found Sino-Forest created fictitious sales contracts that inflated its revenue by US \$231 million in 2010. Based on evidence of Sino-Forest's pledging of the Gengma #1 Plantation assets as collateral for a loan, we found these assets were never sold by Sino-Forest. As a result, Sino-Forest overstated revenue in 2010 by the full amount of the sales contracts. The overstatement of assets and revenue clearly put the pecuniary interests of Investors at risk.
- [1087] Chan's involvement is clear. Despite the fact he did not sign purchase contracts in the regular course of business, he signed Gengma Contract Set 2, the Rescission Contract to Gengma Contract Set 2 (Gengma Contract Set 3), and both contracts in Gengma Contract Set 4. He was involved in negotiations from the beginning. He was consulted regarding the plan to insert Yuda Wood, a company he knew Sino-Forest controlled, into the Gengma #1 Transactions.

- [1088] Chan therefore knew the BVI purchase and sales contracts he signed in the Gengma #1 Transactions were fictitious. Chan knew entering into fictitious purchase and sale contracts would have the effect of overstating assets and revenue, which would put Investors' pecuniary interests at risk.
- [1089] Ip's involvement in the Gengma #1 Transactions was also clear. Emails regarding the Gengma #1 Transactions were sent to him or from him, he was intimately aware of the details of the transactions, reviewed all the contracts and coordinated payments. Notwithstanding his involvement in the true contracts from the beginning, Ip continued to be involved in the evolution of the fraudulent purchase contracts.
- [1090] Ip knew that his role in structuring the Gengma #1 Transactions resulted in fictitious purchases and sales in the BVI Model. He knew the resulting overstatement of assets and revenue would have put Investors' pecuniary interests at risk.
- [1091] The Gengma #2 Transactions provide an example of Chan's, Ip's and Ho's involvement in the perpetration of the Standing Timber Fraud. In the Gengma #2 Transactions, we found Sino-Forest created fictitious purchase contracts that inflated the value of assets on Sino-Forest's financial statements in 2007 and 2008, and created fictitious sales contracts that misstated revenue on Sino-Forest's financial statements between March 2008 and November 2009 by a total of approximately US \$49 million. The overstatement of assets and revenue clearly put the pecuniary interests of Investors at risk.
- [1092] As in the Gengma #1 Transactions, Chan signed BVI purchase contracts in the Gengma #2 Transactions, although he did not normally do so in the ordinary course of business. He signed sales contracts in the BVI and WFOE Models that we found were fictitious. He was also aware of the fraudulent circular flow of funds involved in the settlement of the receivable from the sale to Kun'an, which had no legitimate business purpose. Chan was very involved in the day-to-day operations of Sino-Forest, and was involved in the Gengma #1 and Gengma #2 Transactions from the beginning.
- [1093] Our findings with respect to the Gengma #1 Transactions apply equally to Chan's knowledge about the implications of his conduct in the fraudulent Gengma #2 Transactions. According to Ip, there was no distinction between the two Gengma plantations at the time the transactions were taking place, and Chan was involved in both from the beginning. He knew his signing of fictitious purchase and sales contracts would have the effect of overstating assets and revenue on the financial statements and that this would put the pecuniary interests of Investors at risk.
- [1094] Ip's involvement in the Gengma #2 Transactions was also clear. As with Gengma #1, Ip sent or received numerous emails regarding these transactions. He was intimately aware of the details, reviewed contracts, and coordinated payments.
- [1095] Ip knew that the Gengma #2 Transactions were fictitious. He knew the resulting overstatement of assets and revenue would have put Investors' pecuniary interests at risk.
- [1096] While his role was secondary to that of Chan and Ip, Ho was also involved in the Gengma #2 Transactions. He was closely involved in the payments and settlement process for the Gengma #2 Transactions, which included the circular flow of funds to settle the outstanding receivables from Kun'an, and which had no economic substance. He approved payments from Yuda Wood's bank accounts controlled by Sino-Forest in respect of Sino-Forest's fictitious purchase contracts.
- [1097] As Vice-President, Finance of Sino-Forest and CFO and Vice-President, Finance of Sino-Panel, Ho knew the importance of ensuring accurate disclosure, and the impact of the inaccurate disclosure that resulted from the Gengma #2 Transactions on Investors' pecuniary interests.

**(d) Conclusions on the Standing Timber Frauds**

*i. Chan*

- [1098] We find Chan engaged in all three elements of the standing timber fraud during the Material Time which ultimately caused the assets and revenue derived from the purchase and sale of standing timber to be fraudulently overstated, putting the pecuniary interests of Investors at risk. Chan's involvement is exemplified by his roles in the 450 Transactions, Gengma #1 Transactions and the Gengma #2 Transactions.
- [1099] We find Chan engaged in deceitful and dishonest conduct related to Sino-Forest's standing timber assets and revenue that he knew constituted fraud, contrary to subsection 126.1(b) of the *Securities Act*, and contrary to the public interest

ii. Ip

- [1100] We find Ip was intimately involved in virtually every aspect of the Standing Timber Fraud during the Material Time. He knowingly deceived Investors through his involvement in Sino-Forest's undisclosed control in companies with which it transacted and in the Deceitful Documentation Process. As stated above, these two elements independently deprived Investors by putting their pecuniary interests at risk.
- [1101] Ip's oversight of the execution of all Four Frauds demonstrates the oversight he had of Sino-Forest's fraudulent operations. Ip led employees of the Sino-Panel Group in the fraudulent recording of transactions in the Four Frauds that led to Sino-Forest's overstatement of assets and revenue during the Material Time.
- [1102] We find Ip engaged in deceitful and dishonest conduct related to Sino-Forest's standing timber assets and revenue that he knew constituted fraud, contrary to subsection 126.1(b) of the *Securities Act*, and contrary to the public interest.

iii. Hung

- [1103] Hung was the central figure in and controlled the Deceitful Documentation Process which put Investors' pecuniary interests at risk. He knew his role in the internal control weakness of concentration of duties was a key element of the standing timber fraud, and went along with Chan's failure to remediate this internal control weakness.
- [1104] We find Hung engaged in deceitful and dishonest conduct related to Sino-Forest's standing timber assets and revenue he knew constituted fraud, contrary to subsection 126.1(b) of the *Securities Act*, and contrary to the public interest.

iv. Ho

- [1105] Ho knowingly deceived Investors through his involvement with Sino-Forest's undisclosed control of companies with which it transacted business. As stated above, this element of the Standing Timber Fraud, on its own, put the pecuniary interests of Investors at risk. In the Dacheng Transactions, the 450 Transactions and the Gengma #2 Transactions, Ho knew his conduct put Investors' pecuniary interests at risk.
- [1106] Although Ho was not an architect of the Deceitful Documentation Process in the way that Chan, Ip and Hung were, his involvement in three of the Four Frauds demonstrates he nonetheless played a role in the Standing Timber Fraud.
- [1107] We find Ho engaged in deceitful and dishonest conduct related to Sino-Forest's standing timber assets and revenue he knew constituted fraud, contrary to subsection 126.1(b) of the *Securities Act*, and contrary to the public interest.

v. Yeung

- [1108] Although Yeung was involved in Sino-Forest's undisclosed control of companies and the 450 Transactions, we are not satisfied he knew Investors' economic interests were put at risk by his conduct.

vi. Sino-Forest

- [1109] To establish the requisite intent of a corporation, the Commission has found it is sufficient to show its directing mind(s) knew or reasonably ought to have known the acts of the corporation perpetrated a fraud (*Al-tar* at para 221).
- [1110] Chan was the directing mind of Sino-Forest. As we discuss in greater detail in our consideration of Allen Chan's Role as CEO, we find he was not only the strategic visionary for the company, but was also intimately involved in its day-to-day operations and was the ultimate compensating control.
- [1111] Chan, as the directing mind of Sino-Forest, knew the acts of Sino-Forest and its subsidiaries put the pecuniary interests of Investors at risk. Sino-Forest, as parent company of the Sino-Panel subsidiaries, the entities through which the fraud was conducted, committed fraud when it falsely and misleadingly reported assets and revenue in its public disclosure documents, upon which Investors could not rely.
- [1112] We find Sino-Forest engaged in deceitful and dishonest conduct related to its standing timber assets and revenue that constituted fraud, contrary to subsection 126.1(b) of the *Securities Act* and contrary to the public interest.

4. **Did Chan, Ip, Hung, Ho or Yeung authorize, permit or acquiesce in Sino-Forest's conduct contrary to subsection 126.1(b) of the *Securities Act*?**

[1113] Staff alleges, given their positions as officers of Sino-Forest and/or Sino-Panel, Chan, Ip, Hung, Ho and Yeung authorized, permitted or acquiesced in Sino-Forest's non-compliance with Ontario securities law and should be deemed to have not complied with Ontario securities law pursuant to section 129.2 of the *Securities Act*.

[1114] Section 129.2 of the *Securities Act* states:

**129.2 Directors and officers** – For the purposes of this Act, if a company or a person other than an individual has not complied with Ontario securities law, a director or officer of the company or person who authorized, permitted or acquiesced in the non-compliance shall be deemed to also have not complied with Ontario securities law, whether or not any proceeding has been commenced against the company or person under Ontario securities law or any order has been made against the company or person under section 127.

[1115] We found Chan, Ip, Hung and Ho directly breached subsection 126.1(b) of the *Securities Act* as a result of their conduct in the standing timber fraud. As a result, we find it unnecessary to consider whether they should be deemed to have not complied with Ontario securities law by authorizing, permitting or acquiescing in Sino-Forest's breach of the *Securities Act*.

[1116] We did not, however, find that Yeung's conduct was contrary to Ontario securities law. Yeung submits he was never an officer or employee of Sino-Forest, but was an officer of Sino-Panel, a BVI subsidiary of Sino-Forest. He submits he was never responsible, and was not authorized, to make any decisions relating to the supervision, control and operation of Sino-Forest, nor was he authorized to sign cheques, enter into contracts, or determine the strategic direction of the company.

[1117] We agree that Yeung was not an officer of Sino-Forest. Unlike Chan, Ip, Hung and Ho, Yeung was not listed as an officer or executive in Sino-Forest's annual reports published during the Material Time. Yeung's role as Vice-President, Operations of Sino-Panel can be distinguished from the roles of the other individual Respondents who were all officers of Sino-Forest and who were directly responsible for ensuring its disclosure was accurate and complete.

**VII. ANALYSIS OF THE STANDING TIMBER MATERIALLY MISLEADING STATEMENTS ALLEGATIONS**

**A. Materially Misleading Statements**

[1118] Staff alleges Sino-Forest made statements in Sino-Forest's continuous disclosure documents, including its audited financial statements, MD&As and AIFs, prospectuses and other documents required to be filed or furnished under Ontario securities law during the Material Time that were, in a material respect and at the time and in the light of the circumstances under which they were made, misleading or untrue or did not state facts required to be stated or that were necessary to make the statements not misleading contrary to subsection 122(1)(b) of the *Securities Act* and the public interest.

[1119] Staff also alleges Chan participated in the conduct that made these statements materially misleading and the conduct of Chan was contrary to subsection 122(1)(b) of the *Securities Act*, and contrary to the public interest.

[1120] Staff's allegations relate to statements regarding (i) the ownership of assets and revenue recognition of Sino-Forest, (ii) the reported revenue of Sino-Forest from the Dacheng Transactions, the 450 Transactions, the Gengma #1 Transactions and the Gengma #2 Transactions, and (iii) internal control weaknesses within Sino-Forest, contained in the following Sino-Forest's continuous disclosure documents and prospectuses:

- a. 2006 to 2010 AIFs;
- b. 2006 to 2010 MD&As;
- c. 2006 to 2010 audited annual Financial Statements;
- d. June 5, 2007 Short Form Prospectus (and the continuous disclosure documents incorporated by reference); and
- e. December 10, 2009 Short Form Prospectus (and the continuous disclosure documents incorporated by reference).

(the Impugned Disclosure Documents)

[1121] Further, Staff alleges, pursuant to subsection 122(3) of the *Securities Act*, in their roles as officers of Sino-Forest, Chan, Ip, Hung and Ho authorized, permitted or acquiesced in Sino-Forest's making of certain of the materially misleading statements. Staff originally alleged that Ip, Hung and Ho also breached subsection 122(1)(b) directly, but indicated they were no longer alleging such breach of subsection 122(1)(b) on the part of Ip, Hung, and Ho when they refined their allegations in closing submissions.

**1. The Law**

[1122] Disclosure has been repeatedly identified by the Commission as the cornerstone of securities regulation. This was affirmed by the Divisional Court in *Cornish v Ontario (Securities Commission)*, 2013 ONSC 1310 (Div Ct) (**Cornish**), in which the Court states: "The importance of public disclosure in securities markets cannot be underestimated. Disclosure is fundamental to the fairness of Ontario's capital markets, and to the protective mandate of the Act." (at para 38).

[1123] The Commission has emphasized the importance of accurate and complete disclosure of information in public disclosure documents to provide all persons investing in securities equal access to information that may affect their investment decisions. The Court in *Cornish* refers to the following decision by the Commission (at para. 38):

... All persons investing in securities should have equal access to information that may affect their investment decisions. The Act's focus on public disclosure of material facts in order to achieve market integrity would be meaningless without a requirement that such disclosure be accurate and complete and accessible to investors.

(*Re Philip Services Corp* (2006), 29 OSCB 3941 at para 7)

[1124] The Commission has found disclosure serves to level the playing field amongst investors (*Re AiT Advanced Technologies Corp* (2008), 31 OSCB 712 at para 198), and allows investors to assess the risks involved in making an investment (*Re Rex Diamond Mining Corp* (2008), 31 OSCB 8337 at para 262).

[1125] Moreover, requiring accurate public disclosure enhances the accountability of corporate management to their corporation's shareholders and the investing public.

[1126] In order to achieve investor protection through disclosure, the onus must rest on the company to provide information to the investing public that will enable them to assess the risks involved in making an investment (*Re Rex Diamond Mining Corp* (2008), 31 OSCB 8337 at paras 262-263).

[1127] Subsection 122(1)(b) of the *Securities Act* provides a statutory requirement that disclosure not be misleading or untrue in any material respect. It states:

122. (1) Offences, general — Every person or company that,

...

(b) makes a statement in any application, release, report, preliminary prospectus, prospectus, return, financial statement, information circular, take-over bid circular, issuer bid circular or other document required to be filed or furnished under Ontario securities law that, in a material respect and at the time and in the light of the circumstances under which it is made, is misleading or untrue or does not state a fact that is required to be stated or that is necessary to make the statement not misleading;

...

is guilty of an offence ...

[1128] The term "in a material respect" is not defined in the *Securities Act*. However, in the past the Commission has applied the reasonable investor standard for analyses of materiality under subsection 122(1)(b) of the *Securities Act* (*Biovail, Re Factorcorp Inc* (2013), 36 OSCB 2059). The Commission articulated the reasonable investor standard in *Biovail* at para 74:

... we will treat a statement as material if there is substantial likelihood that a reasonable investor would consider the statement to be important in making an investment decision. By an investment



decision, we mean a decision to buy, sell or hold shares. That will require us to determine whether the statement or omission would have assumed actual significance to a reasonable investor. ...

- [1129] In determining to apply the reasonable investor standard, the Commission in *Biovail* cited *Re Donnini*, where the Commission stated the following in considering materiality in the context of the term “material fact”:

... materiality is a fact-specific relative concept that varies from issuer to issuer according to size of profits, assets and capitalization, the nature of its operations, and many other factors.

Counsel for staff referred us to the materiality standard used in the United States and quoted by the United States Supreme Court in *TSC Industries, Inc.* [citation deleted]:

An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote. ... It does not require proof of a substantial likelihood that disclosure of the omitted fact would have caused the reasonable investor to change his vote. What the standard does contemplate is a showing of a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder.

(*Re Donnini* (2002), 25 O.S.C.B. 6225 (*Donnini*) at paras 135 and 136)

The Commission in *Biovail* noted that the reasonable investor standard for materiality articulated in the U.S. case of *TSC Industries Inc.* has been applied by the Commission in a number of decisions (at para 69).

- [1130] We agree the reasonable investor standard is the appropriate standard to apply in our assessments of the materiality of statements in the Impugned Disclosure Documents. As has been stated in previous cases, we presume the legislature intended the words “in a material respect” to have their ordinary dictionary meaning, which would imply a lower threshold of materiality than for the terms “material fact” and “material change”, which are defined in the *Securities Act* (See *Biovail* at paras 70-72, which cites *R v Maxwell*, [1996] OJ No 4832 (Prov Ct) at paras 54, 63-64, 119-120 and *R v Felderhof* (2007), 24 CCC (3d) 97 (Ont CJ) at 215). In this case, we believe the reasonable investor standard applies.

- [1131] The Commission has also provided general guidance about making materiality assessments. In the frequently cited *Re YBM Magnex International Corp* (2003), 26 OSCB 5285 (*YBM Magnex*), the Commission stated:

Materiality is a question of mixed law and fact, *i.e.* do the facts satisfy the legal test? Some facts are material on their own. When one or more facts do not appear to be material on their own, materiality must also be considered in light of all the facts available to the persons responsible for the assessment.

(*YBM Magnex* at para 94)

- [1132] In *Biovail*, the Commission expanded upon its statement above in *YBM Magnex* and found:

... the assessment of the materiality of a statement is a question of mixed fact and law that requires a contextual determination that takes into account all of the circumstances including the size and nature of the issuer and its business, the nature of the statement and the specific circumstances in which the statement was made. ...

(*Biovail* at para 69)

- [1133] The Commission further stated in *Biovail* that the reasonable investor standard “is an objective test and applying it is ultimately a matter of judgment to be exercised in light of all of the relevant circumstances” (at para 80). The assessment of the materiality of a statement is a question of mixed fact and law that falls squarely within the Commission’s specialized expertise and does not require the opinion or evidence of expert witnesses or of investors (*Biovail* at para 80, citing *Donnini* at para 123). Such opinion or evidence may be relevant or useful but is not necessary (*Biovail* at para 80).

- [1134] As the Commission stated in *Biovail*, common sense judgement must be applied in making materiality determinations (at para 81). We agree with the statement in *YBM Magnex*, that “[a]ssessments of materiality are not to be judged against the standard of perfection or with the benefit of hindsight. It is not a science and involves the exercise of judgement and common sense” (at para 90).

- [1135] We analyze the conduct of Sino-Forest, Chan, Ip, Hung and Ho within this contextual framework.

**2. Materially misleading statements allegations are not duplicative of the fraud allegations**

[1136] Chan submits the materially misleading statements allegations are duplicative of the standing timber fraud allegations. Chan failed to provide the Panel with any case law supporting his position.

[1137] We reject this submission. We do not, in this case, see the allegations as duplicative. Subsections 126.1(b) and 122(1)(b) of the *Securities Act* impose different requirements on participants in the capital markets; the first prohibits perpetrations of fraud relating to securities, and the second requires that statements made in documents required to be filed or furnished under Ontario securities law be true and not misleading. Although a misleading disclosure record may be used as a means to cover up a fraud, the actions of the Respondents with respect to Sino-Forest's statements in the Impugned Disclosure Documents are distinguishable from their involvement in the standing timber fraud.

**3. Who made the statements in the Impugned Disclosure Documents?**

[1138] We first consider which party or parties made the statements at issue in the Impugned Disclosure Documents. Staff submits Sino-Forest and Chan made statements contrary to subsection 122(1)(b) of the *Securities Act*. Chan submits continuous disclosure is the responsibility of the issuer and any misleading statements in Sino-Forest's continuous disclosure were made by Sino-Forest and not by Chan.

[1139] In *Re Norshield Asset Management (Canada) Ltd* (2010), 33 OSCB 2139 (**Norshield**), allegations were made against a company that marketed the securities at issue to investors under subsection 122(1)(b) of the *Securities Act* in respect of statements made in an offering memorandum issued by an affiliate company. While the Commission held the offering memorandum was materially misleading, it found liability under subsection 122(1)(b) attaches to the person or company that made the statements, and in that case, the statements were made by another entity not named as a respondent. The panel stated:

Liability under s. 122(1)(b) attaches to persons or companies that make misleading or untrue statements or fail to state a fact that is required to be stated so as to not make a statement misleading. However, Staff's allegation was against Olympus United Group only. Statements in the offering memorandum were made by Olympus United Funds, and not by Olympus United Group.

Although Olympus United Group was involved in the marketing of securities for which it is alleged that the offering memorandum was misleading, s. 122(1)(b) does not apply to the allegation of misconduct by Olympus United Group in this situation.

...

As the issuer of the offering memorandum, Olympus United Funds would be the entity to which liability would attach under s. 122(1)(b). However, Olympus United Funds is not a Respondent in this matter.

Staff's allegation regarding the offering memorandum is levelled at Olympus United Group, but the offering memorandum is that of Olympus United Funds. In the circumstances, Staff's allegation against Olympus United Group is not made out.

(*Norshield* at paras 294 to 298).

[1140] We find the allegations against Chan in respect of a breach of subsection 122(1)(b) analogous to those against Olympus United Group in *Norshield*. The statements made in the Impugned Disclosure Documents subject to Staff's allegations were made by Sino-Forest, the reporting issuer. It is open to us to consider Staff's allegations regarding Chan's involvement in the making of any material misstatements by Sino-Forest pursuant to subsection 122(3) of the *Securities Act*, which provides that directors or officers of a company may be found to have breached Ontario securities law by authorizing, permitting or acquiescing in the making of any misleading statements by the company.

**4. Materially Misleading Statements Regarding Ownership of Assets and Revenue Recognition**

[1141] Staff alleges Sino-Forest and Chan made statements in the Impugned Disclosure Documents regarding the ownership of assets and revenue recognition in the BVI Model that were, in a material respect and at the time and in the light of the circumstances under which they were made, misleading or untrue or did not state a fact that was required to be stated or that was necessary to make the statements not misleading.

[1142] Staff further alleges Chan, Ip, Hung and Ho authorized, permitted or acquiesced in that course of conduct, in violation of Ontario securities law.

- [1143] Staff submits Sino-Forest used the purchase contracts to acquire and evidence ownership of standing timber in the BVI Model and it failed to disclose, in any of its disclosure documents, fundamental flaws in the purchase contracts, including:
- a. Sino-Forest created and executed the purchase contracts in the BVI Model in the quarters after the assets related to those transactions were recorded in Sino-Forest's financial statements, and backdated the purchase contracts;
  - b. the purchase contracts did not afford Sino-Forest sufficient proof of ownership of the majority of its standing timber assets in the BVI Model because key documents were not attached; and
  - c. the purchase contracts failed to identify the specific assets being acquired such that the standing timber could be identified and independently verified.
- [1144] Staff submits Sino-Forest failed to register its ownership of standing timber acquired in the BVI Model, did not become legal owner and, contrary to its disclosure, Sino-Forest did not apply for, or obtain, PRCs for its purchased plantations, including all the standing timber acquired in the BVI Model. These facts were not disclosed by Sino-Forest in any of its disclosure documents.
- [1145] Finally, Staff submits Sino-Forest's practice of creating and executing sales contracts in the quarters after the revenue related to those transactions was recorded in Sino-Forest's financial statements, and backdating them to the previous quarter, was contrary to the revenue recognition process set out in Sino-Forest's continuous disclosure, including its MD&A and notes to its audited financial statements.
- [1146] It is Staff's position the consequence of the above conduct is the assets and revenue recorded by Sino-Forest during the Material Time were misstated and this caused the Impugned Disclosure Documents to be materially misleading.

**(a) Analysis of Materially Misleading Statements Regarding Ownership of Assets**

- [1147] Sino-Forest's disclosure during the Material Time misrepresents the company's ownership claim to its standing timber assets, based on Forestry Bureau Confirmations. Forestry Bureau Confirmations were not official documents, were not issued pursuant to a legislative mandate or published policy and were not documents of title that could be relied upon in the event of a dispute in a court of law. Despite this, Sino-Forest's AIFs during the Material Time make virtually identical incorrect disclosure regarding proof of ownership of its BVI standing timber assets.
- [1148] Sino-Forest's 2010 AIF discloses that Sino-Forest is required to obtain permits and approvals for the operation of its plantation business, including "Plantation Rights Certificates in respect of the ownership of our purchased trees for our purchased plantations". Sino-Forest goes on to explain its ownership of its purchased plantations:

For our purchased plantations, **we have applied for the corresponding Plantation Rights Certificates** with the relevant local forestry bureaus. As the relevant locations where we purchased our purchased plantations have not fully implemented the new form of Plantation Rights Certificate, we are not able to obtain **all** the corresponding Plantation Rights Certificates for our purchased plantations. Instead, we obtained confirmation of our ownership of our purchased plantations from the relevant forestry bureaus. Based on the relevant purchase contracts and the approvals issued by the relevant forestry bureaus, **we legally own our purchased plantations**.

[emphasis added]

- [1149] There are three false statements in this disclosure regarding Sino-Forest's ownership of purchased plantations in the BVI Model. First, Sino-Forest did not apply for PRCs for its standing timber purchases in the BVI Model. It explicitly stated this. Second, the word "all" implies that Sino-Forest received some of the PRCs for the standing timber acquired in the BVI Model. This is false. Third, Sino-Forest did not legally own the standing timber in the BVI Model. Mr. Liu confirmed there is no ownership until registration of the standing timber is completed. Sino-Forest never registered its standing timber in the BVI Model. We find that this disclosure by Sino-Forest was misleading.
- [1150] In its discussion of the issuance of a new form of PRCs, Sino-Forest in its 2010 AIF states:

We have obtained the plantation rights certificates or **requisite approvals** for acquiring the relevant plantation rights for **most** of the purchased plantations and planted plantations currently under our management, and **we are in the process of applying for the plantation rights certificates** for those plantations for which we have not obtained such certificates.

[emphasis added]

[1151] Again, there are three false statements in the above quotation from the 2010 AIF. First, the requisite approvals refer to Forestry Bureau Confirmations; they are neither required documentation nor approvals which can be used as proof of Sino-Forest's purported ownership since they are for internal Sino-Forest use only and cannot be used externally. They are useless in confirming ownership. Second, Sino-Forest had not obtained PRCs for most of its plantations – it did not obtain any in the BVI Model. Third, Sino-Forest was not in the process of applying for PRCs for BVIs. We find this disclosure regarding PRCs in the BVI Model was misleading.

[1152] With respect to the disclosure regarding the risks associated with the new form of PRCs, Sino-Forest in its 2010 AIF states:

We can give no assurance when the official **Plantation Rights Certificates will be issued by the relevant local PRC governments to all the purchased plantations** and planted plantations acquired and under our management and cultivation. **Until official new form Plantation Rights Certificates are issued**, there can be no assurance that our rights to our tree plantations will not be subject to dispute or challenge. If such certificates are not issued, or are not issued in a timely manner, or if our rights to any of our tree plantation lands are subject to dispute or challenge, **our business, financial condition and results of operations could be materially adversely affected.**

[emphasis added]

[1153] Again, the statements with respect to the issuance of new form PRCs are false. There is no evidence any form of PRC would be issued for standing timber in the BVI Model. Moreover, while Sino-Forest did disclose risks to the business, we find it omitted facts necessary to make the statement not misleading. Sino-Forest never disclosed the vast majority of its assets were held in the BVI Model. Investors could not have known, based on Sino-Forest's disclosure record, that the risks to ownership of standing timber in the BVI Model applied to approximately 70% of Sino-Forest's total timber holdings by hectare for 2007 to 2010. On a value basis, the BVI timber holdings represented 92% of total holdings in 2007, 89% in 2008, 87% in 2009 and 79% in 2010.<sup>17</sup>

[1154] Chan submits statements in the Impugned Disclosure Documents about Sino-Forest's proof of ownership of its standing timber assets were not materially misleading or untrue at the time and in light of the circumstances under which they were made.

[1155] Chan submits Sino-Forest disclosed in its AIFs during the Material Time that ownership of its standing timber assets could be challenged due to the delays in implementing China's new system for PRCs. He points to Sino-Forest's 2006 AIF, which states, "[t]he local PRC [People's Republic of China] government at the county level or above has the power to issue certificates to confirm the use of rights of forests, wood and forest land and the users' ownership of wood. Any change in the ownership or use rights of forest, wood and forest land must be registered".

[1156] He submits investors were further cautioned in the 2006 AIF that new PRCs had not been issued in a timely matter. The risks were set out in the "Risk Factors" section (as quoted above in paragraph 0).

[1157] Similar disclosure, Chan submits, was included in Sino-Forest's AIFs from 2007 to 2010. Chan also submits each of Sino-Forest's MD&As from 2006 to 2010 disclosed the same risks as were disclosed in Sino-Forest's AIFs. Sino-Forest's June 5, 2007 Short Form Prospectus and December 10, 2009 Short Form Prospectus incorporated Sino-Forest's 2006 and 2008 AIFs by reference, respectively. In addition, Sino-Forest's short form prospectuses also reproduced the risk disclosures contained within the AIFs.

[1158] In addition, Chan relies on Mr. Hyde's testimony that Sino-Forest obtained PRCs where it was possible and Forestry Bureau Confirmations where it was not, and Sino-Forest disclosed it could not get PRCs and was continuing to apply for them as they became available. We reject the submission the above excerpts from the Impugned Disclosure Documents were sufficient to make those documents not misleading for the following reasons.

[1159] Chan and Ip knew Sino-Forest subsidiaries in the BVI Model could not get PRCs. Ip testified Sino-Forest never applied for PRCs in the BVI Model. Mr. Hyde's testimony, that he believed Sino-Forest was continuing to apply for PRCs, reveals he was not aware BVI companies could not get PRCs. Although Sino-Forest disclosed ownership of its standing timber assets could be challenged due to the delay in implementing the PRCs, it did not disclose during the Material Time that BVIs could not obtain PRCs at all. This omission made the disclosure misleading.

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<sup>17</sup> The 79% of timber holdings in 2010 includes Sino-Forest's Mandra holdings. Mandra is a company incorporated in Mainland China that was acquired by Sino-Forest in 2010. Without Mandra, BVI timber holdings represented 91% of Sino-Forest's total holdings in 2010 on a value basis.

[1160] Chan submits a reasonable investor, having read Sino-Forest's disclosure, in which Sino-Forest continuously and consistently disclosed it could not obtain PRCs for all of its plantations and without these PRCs, its plantation rights could be subject to challenge, would know Sino-Forest did not have PRCs for all of its plantations and its ownership could be subject to challenge.

[1161] Chan submits whether or not Sino-Forest applied for PRCs for its standing timber holdings and whether or not that fact was disclosed to the public is immaterial because Sino-Forest disclosed there was a material risk to its entire business until the new form PRCs were issued. Chan further submits Sino-Forest disclosed its entire operations were subject to the uncertainty of the Chinese legal system. When asked whether the phrase, "we can give no assurance when the official plantation rights certificates will be issued to all our purchased tree plantations", indicates Sino-Forest is waiting for PRCs to be issued to the BVI subsidiaries, counsel for Chan responded:

Well, if you want to get really technical, it's my understanding that there were also purchased tree plantations in the WFOEs. So I think what's really significant about this is, from an investor's perspective, is the investor given the impression that Sino-Forest has ownership in the way that you or I would register the ownership of our home in the province of Ontario, and it's our submission that there were several clues that that wasn't the case, the first being that they're operating in China ... .

...

[Y]ou need to read the disclosure as a whole, and it's my submission that no reasonable investor could be misled by this disclosure which clearly states that there could be a material adverse impact on their entire business, on their assets. There is no guarantee they could enforce them. I don't think any investor was taken down the garden path on the basis of the passages that I've read to you.

...

Just because they couldn't get the PRCs doesn't mean that they couldn't apply for the PRCs, and I'm not – I mean, we haven't – I don't know whose responsibility it would be to apply for the PRCs. I don't know if that witness was called, so – but I keep coming back to the same thing, which is, you know, this is a whole lot about nothing.

(Hearing Transcript, April 27, 2016 at 84:12-87:7)

We disagree with Chan's counsel that risk disclosure should rest on technicalities or on investors' impressions. Rather, investors should be provided with full, true and plain disclosure of material risks. They should not have to hunt for clues. Misleading statements regarding Sino-Forest applying for PRCs, which Chan knew Sino-Forest could not obtain, is not "a whole lot about nothing".

[1162] Chan relies on the testimony of Dr. Peerenboom that China is a civil law system and the courts therefore defer to administrative agencies if there is ambiguity in the law. In Chan's submission, the courts would therefore look to the Forestry Bureau Confirmations and confer with the Forestry Bureau if Sino-Forest's ownership of its standing timber were challenged in court. We note, however, the Confirmations were not to be used externally and therefore could not be relied upon in the event of a dispute in a court of law. Moreover, Forestry Bureaus may have exceeded their authority in issuing them and the Forestry Bureau Confirmations may contradict the position of the Chinese central government. As we have found elsewhere in these Reasons, Forestry Bureau Confirmations are of no use in establishing Sino-Forest's ownership in the event of any dispute with third parties over ownership of standing timber rights in the BVI Model.

[1163] Chan submits Sino-Forest had the best available proof of ownership and the sufficiency of which was confirmed by legal opinions provided by Jingtian, C&F, E&Y internal counsel and Jun He. The Panel rejects this submission for the same reasons detailed elsewhere in these Reasons. The legal opinion provided by Jun He to the Independent Committee does not support Chan's submissions as it differed significantly from those provided to Sino-Forest by other counsel and confirmed the problems associated with relying on Forestry Bureau Confirmations for ownership and other issues relating to Sino-Forest's evidence of ownership under the BVI Model.

[1164] In addition, Sino-Forest's internal counsel, Xu Ni, agreed with Staff in her examination during Staff's investigation of this matter that if attachments to purchase contracts were missing, there would be problems "to understand the ownership of title, if the timberland exists, and where those trees are". She also noted she raised these issues with Chan and the Operations Department.

- [1165] Furthermore, Forestry Bureau Confirmations were only one of three attachments which were to accompany each BVI purchase contract. Also noted as attachments were Villagers' Resolutions and Survey Reports. Both Ms. Man and Xu Ni were not aware of any Villagers' Resolution ever being attached to a BVI purchase contract. The Impugned Disclosure Documents made no disclosure whatsoever that key attachments were missing from every BVI purchase contract, further weakening Sino-Forest's purported claim of ownership of the Standing Timber. This is misleading by omission.
- [1166] Sino-Forest failed to register its ownership of standing timber in the BVI Model and therefore did not become the legal owner, contrary to its disclosure. We find this is critical information a reasonable investor would consider important in making an investment decision. The disclosure in the 2006 AIF under Risk Factors described above in paragraph 0 and similar disclosure in the 2007 to 2010 AIFs significantly understated this risk. For example, investors could not have known, based on Sino-Forest's disclosure record, that the risks to ownership of standing timber in the BVI Model applied to approximately 70% of Sino-Forest's total timber holdings by hectare and well over 75% on a value basis for 2007 to 2010. On a value basis, the BVI timber holdings represented 92% of total holdings in 2007, 89% in 2008, 87% in 2009 and 79% in 2010.
- [1167] As stated elsewhere in these Reasons, unlike in the WFOE Model where specific locations were identified, BVI purchase contracts and their supporting documents did not sufficiently identify the assets Sino-Forest purported to own such that they could be independently verified.
- [1168] The Respondents submit the backdating of purchase contracts was simply a more efficient way of getting paperwork done. As discussed elsewhere in these Reasons, whatever oral discussions may have occurred between Sino-Forest and a supplier, critical terms of many of the oral agreements we reviewed changed well after those discussions and would not reflect the economic and legal reality expressed in the written contracts, as the Respondents claim. It follows, then, the contracts prepared post-quarter-end with that original date would not be valid as at the purported date, or in the reported quarter.
- [1169] We find Sino-Forest failed to disclose in the Impugned Disclosure Documents the three fundamental flaws in the standing timber purchase contracts which relate to ownership of assets: backdating of contracts post-quarter-end, insufficient proof of ownership, and failure to identify the specific assets being acquired, such that the standing timber could be independently verified.

**(b) Analysis of Materially Misleading Statements Regarding Revenue Recognition**

- [1170] Throughout the Material Time, Sino-Forest's description of its revenue recognition policy set forth in the Impugned Disclosure Documents remained substantially the same.
- [1171] Chan submits Sino-Forest's disclosure of its revenue recognition policy in the Impugned Disclosure Documents was not misleading. He points to the amendment Sino-Forest made in its Consolidated Financial Statements from 2006 forward, to include a reference to when the sales contract was "entered into":
- Revenue from standing timber is recognized when the contract for sale is entered into which established a fixed or determinable sales price with the customer whereby ultimate collection of the revenue is reasonably assured.
- [1172] We disagree with Chan this is not misleading. Evidence presented to the Panel indicated details of sales contracts changed, such that supplier, volume and/or location of standing timber subject to the agreements changed after the quarter in which the transaction was recorded and related revenue was recognized. Furthermore, there was never any disclosure regarding the "daisy chain" of cash in the AR/AP Set-Off Process described by Mr. Clifford. Collection could therefore not be "reasonably assured".
- [1173] Chan, Ho, Hung, and Ip submit the evidence establishes that Sino-Forest entered into binding contracts orally at the "handshake date" and regardless of when the contracts were signed, Sino-Forest's recognition of assets and revenue fairly presented Sino-Forest's financial condition, financial position and cash flows.
- [1174] In the "Critical Accounting Estimates" section of the 2006 MD&A under the heading "Revenue Recognition", Sino-Forest referred to the recognition of revenue as follows:
- To date substantially all of the Company's standing timber revenue has been recognized when the Company and the buyer enter into a binding sales agreement.
- [1175] As noted elsewhere in these Reasons, the handshake date was not necessarily the date of a binding sales agreement since important details of the transaction often changed in the following quarters in the sales transactions we reviewed.

Further, the Respondents' own expert, Mr. Liu, testified a contract is effective after the companies have applied their seals; in other words, when they have signed the contracts, not at the date of the oral agreement.

- [1176] In the "Aging of Accounts Receivable" section of the 2006 MD&A under the heading "Plantation Fibre Operations", Sino-Forest referred to the recognition of revenue as follows: "We recognize revenue from the sales of standing timber when the buyer has **signed** the sales contract". [emphasis added]
- [1177] In its 2008 MD&A Sino-Forest added to this disclosure "after the significant risks and rewards of ownership have been transferred to the buyer".
- [1178] This is clearly a false statement since there is no signed contract in the quarter when revenue is recognized.
- [1179] Further, the Panel heard expert testimony that sales contracts contained conditions (for example, assisting the buyer to obtain harvesting permits) which, if not fulfilled, would have the effect of rescinding the contract, the effect of which would be the parties would return to their original positions, as if the contract between them never existed. Sino-Forest could not assist in obtaining harvesting permits as this required attendance at the Forestry Bureau with proof of ownership. The Forestry Bureau Confirmation was not proof of ownership; the assistance of the holder of the PRC is required to obtain a harvesting permit.
- [1180] Chan submits Staff's argument that Sino-Forest should only have recognized revenue after a signed contract privileges form over substance and will in effect lead to other companies in Sino-Forest's situation being forced to present incorrect financial information to their shareholders. The Panel rejects this submission. In reaching our decision, the Panel considered the form and substance of the disclosure. The disclosure did not reflect the economic or legal reality of the agreements. Our finding is specific to these circumstances.
- [1181] We also note that, if, as the Respondents submit, handshake dates and oral agreements were key to recognizing a transaction, the failure to disclose their existence would be the basis for the Panel to find the disclosure to be misleading through omission.
- [1182] We therefore reject the Respondents' argument that Sino-Forest's disclosure of its revenue recognition policy in the Impugned Disclosure Documents was not misleading. We find Sino-Forest's practice of creating and executing sales contracts in the quarters after the revenue related to those transactions was recognized was contrary to the revenue recognition process set out in Sino-Forest's continuous disclosure documents.

**(c) Did Sino-Forest Make Materially Misleading Statements relating to Ownership of Assets and Revenue Recognition?**

- [1183] In finding a reasonable investor would have considered the statements relating to the ownership of assets and revenue recognition contained in the Impugned Disclosure Documents to be important when making an investment decision whether to buy, sell or hold shares of Sino-Forest, we consider the previous statements of the Commission in *YBM Magnex* excerpted above. Some facts may not appear to be material on their own. However, materiality must be considered in light of all the facts available to the person responsible for the assessment (*YBM Magnex*, at para 94).
- [1184] The BVI Model accounted for approximately 70% of Sino-Forest's revenue between 2007 and 2010. On a value basis, the BVI timber holdings represented 92% of Sino-Forest's total holdings in 2007, 89% in 2008, 87% in 2009 and 79% in 2010. These salient facts were not disclosed. As a result, the misleading disclosure regarding the ownership of assets and revenue recognition related to the majority of the company's business and was material. A reasonable investor would consider this information important in making a decision to buy, sell or hold Sino-Forest securities.
- [1185] As discussed above, we find Sino-Forest made various statements regarding Sino-Forest's ownership of assets and revenue recognition in the Impugned Disclosure Documents, which on their own were, in a material respect and at the time and in the light of the circumstances under which they were made, misleading, untrue or did not state facts that were necessary to make the statements not misleading. These misleading statements alone would be sufficient for a finding Sino-Forest made materially misleading statements contrary to subsection 122(1)(b) of the *Securities Act*.

**(d) Did Chan, Ip, Hung or Ho Authorize, Permit or Acquiesce in the Making of Sino-Forest's Misleading Statements relating to Ownership of Assets and Revenue Recognition?**

- [1186] Subsection 122(3) of the *Securities Act* states every director or officer of a company who authorizes, permits or acquiesces in the company's breach of subsection 122(1) can also be found liable under Ontario securities law.
- [1187] Chan, Ip, Ho and Hung submit they did not authorize, permit or acquiesce in Sino-Forest's making of misleading statements under subsection 122(1)(b) of the *Securities Act*. Ip, Ho and Hung rely on Justice Wilton-Siegel's analysis of

the meaning of the word acquiesce in *JLL Patheon Holdings v Patheon Inc.*, 2009 CarswellOnt 7315 (**Patheon**), in which he states:

... that even the ordinary meaning of ‘acquiescence’ upon which JLL relies carries with it the correlative that the party has at least some element of control over the act in question in the sense of being able to oppose successfully the occurrence of the legal consequence that flows from ‘acquiescence.’

(at para 49)

Although that case considered the word in the context of the *Canada Business Corporations Act*, the Respondents submit it is applicable to the *Securities Act*. As we discuss below, we find Chan, Ip and Hung had control over processes within Sino-Forest and are liable for their misconduct in respect of materially misleading statements made by Sino-Forest relating to ownership of assets and revenue recognition.

[1188] Ip, Ho and Hung further rely on the *R v A & A Foods Ltd.*, [1997] BCJ No 2720 (**A & A Foods**), in which the British Columbia Supreme Court analysed similar language within the *Canada Agricultural Product Act*, and stated:

The terms used in the section, *i.e.* any officer, director or agent of the corporation ‘who directed, authorized, assented to or acquiesced or participated in the commission of the offence is a party ... are far reaching. The clear purpose of these provisions is to bring pressure to bear on those persons who are the directing or operating mind of the company, or its delegated agent. They control the activities of the company, and have the power and authority to see that reasonable steps, usually the placement of an effective system to prevent the commission of the offense, are taken.

(at para 20)

[1189] As we have explained elsewhere in these Reasons, Chan, Ip and Hung controlled the activities of the company addressed in Sino-Forest’s disclosure of ownership of assets and revenue recognition. Chan was CEO, closely involved in day-to-day operations and the ultimate compensating control. Ip controlled the purchase of Standing Timber. Hung controlled the purchase and sale documentation and settlements process.

[1190] Ip, Ho and Hung submit it is not reasonable for the Panel to conclude any of them permitted or authorized the CFO or the Directors to make the statements at issue. Further, as *A & A Foods* and *Patheon* state, the concept of acquiescing entails a power to stop the conduct at issue. They submit it is not reasonable for the Panel to find they had the power to stop their superiors from making the disclosure they did.

[1191] Ip, Ho and Hung imply in their submissions the Board of Directors knew the Impugned Disclosure Documents were misleading but still approved the financial statements and corresponding disclosure. We reject this submission. As discussed elsewhere in these Reasons, the Directors (other than Chan) did not know the scope of the Deceitful Documentation Process. It was in Ip’s and Hung’s power to disclose this; they did not. Passive consent without protest is all that is required (*Coventree* at para 767). The Panel finds the actions of Ip and Hung go far beyond that threshold. We reject the submissions of Ip and Hung they did not have enough power or authority to authorize, permit or acquiesce.

[1192] Chan submits some form of knowledge or intention is required to find a person authorized, permitted or acquiesced in a breach of subsection 122(1)(b). He relies on *Re Momentas Corp* (2006), 29 OSCB 7408 (at para 1180) (**Momentas**) where the Commission held “[a]cquiesce’ means to agree or consent quietly without protest. ‘Permit’ means to allow, consent, tolerate, give permission, particularly in writing. ‘Authorize’ means to give official approval or permission, to give power or authority or to give justification”. These definitions have been applied in other cases as well (*R v Armaugh Corp*, [1993] OJ No 4360 at para 20 and *Coventree* at para 766).

[1193] Finally, Chan submits he certified the Impugned Disclosure Documents but he did not authorize, permit or acquiesce in the making of materially misleading statements.

[1194] While the Commission recognized in *Momentas* some form of knowledge or intention is required under subsection 122(3) of the Act, it also stated the threshold for liability is low:

Although these terms have been interpreted to include some form of knowledge or intention, the threshold for liability under section 122 and 129.2 is a low one, as merely acquiescing [in] the conduct or activity in question will satisfy the requirement of liability.

(*Momentas* at para 1180)



- [1195] We found in our analysis of the Deceitful Documentation Process that Chan, Ip and Hung controlled the BVI Model, designed the actual documentation process and were aware this process was deceitful. The process descriptions, on which the auditors relied, failed to accurately describe the actual processes for purchases, sale and set-off payments for standing timber in the BVI Model. Chan and Ip did not disclose Sino-Forest's BVI subsidiaries could not obtain PRCs and thus could have no ownership claim to the BVI standing timber assets because those rights had not been registered. Chan and Ip knew the Villagers' Resolutions were never attached to purchase contracts. They knew the standing timber could not be independently identified using purchase contracts and their supporting documentation. Chan signed all sales contracts and therefore knew contracts were signed in the quarter after Sino-Forest recognized the revenue from them.
- [1196] We find Chan, as CEO, authorized and permitted the making of materially misleading statements by Sino-Forest relating to ownership of assets and revenue recognition in the Impugned Disclosure Documents.
- [1197] Ip and Hung, by virtue of their control of the BVI Model, their design of the actual documentation process and their awareness this process was deceitful, knew the financial statement disclosure was misleading. Ip was in charge of all purchases of standing timber in the BVI Model and, as a senior officer of Sino-Forest, could have changed the process. Hung was a senior officer of Sino-Forest and on the Disclosure Committee and had influence over how information was disclosed. Both signed sub-certifications, verifying this misleading disclosure was correct, and did nothing to change the disclosure. We find Ip and Hung permitted and acquiesced in the making of materially misleading statements by Sino-Forest relating to ownership of assets and revenue recognition in the Impugned Disclosure Documents.
- [1198] As we find elsewhere in these Reasons, Ho did not have a significant role in the process underlying Sino-Forest's disclosure relating to ownership of assets and revenue recognition. We decline to find he authorized, permitted or acquiesced in the making of misleading statements in this respect.

##### **5. Effect of the Four Frauds on the Reported Revenue of Sino-Forest**

- [1199] Staff submits the overstatement of revenue arising from the four examples of fraud made Sino-Forest's disclosure misleading in a material respect.
- [1200] We have found the Dacheng Transactions resulted in Sino-Forest fraudulently overstating its revenue in Q3 of 2009; the 450 Transactions resulted in Sino-Forest fraudulently overstating its revenue in Q4 of 2009; the Gengma #1 Transactions resulted in Sino-Forest fraudulently overstating its revenue in Q1 and Q2 of 2010; and the Gengma #2 Transactions resulted in Sino-Forest fraudulently overstating its revenue in Q1, Q2 and Q3 of 2008 and Q4 of 2009. We collectively refer to the examples of fraud in the Dacheng Transactions, the 450 Transactions, Gengma #1 Transactions and Gengma #2 Transactions as the **Four Frauds**.
- [1201] Staff alleges these revenue overstatements resulted in disclosure by Sino-Forest which was misleading in a material respect in the Impugned Disclosure Documents in 2008, 2009 and 2010. Staff further submits Chan and Ip authorized, permitted and acquiesced in Sino-Forest's material misstatements regarding the revenue from the Four Frauds, and that Ho authorized, permitted and acquiesced in Sino-Forest's material misstatements regarding the revenue from the Dacheng Transactions, the 450 Transactions and the Gengma #2 Transactions.

###### **(a) The Misleading Statements**

- [1202] In our analysis of the Dacheng Transactions, we found the purported sale of the duplicate assets through the BVI Model was fictitious and resulted in the overstatement of Sino-Forest's revenue in 2009 by approximately US \$48 million. Sino-Forest reported its revenue for Q3 of 2009 in its annual MD&A for 2009 (dated March 16, 2010) and its 2009 Annual Report, in a summary of the "2009 Quarterly Highlights". This resulted in Sino-Forest fraudulently overstating its quarterly reported revenue by approximately 13%.
- [1203] With respect to the 450 Transactions, we found the sales contracts between Sino-Forest and its three customers, Xinqi, Haosen, and Meishan were fraudulent and had no economic substance and, as a result, Sino-Forest overstated its revenue by approximately US \$30 million in Q4 2009. Sino-Forest reported its revenue for Q4 of 2009 in its annual MD&A for 2009 (dated March 16, 2010) and its 2009 Annual Report, in a summary of the "2009 Quarterly Highlights". This resulted in Sino-Forest fraudulently overstating its quarterly reported revenue by approximately 6.4%.
- [1204] In our analysis of the Gengma #1 Transactions, we found the Gengma #1 Plantation was never sold and therefore the fictitious sale of standing timber by Sino-Panel (Yunnan) inflated the revenue of Sino-Forest in 2010 by US \$231.3 million. Sino-Forest reported its revenue for Q1 and Q2 of 2010 in its annual MD&A for 2010 (dated March 15, 2011) and its 2010 Annual Report, in a summary of the "2010 Quarterly Highlights". The Gengma #1 Transactions resulted in Sino-Forest fraudulently overstating its quarterly reported revenue by approximately 29.3% in Q1 2010 and approximately 51.6% in Q2 2010.

[1205] In our analysis of the Gengma #2 Transactions, we found the recorded sales of the Gengma #2 Plantation were fictitious and Sino-Forest misstated revenue from the purported sale of standing timber between March 2008 and November 2009 for a total of approximately US \$49.1 million in its financial statements. Sino-Forest reported its revenue for Q1, Q2 and Q3 of 2008 in its annual MD&A for 2008 (dated March 16, 2009) and its 2008 Annual Report, in the summary of “2008 Quarterly Highlights”. As stated above, Sino-Forest reported its revenue for Q4 of 2009 at page 20 of its annual MD&A for 2009 (dated March 16, 2010) and its 2009 Annual Report, in the summary of the “2009 Quarterly Highlights”. The Gengma #2 Transactions resulted in Sino-Forest fraudulently overstating its quarterly reported revenue by approximately 4.2% in Q1 2008, approximately 2.6% in Q2 2008, approximately 2% in Q3 2008 and approximately 6.9% in Q4 2009.

**(b) Did Sino-Forest Make Materially Misleading Statements with respect to the Four Frauds?**

[1206] We find a reasonable investor would have considered the overstatements in revenue arising from the Four Frauds, described above, made in the Impugned Disclosure Documents to be important when making an investment decision whether to buy, sell or hold securities of Sino-Forest.

[1207] These overstatements would also have cast doubt over the accuracy and integrity of all Sino-Forest financial statements, given the pervasiveness of the overstatements, which occurred over three years: 2008, 2009 and 2010. This undermining of trust in the accuracy and integrity of Sino-Forest’s financial statements would have a damaging effect on the market value of its securities, as trust is ultimately the foundation upon which our financial markets rest.

[1208] We find Sino-Forest’s misleading disclosure about the Four Frauds would undoubtedly be important to a reasonable investor in making a decision to buy, sell or hold Sino-Forest securities.

[1209] As a result we find Sino-Forest made statements in respect of revenue attributed to the Four Frauds that were in a material respect and at the time and in the light of the circumstances under which they were made, misleading and untrue.

**(c) Did Chan, Ip or Ho Authorize, Permit or Acquiesce in Sino-Forest’s Making of Materially Misleading Statements with respect to the Four Frauds?**

[1210] Staff alleges Chan authorized, permitted or acquiesced in Sino-Forest’s making of misleading statements regarding revenue reported in connection with all Four Frauds. We have previously found Chan’s involvement in the Gengma #1 and Gengma #2 Transactions was clear. Chan had ultimate oversight over the fraud relating to the 450 Transactions. As a result, we find Chan authorized and permitted Sino-Forest’s making of materially misleading statements about revenue attributed to three of the Four Frauds. We find no diminishment in the materiality of the misleading statements regarding revenue from these three fraud examples. Significant overstatements in revenue resulting from three examples of fraud over an extended period would nonetheless undermine trust in the accuracy and integrity of Sino-Forest’s financial statements and have a damaging effect on the market value of its securities. A reasonable investor would find the revenue misstatements resulting from the 450 Transactions, the Gengma #1 Transactions and the Gengma #2 Transactions important in making an investment decision.

[1211] Staff also alleges Ip authorized, permitted or acquiesced in Sino-Forest’s making of materially misleading statements regarding the Four Frauds. We find elsewhere in these Reasons Ip was directly and deeply involved in the Dacheng fraud from the beginning (sometime in 2008). Further, we have found Ip had intimate knowledge of the Gengma #1 Transactions and, similarly, was intimately aware of all the details of the Gengma #2 Transactions. Regarding the 450 Transactions, we found Ip was one of the key decision-makers in the extensive planning for the fraudulent transactions. As a result, we find Ip permitted and acquiesced in Sino-Forest’s making of materially misleading statements regarding revenue attributed to the Four Frauds.

[1212] Staff alleges Ho authorized, permitted or acquiesced in Sino-Forest’s making of misleading statements in relation to revenue attributed to each of the Dacheng Transactions, the 450 Transactions and the Gengma #2 Transactions. We found Ho was directly involved in the 450 Transactions. In our analysis of the Gengma #2 Transactions, we found he was aware of the circular flow of funds to settle the outstanding receivables. In our analysis of the Dacheng Transactions, we found that Ho participated in orchestrating the fraud. As a result, we find Ho permitted and acquiesced in Sino-Forest’s making of misleading statements regarding revenue for these three frauds. Although Ho was involved in three of the Four Frauds, we find no diminishment in the materiality of the misleading statements regarding this revenue. Overstatements in revenue resulting from three examples of fraud over an extended period (four quarters over two years) would nonetheless undermine trust in the accuracy and integrity of Sino-Forest’s financial statements and have a damaging effect on the market value of its securities. A reasonable investor would find the revenue misstatements resulting from these three frauds important in making an investment decision.

[1213] In its closing submissions, Staff submits Yeung authorized, permitted or acquiesced in Sino-Forest's misleading statements in relation to the 450 Transactions. Counsel for Yeung responded to these allegations and made submissions. However, given that Staff did not make this allegation against Yeung in the Statement of Allegations or at any time before the closing submissions, we decline to make a finding on this issue.

**6. Materially Misleading Statements Regarding Internal Controls**

[1214] Staff alleges Sino-Forest made statements in the Impugned Disclosure Documents relating to the material weaknesses in its internal controls which were, in a material respect and at the time and in the light of the circumstances under which they were made, misleading or untrue or did not state a fact that was required to be stated or that was necessary to make the statements not misleading.

[1215] The specific Impugned Disclosure Documents Staff submits contained misleading, untrue or incomplete disclosure relating to the material weaknesses in its internal controls are Sino-Forest's AIFs and annual MD&As for 2006, 2007, 2008, 2009 and 2010. This disclosure was also contained in Sino-Forest's short form prospectuses filed in 2007 and 2009 (which incorporated by reference the relevant AIFs and MD&As as required by Ontario securities law).

[1216] Staff further alleges Chan and Hung authorized, permitted or acquiesced in that course of conduct.

[1217] Staff submits while Sino-Forest disclosed that the concentration of authority in senior management and lack of segregation of duties created risks in terms of measurement and completeness of transactions, as well as the possibility of non-compliance with existing controls, this disclosure was wholly inadequate and failed to reveal the extent of the weakness in Sino-Forest's internal controls.

[1218] Staff submits Sino-Forest, in particular, failed to disclose the specifics of Hung's role in the process for documenting and recording purchases, sales and settlements in the BVI Model and that as a result, there is a substantial likelihood reasonable investors would consider these undisclosed risks relevant in their decisions to buy, sell or hold Sino-Forest securities.

**(a) The Misleading Statements**

[1219] Chan submits Sino-Forest did not make materially misleading statements about the extent of the concentration of authority as a material weakness in its internal controls.

[1220] Chan submits the disclosure made by Sino-Forest in its MD&As, AIFs and short form prospectuses relating to material weaknesses in its internal controls informed investors there were risks regarding the company's measurement of its own transactions. We reject this submission. We have found elsewhere in these Reasons that the concentration of duties in Hung, hence the material weakness of the lack of segregation of duties and the associated risks, was not adequately disclosed in these disclosure documents.

[1221] Chan further submits a reasonable investor would understand from Sino-Forest's disclosure that Sino-Forest faced risks in measuring its transactions accurately and risks that employees were failing to comply with Sino-Forest's controls. The Panel rejects this submission as well. First, the risks involved were not in measuring transactions accurately. The risks related to Hung being the central figure in purchases, sales and settlements. With respect to Chan's submission Sino-Forest disclosed the risks employees were failing to comply with controls, we have already established Hung did not comply with Sino-Forest's controls as defined by the process descriptions. Chan was fully aware and supportive of this failure to comply. It was not merely risk; it was fact.

[1222] Hung submits it is unrealistic to expect he be the one to correct the control deficiency arising from the concentration of duties he had. He submits he was carrying out the duties asked of him by his superiors and it was not for him to unilaterally advise his superiors and the Board he would no longer be carrying out his job functions. Hung submits this was a decision to be made by his superiors and the Board.

**(b) Did Sino-Forest Make Materially Misleading Statements with respect to its disclosure relating to internal controls?**

[1223] We find a reasonable investor would have found Sino-Forest's failure to properly disclose the material weaknesses in its internal controls in its MD&As, AIFs and short form prospectuses as specified in paragraph [1215] to be important when making an investment decision regarding whether to buy, sell or hold shares of Sino-Forest.

[1224] The disclosure relating to Sino-Forest's material weaknesses in its internal controls disclosure was misleading because the recording of the purchase and sale of standing timber contracts and the settlement of accounts in the BVI Model

rested on the shoulders of a single member of senior management: Hung. Sino-Forest's disclosure was wholly inadequate and failed to reveal the extent of the weaknesses in Sino-Forest's internal controls.

[1225] Once again, the determination of whether a statement is material must take into consideration all the relevant facts. The BVI Model accounted for approximately 70% of Sino-Forest's revenue between 2007 and 2010. This was not disclosed by Sino-Forest, which effectively concealed the significance of the lack of segregation of duties weakness from Investors. Sino-Forest's misleading statements regarding the weaknesses in its internal controls, taken together with the scope of the BVI Model, would have been important to a reasonable investor making an investment decision regarding whether to buy, sell or hold shares of Sino-Forest.

[1226] As a result, we find Sino-Forest made statements regarding its internal control weaknesses that were in a material respect and at the time and in the light of the circumstances under which they were made, misleading and did not state a fact necessary to make the statement not misleading. These statements alone would be sufficient for a finding that Sino-Forest's disclosure was materially misleading and contrary to subsection 122(1)(b) of the *Securities Act*.

**(c) Did Chan or Hung Authorize, Permit or Acquiesce in Making Sino-Forest's Materially Misleading Statements relating to its disclosure in relation to internal controls?**

[1227] We found in our analysis of Sino-Forest's disclosure of material weaknesses in its internal controls, that Chan was aware of, but did not disclose the extent of, the concentration of duties in Hung. Chan could easily have remediated the weakness and reduced or eliminated the risk, but chose not to do so. As CEO, Chan knew Sino-Forest's disclosure was wholly inadequate. We find Chan authorized and permitted the making of the materially misleading statements by Sino-Forest of the material weakness in its internal controls in its MD&As, AIFs and short form prospectuses.

[1228] Hung was a member of the Disclosure Committee, which was formed to assist senior officers in fulfilling their responsibility for oversight of the completeness, accuracy and timeliness of the disclosures made by Sino-Forest. Given Hung's education and experience, he knew and understood the significance of internal control weaknesses. While we find Hung cannot be held responsible for Chan's failure to remediate the internal control weakness, he acquiesced in this failure. Similarly, by virtue of his position on the Disclosure Committee, as a senior officer of Sino-Forest and his extensive education, we find Hung acquiesced in the making of materially misleading statements by Sino-Forest of the material weakness in its internal controls in its MD&As, AIFs and short form prospectuses.

**B. Is a Due Diligence Defence available to the Respondents?**

**1. The Law**

[1229] The Respondents submit the due diligence defence at subsection 122(2) of the *Securities Act* may be available. The provision states:

**Defence** – Without limiting the availability of other defences, no person or company is guilty of an offence under clause (1)(a) or (b) if the person or company did not know and in the exercise of reasonable diligence could not have known that the statement was misleading or untrue or that it omitted to state a fact that was required to be stated or that was necessary to make the statement not misleading in the light of circumstances in which it was made.

[1230] The parties agree the defence of due diligence at common law is available when an individual proves that he or she took all reasonable care or all reasonable steps to avoid the commission of the alleged offence:

[o]ffences in which there is no necessity for the prosecution to prove the existence of mens rea; the doing of the prohibited act prima facie imports the offence, leaving it open to the accused to avoid liability by proving that he took all reasonable care. This involves consideration of what a reasonable man would have done in the circumstances. The defence will be available if the accused reasonably believed in a mistaken set of facts which, if true, would render the act or omission innocent, or if he took all reasonable steps to avoid the particular event. These offences may properly be called offences of strict liability.

(*R v Sault Ste Marie (City)*, [1978] 2 SCR 1299 at p 14)

[1231] In *R v Felderhof*, 2007 ONCJ 345 at para 183, in considering subsection 122(2) in a criminal proceeding, the Ontario Court of Justice held a Director or Officer is not liable for making materially misleading statements where they establish that they were not negligent or that they were duly diligent or took reasonable care that the disclosure they authorized, permitted or acquiesced in was not misleading or untrue.

[1232] The onus is on the Respondents to establish a defence of due diligence.

**(a) Mistake of Fact and Due Diligence Simpliciter**

[1233] The Supreme Court of Canada held in *Sault Ste Marie (City)* there are two facets to the defence of due diligence: mistake of fact and what is referred to as due diligence simpliciter.

[1234] Criminal decisions have held any mistake of fact regarding a misstatement must be reasonable in all of the circumstances and must not have involved a deliberate failure to make sufficient inquiries (*R v Sisto Finance NV* [1994] OJ No 1184 at para 21; *R v Sansregret*, [1985] 1 SCR 570 at 587-588).

[1235] Chan, Ip, Ho and Hung submit as part of their efforts to be duly diligent, they relied on legal advice given to Sino-Forest in respect of its business and documentation practices.

[1236] In *Re Mega-C Power Corp* (2010), 33 OSCB 8290, the Commission laid out the test for relying on legal advice. In order to be successful, the Respondents must prove:

- a. The lawyer had sufficient knowledge of the facts on which to base the advice;
- b. The lawyer was qualified to give the advice;
- c. The advice was credible given the circumstances under which it was given; and
- d. Sino-Forest made sufficient enquiries and relied on the advice.

(at para 261)

[1237] Reliance on legal advice by officers and directors must be done in good faith, since “[r]eliance would be unreasonable if the directors [or officer] was aware of facts or circumstances of such character that a prudent person would not rely on the professional advice” (*YBM Magnex*, at para 254). We find Chan, Ip and Hung did not disclose, in good faith, the facts and circumstances of the Deceitful Documentation Process – specifically with respect to proof of ownership of assets and the availability of PRCs, which they were able to do, to those legal advisors on whose advice they now purport to rely. As such, we find such claims of reliance are not open to those Respondents.

**(b) The Standard of Care Required**

[1238] The Commission has previously held it will “consider the reasonableness of the respondents’ diligence and their belief from the perspective of a prudent person in the circumstances. This necessarily entails both objective and subjective considerations including their degree of participation, access to information and skill” (*YBM Magnex*, at para 179). This standard takes into account both the general standard of care applicable to the business activity in question and the special circumstances applicable to a particular situation.

[1239] The duty of care required of corporate officers and directors under corporate law is that they exercise their duties “with the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances” (*Canada Business Corporations Act*, RSC 1985, c C-44, s 122(b)). The Commission has held, in order to meet the objective requirement of the reasonably prudent person test, officers and directors may have to go beyond the requirements of corporate law, as the Commission must determine whether conduct was in the public interest (*Re Standard Trustco Ltd* (1992), 15 OSCB 4322, at 32).

[1240] Regarding the subjective component of the reasonably prudent person test, the Commission has held that more is expected of officers and directors with superior qualifications and more may be expected of inside directors than outside directors (*YBM Magnex*, at paras 183-184).

**2. Analysis of the Defense of Due Diligence as it Relates to the Respondents**

[1241] Chan submits Staff incorrectly suggests management is solely responsible for an issuer’s disclosure and that rather, the Board of Directors, the Audit Committee, the Disclosure Committee and management are all responsible. He relies on *Re Flag Resources (1985) Ltd*, 2010 ABASC 143 (*Flag Resources*), a decision of the Alberta Securities Commission, for the proposition that “responsibility for financial statements rests with the reporting issuer, its management, its audit committee and its board of directors” (at para 117).

[1242] The Panel agrees the Board of Directors, the Audit Committee, the Disclosure Committee and management are all jointly responsible for an issuer’s disclosure, but also agrees with the statement in *Flag Resources* that “**management**

is responsible for the **accurate recording** of transactions and for the preparation of its issuer's financial statements" (at para 117) [emphasis added].

- [1243] Expectations are higher in relation to inside directors, such as Chan, than outside directors. The latter necessarily rely on the former, and management, to ensure the disclosure they review is accurate and not misleading, as "boards of directors are the stewards of a company ... the CEO and CFO of a reporting issuer in turn play pivotal roles in coordinating, compiling and vetting material corporate disclosure to the same end" (*Re Ironside*, 2006 ABASC 1930 at para 963).
- [1244] We agree with Staff's submission that when the CEO of a corporation also sits on its board, and personally certified the public disclosure in issue, the due diligence defence will be even more difficult to establish.
- [1245] The evidence shows Sino-Forest was a firm dominated by senior management, at the head of which was Chan. He was the ultimate compensating control. He was engaged in approving all purchase and sales transactions. We find he was more than the hands-off strategic visionary as he submits.
- [1246] Chan submits Sino-Forest financial statements reflected the economic reality: Sino-Forest and its counterparties treated contracts as effective from the date of the handshake agreement. This practice raised no red flags from his point of view because the disclosure was a fair representation of reality. As we have found elsewhere in these Reasons, whatever oral discussions may have occurred between Sino-Forest and a supplier, they frequently would not reflect the economic and legal reality expressed in the corresponding written contracts, contrary to Chan's claim.
- [1247] Chan submits any red flags raised by the disclosure in the Impugned Disclosure Documents would have only been evident to the technical accounting experts, namely, Messrs. Horsley, Hyde, Maradin and Martin and other members of Sino-Forest's Board and Audit Committee. Sino-Forest's process descriptions were the foundational documents on which E&Y relied for understanding the internal controls process underlying information reported in Sino-Forest's financial statements. As we have found elsewhere in these Reasons, the process descriptions were false, which Chan, Ip and Hung knew. Messrs. Hyde and Martin, the Audit Committee and the Board did not review source documents for the financial statements. They did not have the specific knowledge from source documents to recognize any red flags raised by the disclosure. They did not have access to the information necessary to know the disclosure regarding ownership of assets and revenue recognition was misleading.
- [1248] In *Biovail*, the Commission held "more is expected of officers and directors with superior qualifications, such as experienced business people" (at para 386). Ip, Ho and Hung submit the Panel must consider the particular officer's degree of participation, access to information and skill level, when considering if due diligence has been exercised. Chan submits neither he, Ip, Ho or Hung had the education, skill or experience in Canadian public disclosure superior to that possessed by the Canadian members of management or Sino-Forest's Board or Audit Committee.
- [1249] We reject this submission. Each of Chan, Ip and Hung did not require the education or skill that the Board or Audit Committee possessed. They simply had to tell the truth: that the actual process for buying, selling and settling standing timber transactions in the BVI Model differed significantly from the process described in the process descriptions. We find these Respondents deliberately hid the material information concerning ownership of assets and revenue recognition from the Board and the Audit Committee. As such, we reject their submission they relied on the Board, the Audit Committee and Mr. Maradin because of their superior knowledge of Ontario public disclosure requirements.
- [1250] Ip, Ho and Hung submit the environment in which Sino-Forest operated forms the factual circumstances surrounding the actions of the Respondents and must be given due consideration (*Peoples Department Store Inc. (Trustee of) v. Wise*, 2004 SCC 68, para 63). The Panel is cognizant of cultural and geographic issues, but Ontario securities laws apply to reporting issuers in Ontario, which included Sino-Forest.
- [1251] Ip, Ho and Hung submit they did not have the skill or power to do more than they did: that Ip did not understand the particular details in the disclosure; that at a certain time, Ho was mainly involved in business operations unrelated to these allegations; and that Hung had no real power to make decisions within Sino-Forest.
- [1252] Ip testified over 49 hearing days, resulting in 4,930 pages of transcript evidence. Over that time it became clear to the Panel Ip understood far more about his responsibilities than he was willing to admit, and further, where he did not understand, it was a result of his deliberate choice not to make sufficient inquiries. Ip was a Senior Vice-President and reported to Chan. It was his responsibility as a senior officer of Sino-Forest to understand the obligations it had under Ontario securities law within his purview of responsibility, his efforts to shift the blame to others notwithstanding.
- [1253] As discussed elsewhere in these Reasons, regardless of any additional obligations Ho may have had in Russia at the time, he was actively involved in the commission of three of the Four Frauds which led to materially misleading revenue

disclosure. He was also on the Disclosure Committee and signed sub-certifications quarterly attesting to the accuracy of the Sino-Panel Group's financial results.

[1254] The Panel rejects Hung's submission he had no real power to make decisions within Sino-Forest. When Mr. Maradin was cross-examined by Hung's counsel, he was asked the following question:

Q. That was your personal experience in dealing with Mr. Hung, that he had no authority without permission to do things and specific instructions to do things from his superiors within Sino-Forest?

A. I couldn't – I wouldn't conclude on that.

(Hearing Transcript, October 31, 2014 at 141: 17-23)

[1255] Counsel followed up on this answer by showing Mr. Maradin an e-mail string:

Q. And the gist of the e-mail string is even though you are asking Mr. Hung to transfer money from one Sino-Forest bank account to another Sino-Forest bank account, he doesn't believe he has the ability to do that without the permission of Mr. Horsley and Mr. Chan; is that fair?

A. That's a fair comment.

(Hearing Transcript, October 31, 2014 at 144: 5-11)

[1256] We find Mr. Maradin's answer stands for the much more limited purpose of demonstrating Hung had no power to transfer funds, not that Hung had no real power to make decisions within Sino-Forest. One example of Hung's decision-making power was his direction of all settlements in the BVI Model.

[1257] Furthermore, Hung was on the Disclosure Committee, which reviewed the financial statements and MD&A on "a page by page basis", as described by Mr. Maradin. It was completely within his power to raise issues with respect to the undisclosed internal control weakness at that committee. He chose not to do so.

[1258] Chan, Ip, Ho and Hung submit they relied on the comprehensive disclosure process, which included the Board of Directors, the Audit Committee, auditors and other advisors of Sino-Forest, as part of their due diligence efforts regarding Sino-Forest's public disclosure.

[1259] Each of Chan, Ip and Hung had the ability to stop the Deceitful Documentation Process, which they knew to be deceitful and dishonest. They knew this process was the foundation of, and the input for, the information in Sino-Forest financial statements. Ip was in charge of purchasing Standing Timber in the BVI Model. He could have changed the process; he was a senior officer of Sino-Forest. Ho and Hung were on the Disclosure Committee and had influence on how information was disclosed. Ip, Ho and Hung signed sub-certifications regarding elements of this information.

[1260] Chan submits he is entitled to rely on sub-certifications without making any further inquiries in the absence of any red flags. He submits, in such circumstances, he was able to properly certify the covered reports, which contained the financial statements, the AIF, the press release and MD&A, were not false or misleading without going behind the sub-certifications. We reject this submission. Chan was involved in the fraud that made the statements misleading and therefore cannot in good faith rely on the sub-certifications.

[1261] As found elsewhere in these Reasons, Chan controlled the concentration of authority internal control weakness. He could have remediated it. He did not.

[1262] Messrs. Hyde and Clifford testified management was the primary source of information for the auditors in terms of the business and process of Sino-Forest and E&Y relied on the false process descriptions.

[1263] The management representation letters, which Chan signed annually, were of the utmost importance to the auditors in preparing their opinion. A Sino-Forest management representation letter to E&Y dated March 15, 2011, makes the following statements:

- a. "We acknowledge that, as members of management of the Company, we are responsible for the fair presentation of the consolidated financial statements.
- b. "The Company has proper titles and rights on all timber holdings as recorded on the consolidated balance sheet."

- c. “Transactions with related parties ... have been properly recorded and/or disclosed in the consolidated financial statements.”
- d. “ ... settlements of trade receivables by customers ... were made by way of making direct payments ... to the plantation owners.”

- [1264] Fred Clifford described the high importance he ascribed to the management representation letter, stating “so this [management representation] letter is really foundational to the audit process ... without it ... I’m not releasing the opinion”.
- [1265] Representation (a) at paragraph [1263] acknowledges management is responsible for the fair presentation of financial statements; Ip and Hung were responsible for the source transactions which initiated the accounting process, which ultimately resulted in the Impugned Disclosure Documents. Chan approved or signed source documents such as purchase and sales contracts. Representations (b) through (d), which Chan certified as true, are false, as discussed elsewhere in these Reasons.
- [1266] The Respondents submit that Horsley, Mr. Maradin and the Board knew Sino-Forest entered into oral contracts and prepared the written contracts after quarter-end. As we have found elsewhere in these Reasons, members of the Audit Committee and Sino-Forest’s Board were aware that contracts were being signed once a quarter, but they did not know the extent of the Deceitful Documentation Process. It was only after the Muddy Waters Report that the Board learned contracts were signed in the quarter following the quarter when revenue was recognized.
- [1267] Chan submits Mr. Maradin was responsible for the internal controls project and that Mr. Maradin testified he wrote the disclosure about the material deficiencies. Chan submits from Mr. Maradin’s previous experience, he knew how to properly disclose material deficiencies. While this is true, Chan was nevertheless responsible for ensuring disclosure was accurate and complete. He knew it was not.
- [1268] Chan submits Mr. Horsley was responsible for overseeing the preparation of the disclosure relating to internal controls, and that Mr. Horsley testified he understood Hung’s role in the settlement process. As discussed elsewhere in these reasons, Hung’s role involved more than just the settlement process and that the disclosure relating to the segregation of duties was wholly inadequate and failed to reveal the extent of the weakness in Sino-Forest’s internal controls.
- [1269] Mr. Horsley testified he believed Hung’s role was administrative and Hung was “in the middle pushing the paper” (Hearing Transcript, November 25 at 116:17-18). When asked why this internal control weakness was never remediated, Horsley said:

Well, I think it was not deemed to be that important. The conversion of the lack of segregation of duties to concentration of control was really the underlying issue or the underlying weakness. The fact that Alfred Hung pushed paper between Albert Ip and his supplier and Albert Zhao and his customer to me is not – was not significant, and still isn’t.

(Hearing Transcript, November 25 at 117:19-118:1)

- [1270] We find Horsley’s apparent lack of understanding of the significance of this internal control weakness incredible; Hung’s role was key and pivotal in the success of the Deceitful Documentation Process until June 2, 2011.
- [1271] Chan submits the Board and Audit Committee also knew that Hung was the key player in the segregation of duties issue. He submits that various directors, including Messrs. Hyde, Martin and Ardell, testified they were aware of the segregation of duties issue. Chan relies on Mr. Hyde’s testimony that the Audit Committee discussed the segregation of duties issue with the auditors each year, and the auditors were able to produce an audit opinion recognizing internal control weaknesses. Chan further submits the Audit Committee recognized Chan’s role as the ultimate compensating control as a mitigating factor in relation to this issue. Chan misled Mr. Martin and Mr. Ardell: Chan told them Hung’s role could not be split because Hung had important relationships with suppliers and AIs that could be jeopardized if changed. However, Chan’s statement is false; Hung played no role with suppliers or AIs.
- [1272] We find the Respondents are unable to rely on the Board of Directors, the Audit Committee, auditors and other advisors of Sino-Forest, as part of their due diligence efforts regarding Sino-Forest’s public disclosure.
- [1273] The Panel rejects the submissions of Chan, Ip, Ho and Hung that they exercised reasonable due diligence. This is not a case similar to YBM Magnex cited to the Panel above, in which there was good faith reliance on “experienced counsel and financial advisors.” Each of Chan, Ip, Ho, and Hung knew statements in the Impugned Disclosure Documents were misleading or untrue; they did not act in good faith. They each played active roles in the fraud that related to those misleading or untrue statements.



### C. Conclusions on the Allegations of Misleading Statements

[1274] During the Material Time, Sino-Forest consistently misled the public in the disclosure required by Ontario securities law. We found above Sino-Forest's statements in the Impugned Disclosure Documents with respect to each of the following three areas were, on their own, misleading or untrue in a material respect:

- statements regarding Sino-Forest's ownership of assets and revenue recognition;
- effects of the Four Frauds on the reported revenue of Sino-Forest; and
- statements regarding Sino-Forest's internal controls.

[1275] Sino-Forest made statements in its short form prospectuses, financial statements, MD&A and AIFs issued during the Material Time that were, in a material respect and at the time and in the light of the circumstances under which they were made, misleading or untrue or did not state facts that were necessary to make the statement not misleading, contrary to subsection 122(1)(b) of the *Securities Act* and contrary to the public interest.

[1276] Pursuant to subsection 122(3) of the *Securities Act*, as officers of Sino-Forest, Chan, Ip, Ho and Hung, authorized, permitted and acquiesced in Sino-Forest's making of materially misleading statements in the Impugned Disclosure Documents as follows:

- Chan authorized and permitted the making of materially misleading statements in respect of (a) Sino-Forest's ownership of assets and revenue recognition, (b) effects of the Four Frauds on reported revenue of Sino-Forest, which in the case of Chan's involvement involved the three frauds relating to the 450 Transactions, the Gengma #1 Transactions and the Gengma #2 Transactions, and (c) Sino-Forest's internal control weaknesses.
- Ip permitted and acquiesced in the making of materially misleading statements in respect of (a) Sino-Forest's ownership of assets and revenue recognition and (b) effects of the Four Frauds on reported revenue of Sino-Forest.
- Hung permitted the making of materially misleading statements regarding Sino-Forest's ownership of assets and revenue recognition, and acquiesced in the making of materially misleading statements regarding Sino-Forest's internal control weaknesses.
- Ho permitted and acquiesced in the making of materially misleading statements in respect of the effect of the Four Frauds on reported revenue of Sino-Forest, which in the case of Ho's involvement, involved the three frauds relating to the Dacheng Transactions, the 450 Transactions and Gengma #2 Transactions.

## VIII. ANALYSIS OF THE GREENHEART ALLEGATIONS

### A. Review of the Greenheart Allegations

[1277] In 2010, following a complex series of transactions (the **Greenheart Transactions**) carried out over a three-year period, Sino-Forest completed the purchase of a controlling interest in Greenheart Resources Holdings Limited (**Greenheart Resources**), a company incorporated in the British Virgin Islands on October 8, 2004, and subsequently renamed Greenheart Group Limited.

[1278] Staff alleges Chan committed fraud, contrary to subsection 126.1(b) of the *Securities Act* and contrary to the public interest, because he knowingly concealed his interest in the Greenheart Transactions and the substantial benefit he received, which placed the pecuniary interests of investors at risk. Staff alleges Chan was the true beneficial owner of two companies that received over US \$22 million in cash and securities of Sino-Forest as a result of the Greenheart Transactions – Fortune Universe Limited (**Fortune Universe**) and Montsford Limited (**Montsford**). Fortune Universe and Montsford were large shareholders of Greenheart Resources, holding a combined 30% interest in Greenheart Resources in July 2007.

[1279] Staff further alleges Chan and Sino-Forest, through Chan, made materially misleading statements in Sino-Forest's AIFs for 2008, 2009 and 2010, as well as in Sino-Forest's two short-form prospectuses filed with the Commission in 2009 by not disclosing Chan's interest in the Greenheart Transactions, contrary to subsection 122(1)(b) of the *Securities Act* and contrary to the public interest.

- [1280] Staff further alleges Chan, as Chairman of the Board and CEO of Sino-Forest, authorized, permitted or acquiesced in Sino-Forest's commission of fraud and therefore is deemed under section 129.2 of the *Securities Act* to have not complied with Ontario securities law, contrary to the public interest.
- [1281] Staff further alleges Chan, as Chairman of the Board and CEO of Sino-Forest, authorized, permitted or acquiesced in Sino-Forest's making of materially misleading statements pursuant to subsection 122(3) of the *Securities Act*, contrary to Ontario securities law and the public interest.
- [1282] The Panel must determine whether Chan was the beneficial owner of the two companies, Fortune Universe and Montsford. If he was, the Panel has to determine if Chan's non-disclosure of his interest in the Greenheart Transactions put the pecuniary interests of Sino-Forest Investors at risk, and amounted to fraud. If we find Chan was the beneficial owner of Fortune Universe and Montsford, the Panel then must decide whether the failure to disclose his interest in Greenheart Resources and the Greenheart Transactions resulted in Chan and Sino-Forest making materially misleading statements in some of Sino-Forest's public disclosure documents.

## B. The Greenheart Transactions

- [1283] Greenheart Resources held forest concessions in the Republic of Suriname. We heard evidence its main business activity was buying and holding forestland in that country, with the intention of harvesting and transporting some of the logs back to China for sale, as well as building sawmills to process logs into lumber for export sale.
- [1284] By June 2010, Sino-Capital Global Inc. (**Sino-Capital Global**), a subsidiary of Sino-Forest, had acquired 39.61% of the outstanding shares in Greenheart Resources. Also by this time, Sino-Forest had acquired control of Omnicorp Limited (**Omnicorp**), which had been a widely held company listed on the Hong Kong Stock Exchange and which owned the remaining 60.39% of Greenheart Resources. As a result, Sino-Forest held a direct and indirect interest of 72% in Greenheart Resources.
- [1285] As the parties did not put any of the underlying transactions in relation to the Greenheart Transactions in issue, we do not propose to give a detailed history of them here. However, given their multi-faceted and complex nature, we think it is necessary to include a high-level summary of the Greenheart Transactions.
- [1286] Sino-Forest initially provided cash to Greenheart Resources in July 2007, under the terms of a Master Sale and Purchase Agreement dated July 20, 2007 between Sino-Forest, Greenheart Resources and a subsidiary of Greenheart Resources. This agreement provided not only for the purchase by Sino-Forest of 34,285 m<sup>3</sup> of Suriname logs from July 20, 2007 to January 31, 2009 and the payment of a deposit of US \$3,000,000 in respect of the logs to be purchased by Sino-Forest, but also an option to acquire a 13.05% interest in Greenheart Resources. Sino-Capital Global exercised this option on July 20, 2007 for a cash consideration of US \$6,000,000. Judson Martin, a former Sino-Forest director, who became CEO of Greenheart in August 2010, testified he was not aware of any delivery of any Suriname logs under this agreement.
- [1287] Prior to the payments of US \$9,000,000 by Sino-Forest and Sino-Capital Global to Greenheart Resources in July 2007, Greenheart Resources had been in dire financial circumstances in the first half of 2007, as discussed in paragraphs [1325] to [1335], inclusive, below.
- [1288] At a meeting of Sino-Forest's Board of Directors on August 12, 2007, Chan personally disclosed the investments of Sino-Forest in Greenheart Resources to the Board of Directors of Sino-Forest. One month prior to that, Yosanda Chiang sent David Horsley an email titled, "Greenheart – Suriname project", in which she advised David Horsley that Chan would be calling him to explain the slides attached to the email. David Horsley testified Chan told him Greenheart Resources was "an opportunity for the company". At the meeting on August 12, 2007, Chan presented the board with the results of the due diligence conducted by Sino-Forest regarding the exercise of the option under the July 20, 2007 agreement and the resulting US \$6 million equity investment by Sino-Capital Global in Greenheart Resources.
- [1289] On August 20, 2007, Omnicorp, through its subsidiary Silver Mount Group Limited, acquired a 60% interest in Greenheart Resources from Sino-Capital Global and 20 other Greenheart vendors, including Fortune Universe and Montsford (the **First Transaction**); another subsidiary of Omnicorp, Track Star Group Limited, owned 0.39% of Greenheart Resources. As part of the First Transaction, Omnicorp also acquired an option to purchase the remaining 39.61% of Greenheart Resources from Sino-Capital Global and the other 20 Greenheart Vendors. Consideration totalling HK \$375,000,000 was paid to Sino-Capital Global and the other 20 Greenheart vendors in the form of cash, shares of Omnicorp, and convertible bonds of Omnicorp. The First Transaction closed on November 7 and 8, 2007.
- [1290] Judson Martin testified Chan and his management team developed the strategy for the acquisition of a controlling interest in Greenheart Resources by Sino-Forest. David Horsley testified the strategy called for Sino-Forest to increase

its position in Omnicorp. David Horsley and Tommy Lui, a business associate of Chan who was involved with Greenheart Resources since at least 2005, negotiated the terms of a transaction between December 19 and 22, 2008.

- [1291] The **Second Transaction** occurred on February 6, 2009, when Sino-Forest purchased the Omnicorp shares and convertible bonds the other 20 Greenheart vendors, including Fortune Universe and Montsford, had received pursuant to the First Transaction. Sino-Forest paid total cash consideration to the other 20 Greenheart vendors, including Fortune Universe and Montsford, of HK \$65,966,955 for 55,000,000 Omnicorp shares and issued 2,659,900 shares of Sino-Forest at CA \$10.00 per share in consideration for HK \$167,631,300 principal amount of convertible bonds of Omnicorp. Pursuant to the Second Transaction, Sino-Forest paid cash of HK \$2,093,149.40 to Fortune Universe and HK \$8,154,817.30 to Montsford and issued 7,541 shares of Sino-Forest to Fortune Universe and 873,244 shares of Sino-Forest to Montsford.
- [1292] On May 7, 2010, the option to acquire the remaining 39.61% of Greenheart Resources, which had been acquired by Omnicorp as part of the First Transaction, expired. On May 9, 2010 and June 1, 2010, Sino-Capital Global, which held a 5.19% interest in Greenheart Resources, acquired an additional 34.42% interest in Greenheart Resources from the other 20 Greenheart vendors, including Fortune Universe and Montsford (the **Third Transaction**). The total consideration payable in the Third Transaction to the other 20 Greenheart vendors, including Fortune Universe and Montsford, was HK \$258,156,278, which was satisfied by the issue of 1,990,566 shares of Sino-Forest at CA \$17.49 per share. As a result, Sino-Capital Global owned 39.61% of Greenheart Resources, representing the remaining interest in Greenheart Resources other than the 60.39% interest owned by Omnicorp. Pursuant to the Third Transaction, Sino-Forest issued 136,478 shares of Sino-Forest to Fortune Universe and 531,836 shares of Sino-Forest to Montsford.
- [1293] On June 22, 2010, Sino-Forest and Sino-Capital Global together acquired a 53.66% interest in Omnicorp. As a result, Sino-Forest held directly and indirectly a 72% interest in Greenheart Resources.
- [1294] Subsequently, in early 2011, Fortune Universe and Montsford sold in the market all of the Sino-Forest shares, which they had received pursuant to the Second and Third Transactions.
- [1295] Staff submits, together, Fortune Universe and Montsford ultimately realized approximately CA \$40 million from the sale of their interests in Greenheart Resources. In the Statement of Allegations, Staff alleges Fortune Universe and Montsford received over US \$22.1 million as a result of the Greenheart Transactions, US \$18.4 million of which was in Sino-Forest securities that were subsequently sold for approximately US \$35 million. We are concerned with the total consideration paid by Sino-Forest to Fortune Universe and Montsford in the Greenheart Transactions, rather than any subsequent profit on sales of Sino-Forest securities. This total consideration was approximately US \$22.1 million.

### C. Analysis of the Greenheart Fraud Allegations

#### 1. Was Chan the Beneficial Owner of Fortune Universe and Montsford?

- [1296] Staff submits Chan installed one nominee as the sole director and shareholder of each of Fortune Universe and Montsford and committed a dishonest act by not disclosing in respect of the Greenheart Transactions, that he was ultimately the beneficial owner of both companies, which sold securities to Sino-Forest. Chan submits the two companies were owned independently. As we explain below, the Panel finds the individuals who were registered as the sole shareholder and director of each of Fortune Universe and Montsford, Lei Guangyu and John Zeng, respectively, were nominees of Chan. We further find Chan beneficially owned and controlled the two companies during the Material Time.
- [1297] In our analysis of this section, we first consider evidence of the establishment and organization of Fortune Universe and Montsford. We then consider evidence of Chan's involvement with Greenheart Resources prior to Sino-Forest's investment. Next, we consider the differing treatment of Fortune Universe and Spirit Land, a company co-owned by Lei Guangyu that also invested in Greenheart Resources. We then examine the flow of cash proceeds pursuant to the First and Second Transactions. Finally, we review evidence of Fortune Universe and Montsford's holding and sale of Sino-Forest shares.

##### (a) *The establishment and organization of Fortune Universe and Montsford*

- [1298] Staff submits the evidence shows Chan's intimate involvement in the establishment and organization of Fortune Universe and Montsford and Chan's assistant Yosanda Chiang's continued involvement with the two companies should be interpreted as strong evidence of Chan's interest in them. As discussed below, we agree.
- [1299] Fortune Universe and Montsford were shelf companies incorporated in the British Virgin Islands in 2004 and subsequently organized in 2005, purportedly by Lei Guangyu and John Zeng, respectively. Among other business

interests, Lei Guangyu was the principal of Shenzhen Hongji Enterprises (Holdings) Ltd. (**Hongji**), through which he conducted an import and export business. A part of Hongji's business included the buying of logs from Sino-Forest. Lei Guangyu was a friend of Chan and was connected to one of Sino-Forest's AIs, Shanghai Jinwang Wood Co., Ltd. Lei Guangyu, through Hongji, was also an early investor in Greenheart Resources. The Panel was shown an investment agreement between Greenheart Resources (named Super View International Holdings Limited at the time) and Hongji, dated December 28, 2004. As discussed further below, Lei Guangyu would later also control shares of Greenheart Resources through another company, Spirit Land Limited. He would eventually become a director and the Chairman of Greenheart Resources, resigning from those positions shortly before Sino-Forest's first investment in the company.

- [1300] Lei Guangyu was called by Chan as a witness in this proceeding and testified via video-conference from Shenzhen, China. His testimony-in-chief occupied three and one-third hearing days, after which, he was cross-examined for less than 30 minutes by counsel for Ip, Hung, Ho and Yeung. Cross-examination by Staff began on April 17 for less than two hours, and continued on April 20, 2015, for the full day. Lei Guangyu was unable to complete his testimony due to business meetings and a family matter. He was excused with his proposed return to be indicated to the Panel at the beginning of May, 2015. After several forbearances by the Panel, when he did not return by September 1, 2015, we directed that he inform the Panel of three days ending not later than December 4, 2015 when he would return to complete his testimony. Lei Guangyu did not return within the specified timeframe despite repeated requests and multiple additional forbearances of the Panel. As a result, Staff was not able to test all of Lei Guangyu's testimony in-chief by way of cross-examination, particularly with respect to how Fortune Universe acquired its shares in Greenheart Resources and for whose benefit.
- [1301] John Zeng was a partner of the Kai Tong Law Firm. He worked out of the Kai Tong office in Guangzhou, China and represented Chan in the past, as well as at the interview of Chan by Staff during its investigation in September 2011. John Zeng also acted for Sino-Forest and is connected to the Company Caretaker List (described elsewhere in these Reasons). John Zeng did not testify at the hearing.
- [1302] Yosanda Chiang, Chan's long-time assistant, testified she assisted Lei Guangyu and John Zeng at the instruction of Chan. However, Chan submits the establishment of Fortune Universe and Montsford was not for the benefit of himself or Sino-Forest. Nevertheless, it was Yosanda Chiang who completed all of the work relating to the establishment and organization of the two companies in the names of Lei Guangyu and John Zeng.
- [1303] Lei Guangyu testified it was common for his secretary, Jiang Nanyan (also known as Nancy), to work with Yosanda Chiang and secretaries of other companies, and that she might do so without telling him. Lei Guangyu testified Jiang Nanyan asked Yosanda Chiang to help Mr. Lei set up Fortune Universe, and Ms. Chiang did so. The Panel does not find this explanation credible. The evidence, as discussed below, demonstrates Yosanda Chiang's help went beyond the initial setting up of the company and is not consistent with Yosanda Chiang's explanation that Chan simply requested she help Lei Guangyu set up the company. We find the evidence is more consistent with Chan having beneficial ownership and control of Fortune Universe.
- [1304] In support of their submission that John Zeng was not the beneficial owner of Montsford, Staff submits another person, Tommy Lui, was actually Chan's first choice as a nominee owner. On September 21, 2005, Yosanda Chiang sent an email to Tommy Lui stating:

As instructed by Allen, here below is the co. name:

Montsford Ltd.

- [1305] On the same day, Yosanda Chiang sent a "SMS via email" to Chan stating:

Fortune Universe to Lei Guangyu

Montsford Ltd. to Tommy ...

Chan submits Yosanda Chiang was informing him of the name of Lei Guangyu's company and that she had provided the name of Montsford to Tommy Lui of Greenheart Resources. She testified she had sent the email of September 21, 2005, to Tommy Lui at Chan's instruction. She did not know why he asked her to do so.

- [1306] This evidence demonstrates Chan had a high level of interest in Fortune Universe and Montsford dating back to 2005.
- [1307] On September 29, 2006, Yosanda Chiang received an email from Daphne Tse, CFO of Greenheart Resources, requesting various records and information relating to Fortune Universe; this email was not copied to Lei Guangyu or Jiang Nanyan. This request prompted an exchange of documents relating to the organization of Fortune Universe and

Montsford and communications between Yosanda Chiang and the individuals described below. These documents and communications support our finding that Chan was the beneficial owner of Fortune Universe and Montsford.

- [1308] Later on September 29, 2006, Gilbert Chau of Panocean Secretarial Services Limited,<sup>18</sup> sent Yosanda Chiang a number of documents by email relating to Fortune Universe, including First Written Resolutions, Acceptance of Appointment, and an Application for Shares. These documents relate to the appointment of the sole director and shareholder of Fortune Universe. A single name, "CHAN", is indicated throughout and under signature lines; however the documents are unexecuted. When asked about this during her testimony, Yosanda Chiang explained that she thought Gilbert Chau knew her boss's last name and took the initiative based on previous work to fill in his name, albeit incorrectly. She also stated that, in the alternative, he may have merely been indicating where a last name might go in the documents by including reference to a common Chinese last name. Based on the overall evidence with respect to the establishment and operation of Fortune Universe, the Panel rejects both explanations.
- [1309] Yosanda Chiang also testified, even though Lei Guangyu and John Zeng had purchased the companies in 2005, she had them execute First Written Resolutions, Acceptance of Appointment, and an Application for Shares for each of their respective companies in early October 2006. She further testified, as a result of British Virgin Islands' law, the documents were able to be executed either at the date of incorporation or at the date of sale. As a result, the organizational documents are dated January 2, 2004, which was the incorporation date for each company, even though Lei Guangyu and John Zeng purportedly purchased them in 2005 and signed the documents in October 2006.
- [1310] The evidence shows a close connection between Fortune Universe and Montsford. For example, Lei Guangyu's name appears as the shareholder on a draft version of organizational documents of Montsford, even though John Zeng is ultimately recorded as the owner of that company.
- [1311] Yosanda Chiang testified, on October 10, 2006, Chan told her Lei Guangyu and John Zeng wanted to sell the companies to him and instructed her to draft the required change of shareholder and director documents. Conversely, Lei Guangyu testified he was certain his discussion with Chan regarding the sale of Fortune Universe took place after June 2007.
- [1312] Yosanda Chiang prepared draft documents for both companies to change the director and shareholder from Lei Guangyu to Chan, in respect of Fortune Universe, and from John Zeng to Chan, in respect of Montsford, on or about October 11, 2006. She then sent the draft documents in respect of Fortune Universe to May Tsui, a lawyer in a Hong Kong law firm, for review. On October 12, 2006, Yosanda Chiang received an email from May Tsui, attaching revised documents providing for the change of director and change of shareholder to Chan in respect of Fortune Universe. Yosanda Chiang testified she would have made similar revisions to the comparable documents relating to Montsford, after reviewing those done for Fortune Universe by May Tsui. Consistent with the documents being in draft format, they are unsigned. In the draft documents of Fortune Universe, May Tsui crossed out the words "is beneficially wholly owned by Mr. LEI, Guangyu". Given the evidence, the Panel finds it is more likely than not that May Tsui crossed out that description because Lei Guangyu was not the beneficial owner.
- [1313] In undated draft notes to John Zeng, Yosanda Chiang wrote, "[t]he attached document is for signature in advance, with the content stating that you resign as director and appoint Allen as [Montsford's] director and also transfer the shares to Allen." She continued, "a date will not be filled in for the meantime; the date will be filled in when it is necessary". There is no evidence these notes were sent to Mr. Zeng.
- [1314] Yosanda Chiang testified Chan followed up with her several months later concerning whether she had prepared the documents, and that he told her he would inform her if he needed them. She testified the change of directors and shareholders never took place for either company. We accept no public filings with the government were made in respect of such changes.
- [1315] Yosanda Chiang testified the documents relating to Fortune Universe and Montsford, including documents relating to the change of directors and shareholders of Fortune Universe and Montsford, were contained in a deposit box located in Chan's office. This was corroborated by a deposit box list, which was authored by Yosanda Chiang and recorded the items kept in the deposit box. She testified the documents for the change of shareholders and directors relating to Fortune Universe and Montsford referred to in the deposit box list were unsigned. She further testified Chan never knew the documents relating to Fortune Universe and Montsford were in the deposit box and that she had possession of the only key to the deposit box. We do not accept Yosanda Chiang's testimony on this issue. Although executed versions of these documents were not in evidence, we find it more likely than not the executed documents were in the deposit box in Chan's office, as discussed in the following paragraphs.

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<sup>18</sup> Yosanda Chiang used Panocean to facilitate the organization and establishment of BVI-domiciled shelf companies.

- [1316] Other items on the deposit box list included items of high monetary value or personal importance to Chan. These included:
- an insurance policy for himself and his daughters;
  - a copy of a cheque from Chan to George Ho for a HK \$2,000,000 loan;
  - a loan agreement with a former classmate of Chan for a HK \$1,500,000 loan;
  - a certificate of honorary fellowship awarded to Chan by Hong Kong Baptist University;
  - documents relating to various properties; and
  - a key to a bank deposit box in the name of Chan's daughter that contained HK \$1,000,000.
- [1317] Also recorded in the deposit box list were Sino-Forest share certificates in the name of Fortune Universe (7,541 shares) and Montsford (873,244 shares) (recorded on a single entry in the list). This is the precise number of Sino-Forest shares that Fortune Universe and Montsford received in the Second Transaction. We find Chan had possession of the Sino-Forest share certificates owned by Fortune Universe and Montsford and control of those shares.
- [1318] The Panel rejects Yosanda Chiang's testimony regarding Chan's lack of knowledge of the contents of the deposit box. The Sino-Forest share certificates in the names of Fortune Universe and Montsford were worth millions of dollars. The other items recorded on the deposit box list were also of high monetary or personal value to Chan. The deposit box was in Chan's office. We find he knew what was in it.
- [1319] With respect to the documents related to the change of shareholder and director of each of Fortune Universe and Montsford, we reject Yosanda Chiang's testimony it was for convenience's sake that she also kept draft documents relating to two other persons' companies in the same deposit box as Chan's valuable or important items. We reject her explanation that she kept draft versions of the documents in the deposit box. We find the change of director and change of shareholder documents referred to in the deposit box list, authored by Yosanda Chiang, were more likely than not the final and signed versions of the drafts which were the subject of May Tsui's email of October 12, 2006, which documented the transfer of ownership of Fortune Universe and Montsford to Chan.
- [1320] We heard evidence Yosanda Chiang kept the company "chops" or seals of Fortune Universe and Montsford. This means the companies could not conduct official transactions without Yosanda Chiang's knowledge and assistance. Furthermore, Yosanda Chiang testified Greenheart Resources sent documents for Fortune Universe and Montsford to her, which she says she kept safe for Lei Guangyu and John Zeng. The evidence supports Staff's submission Chan had beneficial ownership and control of the two companies.
- [1321] Finally, the evidence shows Yosanda Chiang was directly involved in the dissolution of Fortune Universe and Montsford. After corresponding with Gilbert Chau of Panocean regarding the settlement of an invoice relating to Montsford in January of 2011, she emailed him again on March 22, 2011, attaching receipts for the settlement of invoices relating to other companies. In the body of the email, she advises Gilbert Chau that Fortune Universe and Montsford would be "stuck off [sic]". We find Yosanda Chiang's close involvement in the business of both Fortune Universe and Montsford, as demonstrated here by her involvement in their settlement of invoices and dissolution supports Staff's submission she acted on the direction of Chan who was the beneficial owner of these two companies.
- [1322] The Panel rejects Yosanda Chiang's evidence that Chan had no involvement in Fortune Universe or Montsford other than instructing her to assist Lei Guangyu and John Zeng in their set-up. Instead, we find the evidence, viewed in its totality, shows Chan was closely involved in the establishment and organization of these two companies and that his involvement continued throughout the Material Time. Furthermore, we find this level of involvement, when viewed in conjunction with all the evidence, supports our finding below that Chan was the beneficial owner of Fortune Universe and Montsford.

**(b) Chan's involvement in Greenheart Resources**

- [1323] The evidence shows Chan had a financial interest in Greenheart Resources prior to Sino-Forest's first investment in July 2007.
- [1324] Correspondence with shareholders of Greenheart Resources establishes Chan was being kept informed of the corporation's operations prior to Sino-Forest's investment. We reject Chan's submissions the evidence relating him to the corporation prior to July 2007 should be interpreted in the context of him acting as a representative of Sino-Forest

as a potential investor. On the contrary, we find Chan had a personal investment in Greenheart Resources prior to any involvement by Sino-Forest.

[1325] In the first half of 2007, correspondence between parties involved in Greenheart Resources shows the company was in financial trouble. On March 8, 2007, Chan received an email from David Van Oppen, a shareholder in Greenheart Resources, attaching the company's 2006 draft financial statements. In the email Mr. Van Oppen states, "I finally received the year end accounts and I fear that the situation looks much worse than the already negative report from Tommy [Lui]".

[1326] On April 10, 2007, Mr. Van Oppen, forwarded an email to Chan. The forwarded email was from Tommy Lui, copying Daphne Tse, among others, also dated April 10, 2007. In the email, Tommy Lui informs Mr. Van Oppen of several decisions made at meetings among the key shareholders of Greenheart Resources with respect to roles of executives and officers within the corporation. He states:

Our own Allen [Chan], together with Mr. Lei and Mr. Lok are very much behind the decisions ... and they have all agreed to involve more in the business. And one of the most important things I hope they will honour is to care more about the company not just by words but by action. Allen as you know is very busy, and the next acid test of his attitude will come before the end of the month. He should make himself available for the key monthly meeting. If he does not do that I am afraid it will be unfair for the other parties to shoulder all the responsibilities and not getting appreciated for their efforts.

[1327] Chan submits David Van Oppen was merely doing ongoing due diligence for Simon Murray, a director of Sino-Forest and early investor in Greenheart Resources. We reject this explanation. It ignores and fails to explain why Tommy Lui would think it unfair for "other parties to shoulder all the responsibilities" if Chan did not appear at the next key monthly meeting.

[1328] An email from Tommy Lui, a shareholder in Greenheart Resources, to Chan dated April 26, 2007, confirms that Greenheart Resources continued to experience financial difficulty. He stated, "[t]his should be attached to my email to you sent earlier, and is a very important document for your attention". Attached to the email are minutes of a meeting of certain shareholders of Greenheart Resources dated March 29, 2007, which state, "due to the serious delay of the timber trading agreements, the company has a shortage of funds, and business operations have been seriously affected".

[1329] On May 6, 2007, Lei Guangyu, President of Greenheart Resources at the time, provided an "Update on Suriname Project", outlining difficulties Greenheart Resources was facing. Lei Guangyu's report and comments were discussed at a meeting on May 9, 2007, involving Chan, Jim Lok, Lei Guangyu and Tommy Lui.

[1330] On May 11, 2007, Tommy Lui copied Chan and Jim Lok on an email to Lei Guangyu. Tommy Lui was responding to the management report from Lei Guangyu that recommended Greenheart Resources be shut down and expresses his disapproval of this recommendation. In the email he states, "[i]n your own words you actually said next week's plan was for Allen to consider if Allen did not mind losing money even after having heard your report ... time is fast running out. All hell will break loose soon. All the bridging loans totalling HK\$11.6 million are overdue or due". The plan refers to a presentation to be made by Lei Guangyu at a meeting of key Greenheart shareholders on May 15, 2007. We find Chan must have been a shareholder or had a financial interest in Greenheart Resources at that point in time if he was in danger of losing money.

[1331] On May 15, 2007, Yosanda Chiang sent an email to Chan stating:

Lok called this morning and said he wants to speak to you asap. The reason is he think of the money that **you, Lei and Lok injected to Suriname in the early stage** – Tommy has authority to transfer money by only his signature. Due to Lei's resign, Lok afraid Tommy will transfer all the money to other places.

[emphasis added]

[1332] Yosanda Chiang testified that due to Jim Lok's accent, she had difficulty understanding him and may not have understood him correctly. Chan submits the Panel should not rely on the email. The Panel does not accept Chan's submissions or Yosanda Chiang's explanation of the email. Furthermore, the Panel finds "Suriname" in the email above is a reference to Greenheart Resources. This email is more evidence Chan was a shareholder or had a financial interest in Greenheart Resources before any involvement by Sino-Forest.

- [1333] Furthermore, Jim Lok was a Hong Kong-based businessperson who was Consul General for Hong Kong to Suriname. He was also a director and General Manager of Super View International Holding Limited (Greenheart Resources' predecessor company). As such, we reject Yosanda Chiang's evidence Jim Lok, an accomplished businessperson operating in Hong Kong, could not make himself understood.
- [1334] Attached to Yosanda Chiang's email to Chan on May 15, 2007, was a letter from Tommy Lui to Lei Guangyu accepting Lei Guangyu's resignation as Chairman and Director of Greenheart Resources. Tommy Lui copied Chan and Jim Lok on the letter. Tommy Lui stated in the letter that he was responding as a shareholder of the corporation. We agree with Staff this is further evidence of Chan's role and capacity as a shareholder or investor in Greenheart Resources prior to July 2007.
- [1335] Lei Guangyu testified he learned, in 2007, that Greenheart Resources did not legally own two of its forestry concessions in Suriname, which were its primary assets, but rather that nominees owned them. He identified one of the nominees as Alex Chau Chi Piu. Alex Chau is also identified as Chan's "best friend" by Yosanda Chiang in an email. Alex Chau was, for a time, a director and indirect 25% shareholder of Chan's offshore holding company, ADS Holdings (BVI) Ltd.
- [1336] Lei Guangyu further testified Chan did not have a personal investment in Greenheart Resources. The Panel rejects Lei Guangyu's testimony on this point. We find the communications described above show Chan had a personal financial interest in Greenheart Resources prior to July 2007.

**(c) Treatment of Spirit Land versus Fortune Universe**

- [1337] As discussed above, Lei Guangyu was the purported owner of Fortune Universe. He was also the legal owner of another company, Spirit Land Limited (**Spirit Land**), along with his spouse. In July 2007, Spirit Land held 110,825,000 ordinary shares of Greenheart Resources
- [1338] Staff submits the difference in Lei Guangyu's treatment of Spirit Land and Fortune Universe indicates he was the beneficial owner of only Spirit Land and not Fortune Universe. Chan submits Lei Guangyu's wife handled Spirit Land. Chan further submits there are many possible explanations why an investment by a husband and wife might be dealt with differently, and submits there are as many different marriages and relationships as there are people and how decisions are made may vary.
- [1339] Lei Guangyu testified he instructed his secretary, Jiang Nanyan, also known as Nancy, to help make arrangements to buy Fortune Universe. According to his testimony, discussed at paragraph [1303] above, Jiang Nanyan asked Yosanda Chiang for help setting up the BVI company. We note this differs from Yosanda Chiang's testimony, which was that Chan instructed her to set up a BVI company for Lei Guangyu. The Panel finds this conflicting testimony unhelpful.
- [1340] Conversely, Lei Guangyu testified Spirit Land was set up by his wife and that her secretary had someone in Hong Kong complete the set up. He stated neither his wife nor his wife's secretary knew Yosanda Chiang, which explains why they did not use her to set up Spirit Land. We do not find this explanation convincing. Instead, we find Yosanda Chiang was involved in the organization of Fortune Universe because Chan was the beneficial owner of the company. Conversely, Yosanda Chiang was not involved in the organization or operation of Spirit Land because Chan had no ownership interest in that company.
- [1341] As discussed below under "Flow of cash proceeds pursuant to the First and Second Transactions", Yosanda Chiang was active in arranging for the payment of funds to Fortune Universe; however, she took no interest in the funds due to Spirit Land. Attached to an email dated December 12, 2007, from Yosanda Chiang to Jiang Nanyan, were three deposit slips relating to deposits made to Lei Guangyu's HSBC account. The deposit slips correspond to 50% of the cash consideration, in respect of the First Transaction, due to each of Fortune Universe, Montsford and Spirit Land. However, the deposit slip that corresponds to Spirit Land was crossed out. When asked about the deposit slips, Lei Guangyu testified he did not know why the deposit slip associated with Spirit Land was crossed out.
- [1342] Lei Guangyu also could not explain why Yosanda Chiang had provided information about Fortune Universe to Jiang Nanyan in the December 12, 2007 email, but not Spirit Land. However, he testified Daphne Tse would not have told Yosanda Chiang about Spirit Land because it was entirely managed by his wife.
- [1343] Moreover, Fortune Universe and Montsford had recorded the same P.O. Box in the British Virgin Islands as their corporate address. Spirit Land, however, had recorded a different P.O. Box in the British Virgin Islands as its corporate address.
- [1344] We find the differing treatment of Fortune Universe and Spirit Land shows Lei Guangyu did not beneficially own or control Fortune Universe, and supports our finding below that Chan was the beneficial owner of Fortune Universe.



**(d) Flow of cash proceeds pursuant to the First and Second Transactions**

*i. First Transaction*

- [1345] Staff submits the Panel can infer from following the distribution of the funds paid to Fortune Universe and Montsford, in exchange for their interests in Greenheart Resources, that Chan was their beneficial owner. Chan submits the inferences Staff wants the Panel to draw relating to funds flowing from the interests of Fortune Universe and Montsford in Greenheart Resources are refuted by direct evidence.
- [1346] Combined, Fortune Universe and Montsford ultimately realized approximately CA \$40 million from the sale of their interests in Greenheart Resources. Fortune Universe and Montsford received the consideration for their shares of Greenheart Resources from Omnicorp Limited and Sino-Forest over the course of three transactions and realized additional value from the resale on the TSX of the Sino-Forest shares received by them in the Second and Third Transactions. As we explain below, the distribution of funds supports our finding Chan was the beneficial owner of Fortune Universe and Montsford.
- [1347] The cash consideration due to Fortune Universe and Montsford pursuant to the First Transaction was paid in two installments. The first installment, totalling HK \$536,400 for Fortune Universe and HK \$2,089,800 for Montsford, was paid to Lei Guangyu as "Receiving Agent" of Fortune Universe and Montsford on December 6, 2007.
- [1348] Between November 12 and 19, 2007, Yosanda Chiang and Daphne Tse exchanged a number of emails regarding the cash consideration due to Fortune Universe and Montsford. On November 12, 2007, Yosanda Chiang sent Daphne Tse an email in English requesting the dollar figures that "... Greenheart is going to transfer to **us** (*i.e.* Sino-Capital Global Inc., Fortune Universe & Montsford) individually ..." [emphasis added]. Chan submits the Panel should not draw any inferences from Ms. Chiang's use of the word "us", as English is not her first language. We disagree. Yosanda Chiang proceeds in the parenthetical comment in the same sentence to explain the three companies that she is referring to by "us". Throughout this entire two-page email exchange, Yosanda Chiang communicated clearly in English. Chan, among others, is copied on the email chain. She did not copy this email chain to Jiang Nanyan, Lei Guangyu or John Zeng. We find Yosanda Chiang did not need to inform them because neither Lei Guangyu nor John Zeng had an ownership interest in the companies or the cash consideration. Moreover Lei Guangyu's proceeds in relation to Spirit Land are never mentioned in this correspondence. Instead, Yosanda Chiang includes Fortune Universe and Montsford together with Sino-Capital Global.
- [1349] On November 19, 2007, Yosanda Chiang sent Daphne Tse an email containing the banking information for Sino-Capital Global, Fortune Universe and Montsford in relation to the payment of the cash proceeds. She copied Chan on the email. Again, she did not copy this email chain to Jiang Nanyan, Lei Guangyu or John Zeng. We agree with Staff's submission this was because Yosanda Chiang was keeping Chan informed regarding the cash proceeds not only for Sino-Capital Global, but also for Fortune Universe and Montsford because of his beneficial ownership of Fortune Universe and Montsford.
- [1350] Yosanda Chiang testified John Zeng instructed her to have the proceeds relating to the sale of Montsford's shares wired to Lei Guangyu's bank account because he did not have a bank account based in Hong Kong. Lei Guangyu testified John Zeng had asked him to receive the deposits for Montsford for the same reason. The Panel rejects the evidence of Yosanda Chiang and Lei Guangyu on this point. We find it unlikely John Zeng, a partner at a large law firm, would conduct business affairs in Hong Kong without having established a bank account there. We find John Zeng would not be satisfied using the bank account of someone else if these proceeds belonged to him or to a company owned by him.
- [1351] On December 12, 2007, Yosanda Chiang informed Jiang Nanyan by email that the transfer "to Mr. Lei's HSBC bank account a/c" of amounts equal to 50% of the cash consideration in respect of the First Transaction due to Fortune Universe and Montsford had taken place. Although the email refers to the HK \$2,089,800 ostensibly paid out for John Zeng's shares, Yosanda Chiang did not copy him on the email.
- [1352] The second installment of the cash proceeds from the First Transaction, totalling HK \$345,575.02 for Fortune Universe and HK \$1,381,415.94 for Montsford, was paid out on or about January 9, 2008. As with the first installment, all of the funds were directed to Lei Guangyu's bank account.
- [1353] The first installment of the cash consideration appears to have been applied, in part, towards a donation of HK \$2,000,000 made to the Hong Kong Baptist University in the name of Chan on December 27, 2007. Yosanda Chiang testified Chan informed her the donation was to be made from the proceeds deposited to Lei Guangyu's account for Montsford because John Zeng owed money to Chan. She also testified John Zeng told her he needed to return money to Chan, and asked her to make the arrangements with Chan. There was no documentary evidence of any loan by

Chan to John Zeng. On September 2, 2008, Chan received an honorary university fellowship from the Hong Kong Baptist University.

- [1354] Lei Guangyu testified Chan had called him and asked him to make an urgent payment on Chan's behalf and told him he would return the money very quickly. Lei Guangyu stated it was only later that John Zeng called and instructed him the payment should be deducted from the funds that Lei Guangyu was holding for John Zeng and that Zeng would handle this with Chan. The differences between the testimony of Yosanda Chiang and Lei Guangyu concern us.
- [1355] Part of the consideration received by Fortune Universe and Montsford pursuant to the First Transaction in 2007 was in the form of Omnicorp convertible bonds. The convertible bonds accrued interest at a rate of 4% per annum. Lei Guangyu was the receiving agent for the interest due under the bonds owned by both Fortune Universe and Montsford. Prior to selling the convertible bonds to Sino-Forest, Fortune Universe and Montsford received interest payments that had accrued on the bonds, totalling HK \$2,548,741.41. At Chan's instruction, Yosanda Chiang arranged for Lei Guangyu to transfer all of the interest paid to Fortune Universe and Montsford to Hu Liang Mei, who was in a close personal relationship with Chan.
- [1356] Yosanda Chiang testified these payments by Montsford were also in satisfaction of John Zeng's debt to Chan. There is no documentary evidence to support this loan's existence. We reject Yosanda Chiang's testimony concerning the existence of the loan to John Zeng from Chan. The Panel would expect a loan for more than HK \$2 million to have at least some supporting documentation. Furthermore, we know it was Chan's practice to keep such documentation. Chan kept, in the deposit box in his office, a copy of a cheque to Ho for a loan of HK \$2,000,000 and a loan agreement for HK \$1,500,000 with a former classmate.
- [1357] On October 16, 2007, Fortune Universe sold HK \$13,650,000 principal amount of the Omnicorp convertible bonds received pursuant to the First Transaction to Sino-Capital Global and received US \$1,750,000.

*ii. Second Transaction*

- [1358] Pursuant to the Second Transaction, Sino-Forest purchased Omnicorp shares and Omnicorp convertible bonds. As part of the Second Transaction, Fortune Universe received HK \$2,093,149.40 from Sino-Forest and 7,541 Sino-Forest shares issued at CA \$10.00 per share and Montsford received HK \$8,154,817.30 and 873,244 Sino-Forest shares issued at CA \$10.00 per share.
- [1359] On February 16, 2009, Jiang Nanyan sent an email to Yosanda Chiang enquiring "whether the documents [a Memorandum of the Sole Director of Fortune Universe and Resolutions of the Sole Shareholder of Fortune Universe] could be signed". The intended signatory of both documents was Lei Guangyu. These documents provided for the appointment of Lei Guangyu as receiving agent for Fortune Universe for the Second Transaction, pursuant to which Fortune Universe sold shares of Omnicorp and Omnicorp convertible bonds to Sino-Forest. Jiang Nanyan was asking for instruction from Yosanda Chiang with regard to the signing of the documents.
- [1360] On March 3, 2009, Jiang Nanyan sent an email to Yosanda Chiang regarding the initial payment due from Sino-Forest to Fortune Universe and Montsford pursuant to the Second Transaction. While the three bank deposit advice documents dated February 27, 2009, attached to that email relate to the accounts of Fortune Universe, Montsford and Spirit Land, respectively, Jiang Nanyan states, "[p]lease see the attach documents total 3 pages **but only two pages are for yours**. I think the amounts for Montsford and Fortune Universe are HK 164049.9 and HK 639017.30. I think it would be better if you can check with Ivy (Greenheart) the amounts before you tell me how to arrange the remittance" [emphasis added]. We agree with Staff's submission that the word "yours" relates to Fortune Universe and Montsford, and that Jiang Nanyan is differentiating between those two companies and Spirit Land because Lei Guangyu is only the beneficial owner of Spirit Land. Again, Jiang Nanyan is seeking instructions from Yosanda Chiang with regard to arrangements for the remittance of the proceeds of the Second Transaction that had been received by Lei Guangyu for Fortune Universe and Montsford.
- [1361] On March 4, 2009, Yosanda Chiang followed up by way of email to Daphne Tse and Ivy Ching, both of whom worked at Greenheart Resources, regarding the amount that had been paid to Lei Guangyu "re our recent deal for Montsford and Fortune Universe respectively".
- [1362] The emails described in the preceding two paragraphs are related to the Second Transaction and consistently indicate that Yosanda Chiang and Jiang Nanyan considered Spirit Land separate from Fortune Universe and Montsford. They support our conclusion that Chan was the beneficial owner of Fortune Universe and Montsford and Jiang Nanyan looked to Yosanda Chiang for instructions with respect to those two companies.
- [1363] Chan's direction, through Yosanda Chiang, of the flow of funds from Fortune Universe and Montsford to friends and an institution connected to him further supports our finding he was the beneficial owner of the two companies. While Staff

has not been able to account for all of the funds after they were transferred to Lei Guangyu's bank account, they are not required to do so. After examining the evidence, we find Chan directed the dispersal of this money.

(e) **Fortune Universe and Montsford's Holding and Sale of Sino-Forest Shares**

[1364] As outlined above, Sino-Forest issued shares to Fortune Universe and Montsford as consideration pursuant to the Second Transaction in February 2009 and the Third Transaction in May 2010. In order to facilitate the sale of all of these Sino-Forest shares, Yosanda Chiang arranged for Fortune Universe and Montsford to have brokerage accounts opened in Hong Kong at a securities firm, Sun Hung Kai Financial (**Sun Hung Kai**), in January 2011. Staff submits she was directed to do so by Chan and not Lei Guangyu or John Zeng. We agree for the reasons outlined below.

i. *Fortune Universe*

[1365] Yosanda Chiang testified Lei Guangyu told her he wanted to sell Fortune Universe's Sino-Forest shares. Lei Guangyu testified he had a contact at Sun Hung Kai and he had previously set up a brokerage account there. He testified he requested Yosanda Chiang's assistance setting up this specific account because he was not sure of the procedure of opening a Canadian share account. We do not find Lei Guangyu's or Yosanda Chiang's explanations regarding the instructions to set up this account and sell the Sino-Forest shares convincing for the reasons set out below.

[1366] On November 24, 2010, Yosanda Chiang sent an email to Lei Guangyu's secretary, Jiang Nanyan. In the email, she states "Mr. Lei is the director and shareholder of Fortune Universe. Fortune Universe currently holds 144,019 Sino-forest shares". She further writes, "**we** would like to sell the shares" [emphasis added] and then requests Lei Guangyu come to Hong Kong in order to open a securities account so the Sino-Forest shares can be sold.

[1367] When questioned why she included the number of shares that Fortune Universe owned in the email, Yosanda Chiang stated it was because she was unsure whether Jiang Nanyan or Lei Guangyu remembered how many Sino-Forest shares were owned by Fortune Universe.

[1368] When questioned why she wrote "we would like to sell the shares", Yosanda Chiang testified she had intended to write the word "he" and not "we" in her email to Jiang Nanyan, and that this was a "typo" (Hearing Transcript, January 8, 2015 at 27-28). Staff submits this was not a mistake and that the Panel should interpret "we" as a reference to Chan. When questioned further, Yosanda Chiang admitted the characters for "he" and "we" are not close to each other on a Chinese keyboard. We agree with Staff's submission that "we" refers to Chan.

[1369] Lei Guangyu testified he does not believe in holding securities, preferring cash instead: "I'm not interested in any kind of shares. I am of the opinion that only cash is cash and any sort of securities is actually not safe". (Hearing Transcript, April 20, 2015 at 18).

[1370] Fortune Universe first received Sino-Forest shares on February 6, 2009, pursuant to the Second Transaction. When questioned about Sino-Forest shares received by Spirit Land, Lei Guangyu testified he was uncertain when he had sold them but he thought it was at the same time. Lei Guangyu did not offer an explanation why he held onto those Sino-Forest shares for approximately two years if he preferred not to hold shares.

[1371] All 144,019 Sino-Forest shares, which had been deposited by Fortune Universe in its Sun Hung Kai brokerage account, were sold on February 18 and 21, 2011. In an email dated February 16, 2011, Yosanda Chiang informed Jiang Nanyan, "Mr. Lei has texted to inform Allen that the shares have been deposited to the account." She then instructed Ms. Nanyan to "have Mr. Lei instruct the securities company within one or two days to sell separately over two nights (at the current value)". We find the fact that Lei Guangyu informed Chan about this share deposit further supports our finding Chan was the beneficial owner of Fortune Universe.

[1372] Yosanda Chiang also instructed Lei Guangyu personally by fax on February 17, 2011, setting forth the same detailed instructions:

With regard to the sale of shares, please arrange as follows:

- Total number of shares: 144,019
- Please give instructions to Sun Hung Kai Securities Company today or tomorrow to sell separately in two nights (at current value)
- After receiving the funds (preferably in Canadian dollars), remit to the following bank and inform me of the amount remitted.

Thank you.

Eminens Limited

HSBC Foreign Currency A/C

A/C # [Redacted]

- [1373] Yosanda Chiang testified it was Lei Guangyu's wish to sell the shares within a couple of days. She stated it was her own initiative to specify it happen over a two-night period at their current value. She testified it was also her idea the funds be received in Canadian dollars as she knew Lei Guangyu wished to invest in Eminens Limited, and that would be Eminens' preference. Eminens was incorporated in Hong Kong on February 20, 2009 and was controlled by Pauline Chan, Chan's sister. Yosanda Chiang confirmed she was also involved in the establishment of Eminens.
- [1374] Lei Guangyu testified he went to Chan for advice on when to sell the shares. When cross-examined on this point, he stated Chan referred him to Yosanda Chiang and that it was Yosanda Chiang's advice not to sell all the shares at once because it would affect the company's share price. The Panel does not find Yosanda Chiang's and Lei Guangyu's testimony on this issue convincing. We find the decision to sell the shares came from Chan and he instructed Yosanda Chiang on the coordination of the sale (including the opening of the account) and the application of the proceeds of the sale.
- [1375] The total number of Sino-Forest shares sold by Fortune Universe, 144,019, was the exact number of shares that Fortune Universe received pursuant to the Second and Third Transactions. The proceeds from the sale of Fortune Universe's Sino-Forest shares, which amounted to CA \$3,197,746.25 or HK \$25,173,341.89, were paid to the HSBC bank account of Lei Guangyu on February 28, 2011.
- [1376] Yosanda Chiang then organized the remittance from Lei Guangyu's HSBC bank account to Eminens. On February 28, 2011, Yosanda Chiang sent Jiang Nanyan an email stating, "[a]s the funds are remitted into the account of Eminens, for the sake of accounting, it will be listed as funds provided by Mr. Lei to Eminens for investment purpose ... May I ask whether Mr. Lei will sign the contract in his own name or in the name of a company?"
- [1377] Later on that day, in the same email chain, Yosanda Chiang asked Jiang Nanyan whether Lei Guangyu had a BVI company. This question is surprising, given Fortune Universe is a BVI company purportedly owned by Lei Guangyu, and given Yosanda Chiang's close involvement with the company. We find this supports Staff's argument that Lei Guangyu was not the beneficial owner of Fortune Universe. If Fortune Universe was Lei Guangyu's company, Yosanda Chiang would not have asked this question.
- [1378] As previously directed by Yosanda Chiang, two days later on March 2, 2011, Lei Guangyu remitted the proceeds from his HSBC bank account to a HSBC bank account of Eminens Limited. Jiang Nanyan reported to Yosanda Chiang on the same day in an email attaching information from the Sun Hung Kai brokerage account. Jiang Nanyan stated, "Mr. Lei has already remitted share funds of HK 25173341.89 to your designated account, please receive and check" and further stated the attached information was "provided for your reference and file record". We find this to be consistent with Lei Guangyu acting as Chan's nominee for Fortune Universe. It is also consistent with Yosanda Chiang receiving a full accounting of that company so Chan, its beneficial owner, had full records and confirmation his instructions for the transfer of the sale proceeds to Eminens had been carried out.
- [1379] After considering the evidence relating to the sale of Fortune Universe's Sino-Forest shares, and the use of the sale proceeds, we find the instructions to sell the shares and the disposition of the sale proceeds came from Chan.

*ii. Montsford*

- [1380] Yosanda Chiang also organized setting up a brokerage account for John Zeng at Sun Hung Kai Financial. She testified she did this because John Zeng told her he wanted to open a securities account for Montsford. She stated John Zeng did not tell her why he wanted to open the account, but that he knew she helped Lei Guangyu set up a securities account, and he wanted her to also help him. No written evidence of such communication was provided.
- [1381] On January 4, 2011, Yosanda Chiang sent John Zeng an email informing him she had arranged for him to meet with the securities company and instructing him what he would need to open a securities account for Montsford in Hong Kong. Sun Hung Kai Financial approved the account application forms for Fortune Universe on January 21, 2011 and for Montsford on January 25, 2011. Lei Guangyu and John Zeng opened brokerage accounts for Fortune Universe and Montsford within four days of each other. The fact that two individuals supposedly acting independently opened brokerage accounts within four days of each other supports our finding that it was Chan who directed the opening of these accounts.

- [1382] Montsford sold all of its Sino-Forest shares from its Sun Hung Kai Financial brokerage account in the market between March 16 and 29, 2011. The total number of Sino-Forest shares sold by Montsford, 1,405,080, was the exact number of shares that Montsford received pursuant to the Second and Third Transactions. The proceeds totalled CA \$31,641,318.72 and were paid to John Zeng's HSBC account. This HSBC account was opened in January 2011, and the only activity in it related to the Greenheart Transactions.
- [1383] We find it unlikely these decisions regarding the sale in the market by Fortune Universe and Montsford in February and March 2011 of all 1,549,099 Sino-Forest shares, which had been received by Fortune Universe and Montsford pursuant to the Second and Third Transactions in February 2009 and May 2010, were arrived at independently of each other. We find Chan directed the disposition of the Sino-Forest shares by Fortune Universe and Montsford.
- [1384] On April 7, 2011, CA \$31,641,000 was transferred from John Zeng's HSBC account to an account of Momentom (China) Real Estate Development at China Merchants Bank. The Panel is satisfied Momentom appears on the Company Caretaker List (described elsewhere in these Reasons) under the name Renshi (China) Real Estate Development Limited. Renshi is listed under the control of "John". We find the "John" referenced in the Company Caretaker List is John Zeng.
- [1385] The evidence shows funds totalling HK \$52,464,530 flowed from Momentom's bank account to Eminens' HSBC account on July 28, 2011 and August 17, 2011. Staff submits it is reasonable to assume these funds were a portion of the proceeds of Montsford's Sino-Forest share sales. Chan submits it would be improper for us to draw this inference. In view of all the evidence and circumstances of the Greenheart Transactions, we find it more likely than not these funds were derived from part of the proceeds of the sale of Sino-Forest shares by Montsford.
- [1386] In an email dated March 22, 2011, Yosanda Chiang instructed Gilbert Chau of Panocean that Fortune Universe and Montsford should be cancelled. She testified Lei Guangyu and John Zeng had advised her they no longer needed the companies so they could be cancelled. Staff submits it is curious that both Lei Guangyu and John Zeng would want these two companies cancelled at the same time. Staff submits the instructions from Yosanda Chiang to Gilbert Chau are consistent with Chan no longer needing these companies as all their holdings of Sino-Forest shares had been sold. We agree with Staff's submission.
- [1387] The Panel does not have much direct evidence regarding the disposal of the proceeds from the sale of Sino-Forest shares by Montsford as compared to Fortune Universe. However, when viewed as a whole and taking into consideration the close connection between the companies at every stage of the Greenheart Transactions, we find the directions and instructions to sell Montsford's Sino-Forest shares, and transfer part of the proceeds to his sister's company, came from Chan.

**(f) Chan was the beneficial owner of Fortune Universe and Montsford**

- [1388] We find Chan had a personal financial interest in Greenheart prior to Sino-Forest's initial involvement in July 2007.
- [1389] The differing treatment of Fortune Universe and Lei Guangyu's company Spirit Land leads us to find Lei Guangyu did not beneficially own Fortune Universe.
- [1390] We find Chan was the beneficial owner of Fortune Universe and Montsford. He was closely involved in the establishment and organization of these companies and actively directed their operation through his secretary, Yosanda Chiang. She kept the company seals for both Fortune Universe and Montsford. Important business of both companies could only be done through her. Chan and Yosanda Chiang were involved in both companies from their initial organization until they were dissolved.
- [1391] An examination of the disposition of the funds and the proceeds from the sale of Sino-Forest shares from the sale of both companies' interests in Greenheart Resources also supports the conclusion Chan was their beneficial owner. Cash proceeds in the amount of HK \$2,000,000 were donated to a university at the direction of Chan. He also directed some proceeds in the amount of HK \$2,548,741.41 to Hu Liang Mei, a person in a close personal relationship with him. Yosanda Chiang was also closely involved in these transfers. Even though Chan submits Montsford's share of these funds belonged to John Zeng, the email record is clear Yosanda Chiang often did not even copy John Zeng on correspondence relating to the disposition of those funds.
- [1392] Fortune Universe and Montsford, companies supposedly independent of each other, opened securities brokerage accounts at the same firm in Hong Kong within days of each other, two years after they received their first Sino-Forest shares. Yosanda Chiang was, once again, intimately involved in this process for both companies. In addition, Sino-Forest share certificates received by Fortune Universe and Montsford in the Second Transaction were kept in Chan's deposit box in his office at Sino-Forest, along with other items of significant personal value.

[1393] While Staff was not able to account for all of the proceeds from the sale of Sino-Forest shares by Fortune Universe and Montsford, it was able to demonstrate millions of Hong Kong dollars flowing from accounts linked to Lei Guangyu (in the amount of HK \$25,173,341.89) and John Zeng (in the amount of HK \$12,464,585 and HK \$39,999,945) to Chan's sister's company, Eminens.

[1394] The Panel finds Chan was the beneficial owner of Fortune Universe and Montsford, which together owned 30% of Greenheart Resources, and received over US \$22 million in cash and securities in consideration for the Greenheart Transactions.

## 2. Was Chan's non-disclosure of his interest in the Greenheart Transactions a dishonest act?

[1395] Staff submits Chan did not disclose his interest in the Greenheart Transactions and the substantial benefit he received to the Board of Directors or to the Investors, thereby committing a dishonest act. Staff also submits Chan actively hid his interest behind nominees, which is inherently dishonest. Chan submits the fact he disclosed Sino-Forest's initial investment in Greenheart Resources as part of the discussion of the corporation's strategy of sourcing timber from outside of China demonstrates his transparency with respect to his involvement in the Greenheart Transactions. The Panel finds although Chan disclosed Sino-Forest's initial investment, he did not disclose his interest in the Second and Third Transactions nor his holding of a 30% interest through two nominees.

[1396] As discussed elsewhere in these Reasons, a dishonest act is established by proof of deceit, falsehood, or other fraudulent means. Fraud by deceit or by falsehood only requires the respondent to have represented that a situation was of a certain character, when, in reality, it was not (*Théroux* at 17).

[1397] The commission of fraud by "other fraudulent means" is determined on an objective standard. The question we must ask is whether a reasonable person would consider the conduct dishonest (*Théroux* at 16). Courts have previously held the non-disclosure of important facts to be a dishonest act (*Théroux* at 16, referring to *R v Rosen* (1979), 55 CCC (2d) 342 (Ont Co Ct). The Quebec Court of Appeal held that fraud by other fraudulent means "can consist of a positive act, but also sometimes a mere omission, that is to say a situation where, through his silence, an individual hides from the other person a fundamental and essential element" (*Émond* at para 29). Other Commissions have held the failure to disclose information in offering memorandums amounted to a dishonest and fraudulent act (*Re Patrick*, 2014 BCSECOM 264; *Re Capital Alternatives Inc*, 2007 ABASC 79).

[1398] The parties do not dispute Chan never disclosed any interest in Greenheart Resources or in the Greenheart Transactions to the Board of Directors of Sino-Forest, or the Investors before, during or after the Greenheart Transactions. No disclosure of Chan's 30% interest in Greenheart Resources or his conflict of interest in the Second and Third Transactions was made as required by Ontario securities laws in Sino-Forest's AIFs or MD&As for each of the years ended December 31, 2008, 2009 and 2010, or in Sino-Forest's two short-form prospectuses filed with the Commission on June 1, 2009 and December 10, 2009 (which included the AIF and MD&A for the year ended December 31, 2008). As a result, Sino-Forest shareholders and the Investors were not made aware of Chan's interest in Greenheart Resources or his interest in the Second and Third Transactions before, during or after the Greenheart Transactions.

[1399] Chan, as Chief Executive Officer, certified that each of the AIFs of Sino-Forest for 2008, 2009, and 2010 did not omit to state a material fact required to be stated or that is necessary to make a statement not misleading in light of the circumstances under which it was made. Chan also certified that the short form prospectuses, together with the documents incorporated therein by reference (which included the AIF and MD&A for the year ended December 31, 2008), constituted full, true and plain disclosure of all material facts as required by the securities legislation of Ontario.

[1400] Furthermore, the non-disclosure by Chan of his 30% interest in Greenheart Resources and his conflict of interest in the Second and Third Transactions, as reflected by the minutes of meetings of the Board of Directors of Sino-Forest, stands in stark contrast to the disclosure by Simon Murray, another director of Sino-Forest, who disclosed his interest and the interest of an entity he controlled, in the sale of their 5.5% interest, in Greenheart Resources and his conflict of interest in the Second Transaction to the Board of Directors of Sino-Forest on January 19, 2009, and did not participate in the voting on the Second Transaction. Nevertheless, even though Chan was present at that meeting, he never disclosed his 30% interest in Greenheart Resources through Fortune Universe and Montsford or his conflict of interest in the Greenheart Transactions at that meeting or any other meeting of the Board of Directors that considered the Second and Third Transactions.

[1401] The 5.5% interest of Simon Murray, a director of Sino-Forest, in Greenheart Resources and his conflict of interest in the Second and Third Transactions were clearly disclosed as required by Ontario securities laws under the following headings in Sino-Forest's disclosure documents:

- “Interest of Management and Others in Material Transactions” and “Conflict of Interest” in the AIFs of Sino-Forest for 2008, 2009 and 2010;
- “Significant Business Activities” and “Transactions with Related Parties” in the MD&As of Sino-Forest for 2008, 2009 and 2010;
- “Subsequent Event” in the Notes to Sino-Forest’s consolidated financial statements for 2008; and
- “Related Party Transactions” in the Notes to the Consolidated Financial Statements of Sino-Forest for the years 2009 and 2010, which disclosure documents, for the year ended December 31, 2008, were incorporated by reference in Sino-Forest’s two prospectuses filed in 2009.

[1402] Staff submits the non-disclosure by Chan of his interest in Greenheart Resources and his interest in the Greenheart Transactions was a dishonest act. Chan, as the Chief Executive Officer and a director of Sino-Forest, had to certify or sign off on each one of the above-listed public disclosure documents. As he did so, in each instance he would have known he had not reported his interest in Greenheart Resources and his conflict of interest in the Second and Third Transactions to Sino-Forest’s Board of Directors. He would have also known as a result, Sino-Forest had not disclosed his interest in Greenheart Resources and conflict of interest in the Second and Third Transactions under the following headings:

- “Interest of Management and Others in Material Transactions” and “Conflict of Interest” in its AIFs for the years 2008, 2009 and 2010;
- “Significant Business Activities” and “Transactions with Related Parties” in the MD&As for the years 2008, 2009 and 2010;
- “Subsequent Event” in the Notes to Sino-Forest’s consolidated financial statements for 2008; and
- “Related Party Transactions” in the Notes to the Financial Statements for the years 2009 and 2010, which disclosure documents, for the year ended December 31, 2008, were incorporated by reference in Sino-Forest’s two prospectuses filed in 2009.

[1403] In fact, Chan actively hid his interest in Greenheart Resources by hiding behind two nominee companies he organized in the names of his friends and administered by his executive assistant.

[1404] As we find below, Chan’s 30% interest in Greenheart Resources and his interest in the Second and Third Transactions were material facts that he should have disclosed to the Board and to Investors.

[1405] We find Chan’s course of conduct by which he hid his interest in Greenheart Resources and his non-disclosure of his interest in Greenheart Resources and his interest in the Second and Third Transactions to the Board of Directors and the Investors satisfies the requirement for a dishonest act under the criteria set out in *Théroux*, as fraud by other means. We find this conduct engaged in by Chan reaches the level of “dishonest dealings” contemplated by *Théroux* and the kind of omission that was of concern to the Quebec Court of Appeal in *Émond*.

[1406] Chan submits even if the Panel finds he did have beneficial ownership of Fortune Universe and Montsford, Staff has failed to prove his non-disclosure of his interest in Greenheart Resources and conflict of interest in the Greenheart Transactions was dishonest. In support of his argument, he submits the courts have held not every failure of an officer or director in the exercise of their duties amounts to a dishonest act:

There is a range of such failures that extends from mere errors in judgment to negligence to dishonesty. For the offence of fraud to be made out, the failure must reach the level of a dishonest act.

(*Sorbara v Canada*, [2006] OJ no 1973 at para 57)

[1407] The facts in the *Sorbara* decision are readily distinguishable from those in this matter. That decision was made on an application for an order severing and/or expunging all reference to the applicant Sorbara in four search warrants issued in respect of alleged offences under the *Criminal Code* because the applicant contended that another judge who had issued the search warrants ought not to have been satisfied there were reasonable grounds to believe the applicant had committed the criminal offences alleged in the search warrants. The judge on the application concluded there was insufficient evidence before the issuing judge upon which the issuing judge could have concluded there were reasonable and probable grounds to believe the applicant had committed the offence of fraud. In reaching that conclusion, the judge on the application noted the absence of evidence of a requirement on the applicant to disclose all

related party transactions, regardless of the amount, to the auditors or the board of directors of a reporting issuer of which the applicant was a director. The judge further noted it was not clear that such disclosure was not made.

[1408] Chan was required to disclose his 30% interest in Greenheart Resources and his interest in the Second and Third Transactions. He did not disclose this, but rather hid his interest in Greenheart Resources behind nominee shareholders. We find a reasonable person would consider Chan's non-disclosure of this important fact to be dishonest.

[1409] In this matter before a panel of the Commission, sufficient evidence of a requirement for Chan to disclose a significant interest in Greenheart Resources and interest in the Second and Third Transactions has been presented. We find because of Chan's failure to disclose his significant interest in Greenheart Resources and interest in the Second and Third Transactions to the Board of Directors of Sino-Forest, and ultimately to the Investors, as well as his actions in hiding his interest, the first element of *actus reus* under the *Théroux* test, proof of a fraudulent act by other means, is satisfied.

**3. Were Sino-Forest Investors put at risk as a result of Chan's non-disclosure of his beneficial interest in the Greenheart Transactions to the Sino-Forest Board?**

[1410] Proof of a deceitful act alone is not enough to find Chan committed the *actus reus*, or required act, of fraud. Staff must also show there was a deprivation caused by the prohibited act. A deprivation is established by proof of detriment, prejudice, or risk of prejudice to the economic interest of the victim, caused by the dishonest act (*Théroux*).

[1411] The case law is clear that the notion of deprivation goes beyond pure economic loss. As stated by the Supreme Court in *Olan*, "prejudice" or "risk of prejudice" to an economic interest is sufficient.

If the deceit which is employed imperils the economic interest of the person deceived, this is sufficient to constitute fraud even though in the event no actual loss is suffered and notwithstanding that the deceiver did not desire to bring about an actual loss.

...

Where a person intends by deceit to induce a course of conduct in another which puts that other's economic interest in jeopardy, he is guilty of fraud even though he does not intend or desire that actual loss should ultimately be suffered by that other in this context.

(*Olan* at 1182 and 1183)

[1412] The Commission has also held even where victims profit from a fraud, there can still be a deprivation, as the deprivation is a result of the risk to which their interests are subjected (*Re Axxess Automations LLC* (2012), 35 OSCB 9019 at paras 256-258).

[1413] Staff submits by failing to publicly disclose his interest in the Greenheart Transactions, Chan placed the pecuniary interests of Investors at risk and subjected the Investors to the risk of prejudice to their economic interests, amounting to a deprivation.

[1414] Staff submits inaccurate financial statements in a public company can cause prejudice to investors where the misstatement or omission is material. If public disclosure documents omit information or contain misrepresentations that are material to an investor's decision-making, the investing public is put at risk (*R v Drabinsky*, [2009] OJ No 1227 (Sup Ct J) at para 492).

[1415] Chan submits the pecuniary interests of the Investors were not put at risk by the Greenheart Transactions. He submits Staff failed to prove Sino-Forest's assets were put at risk in the Greenheart Transactions or that the Greenheart Transactions were not in Sino-Forest's best interest. Moreover, Chan submits the Greenheart Transactions were reasonable and fair at the time they were transacted. He submits Sino-Forest negotiated the Greenheart Transactions at arm's length and the Sino-Forest board approved them.

[1416] We reject Chan's submission that the pecuniary interests of Sino-Forest's Investors were not put at risk when he failed to disclose his interest in Greenheart Resources and his interest in the Second and Third Transactions. We find below that Chan's 30% interest in Greenheart Resources and his interest in the Second and Third Transactions were material facts. If investors are not informed about material facts with respect to their investment, they cannot make informed decisions. Chan's non-disclosure put their investments at risk.



- [1417] We note Chan made extensive submissions on the topic of the value of Greenheart Resources in relation to the price paid for Sino-Forest's controlling share. The Panel carefully considered this argument; however, as our finding is based on the risk of prejudice to the economic interests of the Investors due to Chan's non-disclosure, it is not necessary we examine whether the price paid by Sino-Forest pursuant to the Greenheart Transactions was reasonable or fair.
- [1418] The omission of disclosure of Chan's interest in Greenheart Resources and his interest in the Second and Third Transactions is a dishonest act. Since the Investors are entitled to rely on Sino-Forest's prospectuses and public disclosure documents before risking their funds, the omission of disclosure of Chan's interest in Greenheart Resources and the Second and Third Transactions creates a potential risk to the Investors.
- [1419] We find Investors' interests were put at risk by Chan's failure to disclose his interest in Greenheart Resources and in the Second and Third Transactions. Investors need to be able to rely on the accuracy and truthfulness of the public disclosure documents of issuers so they can reliably base their investment decisions on this disclosure. In the absence of this required and truthful disclosure, Sino-Forest Investors were unable to make informed investment decisions. As a result, their pecuniary interests were put at risk when Chan failed to disclose his interest in Greenheart Resources and in the Second and Third Transactions.

**4. Did Chan have the requisite *mens rea* for the offence?**

- [1420] Proof of two states of mind are required for the requisite intent for fraud: (i) subjective knowledge of the prohibited act of dishonesty and (ii) subjective knowledge the dishonest conduct could result in deprivation to another.
- [1421] Staff is not required to show direct evidence regarding Chan's state of mind in relation to the Second and Third Transactions during the commission of the prohibited act in order to prove their allegations. Rather, subjective intention may be inferred from the act itself (*Théroux* at 18).
- [1422] For the reasons below, we find Staff has met its burden of proof regarding both of the *mens rea* elements required by the *Théroux* test.

**(a) Chan had subjective knowledge of the prohibited act**

- [1423] Chan submits Staff has failed to prove he had subjective knowledge of the prohibited act. He submits the requirement for Staff to prove his mental intent is intended to protect the morally innocent who are defined as those who do not understand or intend the consequences of their acts. We reject Chan's submission Staff has failed to meet its burden and instead find he had subjective knowledge of the prohibited act, which, in this case, was the non-disclosure of his personal financial interest in the Second and Third Transactions through his 30% beneficial ownership of Greenheart Resources. Furthermore, not only was Chan present when Simon Murray, a director of Sino-Forest, disclosed his 5.5% interest in Greenheart Resources and his interest in the Second Transaction, Chan also would have read disclosure of Simon Murray's interest in Greenheart Resources and conflict of interest in respect of the Second and Third Transactions in Sino-Forest's continuous disclosure documents, which did not disclose Chan's interest in Greenheart Resources nor his conflict of interest in the Second and Third Transactions, and which Chan certified as full and true.
- [1424] Chan did not perpetrate this fraud on a whim. As we found above, the evidence demonstrates Chan was the beneficial owner of Fortune Universe and Montsford by at least 2005, more than a year before the First Transaction. Through his long-time executive assistant, Yosanda Chiang, he directed the establishment and organization of these companies. He chose their nominee owners and controlled the material decisions through Ms. Chiang. Even the company seals were kept in Yosanda Chiang's possession. Fortune Universe and Montsford could not conduct important company business without her. Chan, through Yosanda Chiang and his nominee owners, carefully controlled the disposition of funds received from the Greenheart Transactions and the sales and use of proceeds of Sino-Forest shares belonging to Fortune Universe and Montsford received in the Second and Third Transactions. This fraud took years to plan and execute. The premeditation involved on the part of Chan is evident from the document trail created in execution of the fraud. We find Chan had subjective knowledge of the prohibited act of dishonesty.

**(b) Chan had subjective knowledge that the dishonest conduct could result in deprivation to another**

- [1425] The second required state of mind is that Chan must be shown to have had subjective knowledge the dishonest conduct could result in deprivation to another, including putting pecuniary interests of Investors at risk.
- [1426] Chan submits the reasonable and logical inference about his subjective knowledge of the consequences of non-disclosure of his interest is that he knew that the Greenheart Transactions were in the best interests of Sino-Forest. In rejecting this argument we point to the Supreme Court's decision in *Théroux*, where it held "a sanguine belief that all will come out right in the end" is not a defence to fraud (at 24). Chan may well have believed the Greenheart

Transactions would result in financial gains for Sino-Forest and the Investors. However, the impugned conduct at issue is not the Greenheart Transactions themselves, but rather his non-disclosure of his interest in them.

- [1427] Staff must prove Chan subjectively knew non-disclosure of his interest in the Second and Third Transactions would put the pecuniary interests of the Investors at risk. Chan submits Staff did not lead any evidence on this point. We reject this submission.
- [1428] Staff does not need to provide the Panel with a “snapshot” of a respondent’s mind at the time the prohibited act is committed. As the courts have stated and this Commission has held, the Panel is able to look at the totality of the evidence to determine whether a respondent subjectively appreciated the possible consequences of a course of conduct.
- [1429] Chan was the Chairman and CEO of a large reporting issuer in Ontario and was recognized as a sophisticated, experienced and well-respected businessperson in China. This is evidenced by his positions in, and awards from, industry and government bodies in China. The Panel finds Chan knew his failure to disclose his interests in the Second and Third Transactions to the Board of Directors of Sino-Forest, and furthermore to the Investors would result in the risk of prejudice to the economic interests of the Investors.
- [1430] The Panel finds, on a balance of probabilities, in view of all the evidence, Staff has proven the *actus reus* and *mens rea* of fraud on the part of Chan. We find Chan engaged in an act and course of dishonest conduct that he knew constituted fraud on Sino-Forest Investors, contrary to subsection 126.1(b) of the *Securities Act* and contrary to the public interest.

**D. Did Sino-Forest and Chan make materially misleading statements by failing to disclose Chan’s interest in the Greenheart Transactions in Sino-Forest’s public disclosure?**

- [1431] Staff alleges by not disclosing Chan’s 30% interest in Greenheart Resources and in the Greenheart Transactions, Chan and Sino-Forest made materially misleading statements in Sino-Forest’s AIFs for the years ended December 31, 2008, 2009 and 2010 and its two short-form prospectuses filed in 2009 (which incorporated by reference the relevant AIF and MD&A for the year ended December 31, 2008, as required by Ontario securities law) (together, the **Impugned Greenheart Documents**), contrary to subsection 122(1)(b) of the *Securities Act*. Staff also alleges Chan, as Chairman and Chief Executive Officer of Sino-Forest, authorized, permitted or acquiesced in Sino-Forest’s making of materially misleading statements and thereby committed an offence pursuant to subsection 122(3) of the *Securities Act*.
- [1432] As we determine below, Sino-Forest’s failure to disclose Chan’s 30% interest in Greenheart Resources and the Second and Third Transactions resulted in a breach of Ontario securities law pursuant to subsection 122(1)(b) of the *Securities Act*. Chan, as Chairman and Chief Executive Officer of Sino-Forest, breached Ontario securities law pursuant subsection 122(3) of the *Securities Act* by authorizing, permitting and acquiescing in Sino-Forest’s making of materially misleading statements.

**1. Were the statements misleading in a material respect?**

- [1433] Subsection 122(1)(b) provides that it is an offence to make a statement in certain documents, including a prospectus, financial statements or other documents required to be filed or furnished under Ontario securities law that, in a material respect and at the time and in the light of the circumstances in which it is made, is misleading or untrue or does not state a fact that is required to be stated or that is necessary to make the statement not misleading. The *Securities Act* does not define the phrase “in a material respect”.
- [1434] The Commission has described its role in making an assessment of materiality of a statement as follows:

... the assessment of the materiality of a statement is a question of mixed fact and law that requires a contextual determination that takes into account all of the circumstances including the size and nature of the issuer and its business, the nature of the statement and the specific circumstances in which the statement was made.

(*Biovail* at para 69)

- [1435] The parties agree in their submissions the standard of assessment of materiality should be the “reasonable investor standard”. We agree the “reasonable investor standard” is the appropriate standard to apply in our assessment of the materiality of the misstatement in the Impugned Greenheart Documents.
- [1436] In *Biovail*, the Commission held a statement is to be treated as material if “there is a substantial likelihood that a reasonable investor would consider the statement to be important in making an investment decision ... to buy, sell or

hold shares” (para 74). We are of the view an omitted fact is to be treated as material if there is a substantial likelihood a reasonable investor would consider the omitted fact important in making an investment decision to buy, sell or hold securities. We therefore must determine whether the Impugned Greenheart Documents contained statements that were misleading or untrue, at the time and in light of the circumstances in which the statements were made, or did not state a fact that was required to be stated or that is necessary to make the statement not misleading, in a respect a reasonable investor would consider important in making an investment decision with respect to the securities of Sino-Forest.

[1437] Staff submits, and Chan admits, the Impugned Greenheart Documents are all documents required to be filed with the Commission or furnished under Ontario securities law. We agree and so find.

[1438] We found above that Chan beneficially owned a 30% interest in Greenheart Resources. Chan was the Chairman of the Board and CEO of Sino-Forest at the date and during the periods of the Impugned Greenheart Documents. Chan’s 30% interest in Greenheart Resources and conflict of interest in the Second and Third Transactions were not disclosed in any of the Impugned Greenheart Documents. We must decide whether these undisclosed facts were required to be stated or were necessary to make the statements in the Impugned Greenheart Documents not misleading or untrue, in a *material respect* and at the time and in light of the circumstances in which the statements were made or omitted.

[1439] Under Ontario securities laws, the interest of management and directors of reporting issuers in material transactions and conflicts of interest of management and directors of reporting issuers must be disclosed in documents such as the Impugned Greenheart Documents.

[1440] An example of statements in the Impugned Greenheart Documents made in compliance with such requirements is the disclosure in respect of Simon Murray’s 5.5% interest in Greenheart Resources and his conflict of interest in the Second and Third Transactions, which was discussed in paragraphs [1401] and [1423] above. Sino-Forest disclosed the Second and Third Transactions as material transactions and made disclosure of the conflict of interest on the part of one director, Simon Murray, in respect of the Second and Third Transactions.

[1441] We find the 30% interest of Chan, the Chairman and Chief Executive Officer of Sino-Forest, in Greenheart Resources and his conflict of interest in the Second and Third Transactions were required to be stated or disclosed in the Impugned Greenheart Documents. We find the required facts, with respect to disclosure of Chan’s interests in Greenheart Resources and conflict of interest in the Second and Third Transactions, were not stated in the Impugned Greenheart Documents.

[1442] As the Commission stated in *Biovail*, “[a] public statement can take on more significance to investors than it might otherwise have if it causes investors to question the integrity or competence of management” (at para 233). Furthermore, we agree with the statement of the Alberta Securities Commission in *Re Ironside*, 2006 ABASC 1930 at para 615 that “[t]he market price of the securities of a public company reflects in large part, the market’s confidence in the fitness and integrity of that company’s management team ... [and] market knowledge of the true facts and circumstances ... would reasonably be expected to have a significant impact on [an issuer’s] price”.

[1443] The required disclosure of the 30% interest of Chan in Greenheart Resources and his conflict of interest in the Second and Third Transactions, which were material transactions involving Sino-Forest, are facts that a reasonable investor would consider to be important in making an investment decision to buy, sell or hold securities of Sino-Forest and would reasonably be expected to affect the price of Sino-Forest securities.

[1444] We find Chan’s 30% interest in Greenheart Resources and his conflict of interest in the Second and Third Transactions are facts that were omitted from the Impugned Greenheart Documents, which a reasonable investor would consider important in making an investment decision with respect to the securities of Sino-Forest. We find these undisclosed facts were required to be stated or were necessary to make the statements in the Impugned Greenheart Documents not misleading or untrue, in a material respect and at the time and in light of the circumstances in which the statements were omitted.

## 2. Did Sino-Forest breach Ontario securities law pursuant to subsection 122(1)(b) of the *Securities Act*?

[1445] Ontario securities law requires a reporting issuer to make accurate and complete disclosure of information in its public disclosure documents because all persons investing in securities should have equal access to information that may affect their investment decisions. Investors should have equal access to information that may affect their investment decisions. To be meaningful, such public disclosure needs to be accurate and complete (*Cornish v Ontario (Securities Commission)*, 2013 ONSC 1310 (Div Ct), citing *Re Philip Services Corp.* (2006), 29 OSCB 3941 at para 7). Accurate and complete public disclosure allows investors to assess the risks involved with making an investment. The requirement to provide accurate public disclosure serves to level the playing field between investors (*Re AiT Advanced Technologies Corp* (2008), 31 OSCB 712 at para 199). Moreover, requiring accurate public disclosure enhances the

accountability of corporate management to their corporation's shareholders and the investing public. In order to achieve this aim, the onus must rest on the company to provide information to the investing public to enable them to assess the risks involved in making an investment (*Re Rex Diamond Mining Corp.*, (2008), 31 OSCB 8337 at para 263).

[1446] For the purpose of determining the responsibilities for a breach of subsection 122(1)(b) of the *Securities Act*, we accept Chan's submission disclosure to the public is the responsibility of the issuer, Sino-Forest. We find the misstatements in the Impugned Greenheart Documents were made by Sino-Forest, the reporting issuer.

[1447] Having found the omission of the facts of Chan's 30% interest in Greenheart Resources and his conflict of interest in the Second and Third Transactions made the Impugned Greenheart Documents misleading *in a material respect*, we find Sino-Forest did not state facts that were required to be stated in those documents, contrary to subsection 122(1)(b) of the *Securities Act* and contrary to the public interest.

**3. Did Chan authorize, permit or acquiesce, pursuant to section 122(3) of the *Securities Act*, in Sino-Forest's breach of Ontario securities law?**

[1448] Subsection 122(3) of the *Securities Act* states every director or officer of a company who authorizes, permits or acquiesces in the company's breach of subsection 122(1), is also guilty of an offence.

[1449] Chan submits he certified the Impugned Greenheart Documents, but he did not authorize, permit or acquiesce in the making of materially misleading statements. In our view, the certification by Chan of the Impugned Greenheart Documents heightens his involvement and his responsibility for the omission of facts pertaining to his 30% interest in Greenheart Resources and his conflict of interest in the Second and Third Transactions from the Impugned Greenheart Documents.

[1450] Chan had subjective knowledge of the underlying information and actions that made each of the Impugned Greenheart Documents misleading or untrue at the time of their making, due to the omission and active hiding of his 30% interest in Greenheart Resources and conflict of interest in the Second and Third Transactions. Chan, by his failure to disclose his interest in Greenheart Resources and his conflict of interest in the Second and Third Transactions, intentionally prevented Sino-Forest from making the required disclosure. Chan's conduct and knowledge satisfies the threshold required by subsection 122(3).

[1451] We find pursuant to subsection 122(3) of the *Securities Act*, Chan, as Chairman and Chief Executive Officer of Sino-Forest, authorized, permitted and acquiesced in Sino-Forest's failure to state the facts that were required to be stated in the Impugned Greenheart Documents contrary to subsection 122(1)(b) of the *Securities Act* and the public interest.

**IX. ANALYSIS OF THE ALLEGATIONS OF MISLEADING STAFF**

[1452] Staff alleges, during the course of interviews conducted as part of Staff's investigation into this matter, each of Chan, Ip, Hung, Ho and Yeung made statements, which, in a material respect and at the time and in the light of the circumstances under which they were made, were misleading or untrue or did not state a fact that was required to be stated or that was necessary to make the statements not misleading, contrary to subsection 122(1)(a) of the *Securities Act* and contrary to the public interest.

**A. The Law – Misleading the Commission**

[1453] Subsection 122(1)(a) of the *Securities Act* states:

**122. (1) Offences, general** — Every person or company that,

(a) makes a statement in any material, evidence or information submitted to the Commission, a Director, any person acting under the authority of the Commission or the Executive Director or any person appointed to make an investigation or examination under this Act that, in a material respect and at the time and in the light of the circumstances under which it is made, is misleading or untrue or does not state a fact that is required to be stated or that is necessary to make the statement not misleading;

...

is guilty of an offence and on conviction is liable to a fine of not more than \$5 million or to imprisonment for a term of not more than five years less a day, or to both.

...

(2) **Defence** — Without limiting the availability of other defences, no person or company is guilty of an offence under clause (1)(a) or (b) if the person or company did not know and in the exercise of reasonable diligence could not have known that the statement was misleading or untrue or that it omitted to state a fact that was required to be stated or that was necessary to make the statement not misleading in light of the circumstances in which it was made.

**B. Allegations against Chan**

**1. Submissions of the Parties**

**(a) Staff's Submissions**

[1454] Staff alleges Chan misled Staff, when asked whether Sino-Forest had any control over certain suppliers or whether those suppliers were independent, by responding they were independent companies. Staff alleges Chan repeatedly confirmed Yuda Wood was an independent company and that it was not controlled by any employee of Sino-Forest, which was false and misleading. Staff refers to an email concerning the SAFE investigation in April 2011.

**(b) Chan's Submissions**

[1455] Chan refers to three emails, on which Chan is copied, which Staff alleges indicate Sino-Forest's control over Yuda Wood. In addition to the email concerning the SAFE investigation, these emails refer to Yuda Wood's tax issues and a scheme to increase the cost of Yuda Wood's forest purchase from another standing timber supplier, in April and May 2011, respectively. Chan submits it is not reasonable to infer that he read every email on which he was copied.

[1456] Chan submits Staff failed to prove Sino-Forest controlled Yuda Wood and therefore Chan did not make materially misleading statements in his interview contrary to subsection 122(1)(a) of the *Securities Act*.

**2. Analysis**

[1457] Elsewhere in these Reasons, we found Sino-Forest controlled its supplier Yuda Wood. Evidence shows Chan was aware Sino-Forest (Ho specifically) controlled two of Yuda Wood's bank accounts. Yet Chan stated no Sino-Forest employee had any control over any aspect of Yuda Wood's business.

[1458] We agree with Chan it is not reasonable to infer Chan read every email on which he was copied. However, with respect to the April 2011 email concerning the SAFE investigation, this email was a chain of emails beginning on April 13 to May 11, 2011. It was 31 pages long, linking 23 emails. Chan was copied on all 23 emails. Elsewhere in these Reasons, we found it reasonable to conclude Chan read at least some, if not all, of these emails, which dealt with a serious investigation by SAFE and indicated Sino-Forest had control over Yuda Wood.

[1459] Moreover, Yuda Wood was Sino-Forest's largest supplier from 2007 to 2010 with purchases totalling RMB 4,561,599,313. Chan, as a hands-on CEO, would have been aware of any issues of SAFE's investigation of Sino-Forest which related to a major supplier like Yuda Wood.

[1460] In reading the transcript excerpts of Chan's interview, Chan was asked numerous times and in various ways if Sino-Forest had any control over Yuda Wood. In fact, the interviewer stated: "If your opinion does change and you want to change your answer, sir, I'll invite you to do that".

[1461] Despite at least three opportunities, each time Chan denied unequivocally that Sino-Forest had any control over Yuda Wood. We find Chan misled Staff, contrary to subsection 122(1)(a) of the *Securities Act* and the public interest.

**C. Allegations against Ip**

**1. Submissions of the Parties**

**(a) Staff's Submissions**

[1462] Staff alleges Ip misled Staff concerning the creation of Forestry Bureau Confirmations by Sino-Forest when he falsely informed Staff as to the nature of the interaction between the Forestry Bureaus and Sino-Forest personnel surrounding the issuance of Forestry Bureau Confirmations.

[1463] Staff alleges Ip misled Staff about the timing of purported payments made by Sino-Forest to suppliers. Staff alleges Ip stated payments were only made once the purchase contracts were signed, which was false and misleading.

**(b) Ip's Submissions**

[1464] On August 29, 2011, Ip was questioned about payments to suppliers by AIs. Ip's counsel submits there was considerable confusion during the interview, which influenced Ip's reply to a question from Staff. Ip replied:

Okay, I make a claim. So once we confirm with the suppliers on such agreements to purchase. Then I would inform Albert Hung ... Okay, I have to reorganize my thoughts. (Pausing)

So after we have signed agreements to purchase, we would inform Albert Hung to release the payments to the suppliers.

**2. Analysis**

[1465] Staff submits Ip underplayed the influence and control that Sino-Forest had over the process of obtaining Forestry Bureau Confirmations and overplayed the role of suppliers.

[1466] The first reference Staff relies upon regarding the role of Sino-Forest Legal Department, external counsel and the Auditing Department<sup>19</sup> in the preparation of Forest Bureau Confirmations is:

Q. So who are the people who prepared this document?

A. I make a claim. So the draft of this confirmation letter was prepared through our Legal Department in consultation with the legal opinion of Jing Tian company and also in fitting with the demands or stipulation of the Auditing Department.

This describes correctly, in the Panel's view, the process to prepare the original template for the Forestry Bureau Confirmations. We do not find Ip's response to this question misleading.

[1467] The second reference on which Staff relies is in respect of the preparation and issuance of Forestry Bureau Confirmations. In his examination by Staff, Ip stated "the term page would be adjusted in accordance to the formats by the Forestry Bureau". In fact, the format of the Forestry Bureau Confirmations was not changed based on instructions from Forestry Bureaus. Moreover, Sino-Forest was responsible for the entire process of drafting Forestry Bureau Confirmations. Ip's answers to other questions suggested suppliers had a much greater role than was actually the case. Suppliers simply brought the Confirmations to the Forestry Bureaus to be chopped in the format prepared by Sino-Forest. We find Ip misled Staff by underplaying the influence and control of Sino-Forest in the preparation and issuance of the Forestry Bureau Confirmations.

[1468] With respect to Ip's testimony about the timing of payments to suppliers, we accept Ip's submission he was confused. The transcript of Ip's examination indicates the interpreter was tired. Staff was questioning Ip about AIs, yet Ip's response referred to suppliers and he stated at the end that "I have to reorganize my thoughts". Staff did not follow up to clarify either the question they were asking or Ip's answer. This is in contrast to Staff's questioning of Chan, discussed above, where Staff gave Chan several opportunities to clarify or change his misleading answer.

[1469] We find Ip misled Staff with respect to Sino-Forest's role in the creation and issuance of Forestry Bureau Confirmations, contrary to subsection 122(1)(a) of the *Securities Act* and the public interest.

**D. Allegations against Hung**

**1. Submissions of the Parties**

**(a) Staff's Submissions**

[1470] Firstly, Staff alleges Hung misled Staff by falsely describing the creation of purchase contracts, sales contracts and their attachments. Staff alleges Hung made statements that were false and misleading when he informed Staff he confirmed the accuracy of all the information in the purchase contracts and that he ensured the attachments to the purchase contracts, including the Forestry Bureau Confirmations and Survey Reports, would be "in place".

[1471] Secondly, Staff alleges Hung misled Staff as to the timing of alleged payments made pursuant to the Sino-Forest purchase contracts.

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<sup>19</sup> In his examination, Ip referred to the Auditing Department. We assume this is a reference to the Finance Department.

**(b) Hung's Submissions**

[1472] Hung submits a review of his examination by Staff demonstrates he was not evasive about the timing of creation of contracts, nor about the number of times suppliers were paid before the contract was signed.

**2. Analysis**

[1473] A review of Hung's examination does not support the first of Staff's allegations that Hung deliberately misled Staff, but does support the second allegation.

[1474] Hung provided Staff a description of the creation of purchase contracts, sales contracts and their attachments, which we find was generally consistent with the evidence. Hung did not respond directly or fully to certain of Staff's questions. When asked whether there was a schedule associated with the preparation of the contracts, he responded that he would arrange for the preparation of a single contract or several contracts when all of the information was ready. Moreover, when Staff asked Hung if he backdated the contracts, he responded the contracts were dated with the date of the verbal agreement. Although Hung's responses were not directly responsive to those questions, the information he provided was not incorrect. Staff did not follow up with questions which might have probed the responses provided by Hung.

[1475] We find Hung did not mislead Staff when he told Staff he checked details in regards to location, area, inventory, and price and ascertained that "all the information is correct" and would make sure the whole contract, with the attachments inclusive is complete "before forwarding a copy to the accounting service for financial records". Hung stated he would check that two attachments – the Survey Report on forest resources and Forestry Bureau Confirmation – were included. Furthermore, Hung clearly stated he never saw a Villagers' Resolution attached to any BVI purchase contract.

[1476] Turning to the second allegation that Hung misled Staff about the timing of purported payments, the transcript discloses Hung stated he made a payment more than once to a supplier on the verbal instructions of Ip without seeing the contract first. He declined to answer if he made such payments more than ten times or more than twenty times or once a month and stated repeatedly that he could not recall or remember. Hung states in his affidavit he had a sense that the Staff examiner was pressing him for a precise number, which he declined to provide. The transcript discloses clearly, however, that although the Staff examiner was persistent, the Staff examiner was asking for "an estimate", which could be "rather vague", in fact.

[1477] We do not agree the examiner was pressing for a precise number. We find Hung misled Staff with respect to the timing of purported payments made pursuant to the purchase contracts.

[1478] We find Hung misled Staff contrary to subsection 122(1)(a) of the *Securities Act* and the public interest.

**E. Allegations against Ho**

**1. Submissions of the Parties**

**(a) Staff's Submissions**

[1479] Staff alleges Ho misled Staff when specifically asked about what role he took "in the whole BVI process", by providing false and misleading responses of "None whatsoever," and "No, I'm not at all involved in the BVI whatsoever".

[1480] In addition, Staff alleges Ho denied he was copied on any emails or communications involving the BVI Model, which was false and misleading.

[1481] Finally, Staff alleges Ho asserted Yuda Wood was independent of Sino-Forest and that he had no control over any aspect of its business, which information was false and misleading.

**(b) Ho's Submissions**

[1482] Ho submits he was not involved in the BVI process. His activity with Yuda Wood was only regarding WFOE transactions.

## 2. Analysis

[1483] The evidence indicates Ho was copied on emails that involved the BVI Model. We interpret Ho's assertion that he was not involved in the BVI process to mean his involvement was peripheral to his main role in the WFOE Model. Staff has not provided us with any emails or communications otherwise, that indicate a deeper involvement in the BVI Model.

[1484] Ho submits his interaction with Yuda Wood was only with respect to WFOE transactions, and not with the BVI Model. In the interview, Ho is asked if Yuda Wood is a related party. He states:

A. I'm not aware that it is. Yeah.

...

Q. Do you believe Yuda Wood to be an independent company?

A. As far as I can tell, yes, I believe it's an independent company.

Q. Totally independent from Sino-Forest?

A. That's correct.

Q. And you have no control over any aspect of their business whatsoever?

A. No, no. None whatsoever.

[1485] It is clear to the Panel that Ho is asked if Yuda Wood was independent from Sino-Forest. The questions do not specify any relationship to the WFOE Model. Ho monitored Yuda Wood's bank account, had control over it through an internet banking password and authorized transfers from this account. Clearly, Ho had control over this aspect of Yuda Wood's business. We find Ho misled Staff when he asserted he had no control over any aspect of Yuda Wood's business. We find Ho misled Staff contrary to subsection 122(1)(a) of the *Securities Act* and the public interest.

## F. Allegations against Yeung

### 1. Submissions of the Parties

#### (a) Staff's Submissions

[1486] Staff alleges Yeung misled Staff, when specifically asked about his involvement in the creation of Yuda Wood, by responding that he assisted with the application process as a favour to his friend, Huang Ran, and denying Sino-Forest supplied the registration capital for Yuda Wood.

#### (b) Yeung's Submissions

[1487] Yeung submits he was involved in establishing a company called Jaiyu Wood. He explained he was helping Huang Ran register Yuda Wood and his understanding was that HK Sonic Jita paid Yuda Wood's capital.

## 2. Analysis

[1488] Yeung stated in his interview "[t]he capitalization of Yuda has nothing to do with me".

[1489] We discuss extensively elsewhere in these Reasons Yeung's role with respect to Yuda Wood, and why we do not find his explanation in his affidavit and testimony credible.

[1490] We find Yeung misled Staff about his involvement in the creation and capitalization of Yuda Wood.

[1491] We find Yeung misled Staff, contrary to subsection 122(1)(a) of the *Securities Act* and the public interest.

## X. CONCLUSIONS

[1492] For the reasons discussed above, we make the following conclusions.



[1493] In respect of the Standing Timber Fraud Allegations, we find:

- a. Sino-Forest, Chan, Ip, Hung and Ho engaged in deceitful or dishonest conduct related to Sino-Forest's standing timber assets and revenue they knew constituted fraud, contrary to subsection 126.1(b) of the *Securities Act*, and contrary to the public interest.
- b. We dismiss the allegation against Yeung.

[1494] In respect of the allegations of misleading statements regarding Sino-Forest's ownership of assets and revenue recognition, the effect of the Four Frauds on Sino-Forest's reported revenue and Sino-Forest's internal controls, we find:

- a. Sino-Forest made statements in its short form prospectuses, financial statements, MD&As and AIFs issued during the Material Time that were, in a material respect and at the time and in the light of the circumstances under which they were made, misleading or untrue or did not state facts that were necessary to make the statements not misleading, contrary to subsection 122(1)(b) of the *Securities Act* and the public interest;
- b. Pursuant to subsection 122(3) of the *Securities Act*, as an officer of Sino-Forest, Chan authorized and permitted Sino-Forest's making of statements that were, in a material respect and at the time and in the light of the circumstances under which they were made, misleading or untrue or did not state facts that were necessary to make the statements not misleading, contrary to subsection 122(1)(b) of the *Securities Act*, and contrary to the public interest;
- c. Pursuant to subsection 122(3) of the *Securities Act*, as officers of Sino-Forest, Ip and Ho permitted and acquiesced in Sino-Forest's making of statements that were, in a material respect and at the time and in the light of the circumstances under which they were made, misleading or untrue or did not state facts that were necessary to make the statements not misleading, contrary to subsection 122(1)(b) of the *Securities Act*, and contrary to the public interest; and
- d. Pursuant to subsection 122(3) of the *Securities Act*, as an officer of Sino-Forest, Hung permitted Sino-Forest's making of statements in respect of ownership of assets and revenue recognition and acquiesced in Sino-Forest's making of statements in respect of its internal controls that were, in a material respect and at the time and in the light of the circumstances under which they were made, misleading or untrue or did not state facts that were necessary to make the statement not misleading, contrary to subsection 122(1)(b) of the *Securities Act*, and contrary to the public interest.

[1495] In respect of the allegations relating to the Greenheart Transactions, we find:

- a. Chan engaged in an act and course of dishonest conduct that he knew constituted a fraud on Sino-Forest Investors, contrary to subsection 126.1(b) of the *Securities Act* and contrary to the public interest;
- b. Sino-Forest did not state facts that were required to be stated in the Impugned Greenheart documents, contrary to section 122(1)(b) of the *Securities Act* and contrary to the public interest; and
- c. Pursuant to subsection 122(3) of the *Securities Act*, Chan, as Chairman and Chief Executive Officer of Sino-Forest, authorized, permitted and acquiesced in Sino-Forest's failure to state the facts that were required to be stated in the Impugned Greenheart Documents, contrary to subsection 122(1)(b) of the *Securities Act* and the public interest.

[1496] In respect of the allegations of misleading the Commission, we find that each of Chan, Ip, Hung, Ho and Yeung misled Staff during its investigation, contrary to subsection 122(1)(a) of the *Securities Act*, and contrary to the public interest.

[1497] Staff and the Respondents shall contact the Office of the Secretary of the Commission within 30 days of the date of these Reasons to schedule a hearing with respect to sanctions and costs.

Dated at Toronto this 13th day of July, 2017.

"James D. Carnwath"  
James D. Carnwath, Q.C.

"Edward P. Kerwin"  
Edward P. Kerwin

"Deborah Leckman"  
Deborah Leckman

## APPENDIX A – GLOSSARY OF TERMS

Term or Person	Description
Als	Authorized intermediaries, purportedly arm's length companies used in the BVI Model that acted as sales agents in Mainland China for the Sino-Forest BVI subsidiaries.
Ansu Factory	A plastic products factory in Hunan Province that was purchased by the Sino-Forest supplier Yuda Wood in 2006.
AR/AP Set-Off Process	Sino-Forest's off-book system of netting out its accounts receivable and accounts payable such that Sino-Forest customers made payments to its suppliers rather than to Sino-Forest directly.
Ardell, William	Member of the Sino-Forest Board of Directors from January 2010 until dissolution in 2012. Was a member of the Audit Committee, the Corporate Governance Committee, the Compensation and Nominating Committee, and from June 2010 was Lead Director. Following the Muddy Waters Report, was appointed a member of the Independent Committee. Testified in the hearing.
Audit Confirmation Letters	Letters provided to Sino-Forest's auditor E&Y, by Sino-Forest's suppliers and customers, meant to provide independent confirmation of the details of their transactions with Sino-Forest.
BDO	BDO McCabe Lo Limited, Sino-Forest's auditors prior to E&Y.
BVI	British Virgin Islands. Also refers to Sino-Forest subsidiaries incorporated in the British Virgin Islands.
BVI Model	One of Sino-Forest's two main business models whereby Sino-Forest incorporated subsidiary companies in the British Virgin Islands to facilitate its purchase and sale of standing timber in Mainland China.
C&F	Commerce & Finance Law Offices, Chinese counsel whose opinion is in evidence.
Cash Flow Gap	The RMB 50.2 million difference between the accounts receivable and accounts payable that arose as a result of the 450 Transactions.
Chan, Eric	Former Assistant Vice-President of Sino-Forest.
Chan, Pauline	Allen Chan's sister. Principal of Eminens Limited, a company involved in the Greenheart Transactions.
Chau, Alex (a.k.a: Chau Chi Piu)	Chan's "best friend". A director and indirect 25% shareholder of Chan's offshore holding company, ADS Holdings (BVI) Ltd.
Chen Hua	Senior Vice-President – Administration and Finance for Sino-Forest.
Chen Jinxing	Former Sino-Forest employee. Shareholder in Taiyuan, a Sino-Forest supplier.
Chiang, Yosanda	Allen Chan's Executive Assistant at Sino-Forest. Continued to work for Chan following his departure as CEO of Sino-Forest in 2011. Testified in the hearing.
Ching, Ivy	Greenheart Resources employee.
Clifford, Fred	Partner at E&Y, Sino-Forest's auditor from 2007 to 2010. Testified in the hearing.
CNFIF	China National Forestry Industry Federation.
Company Caretaker List	A document containing a list of more than 120 companies. Referred to in our analysis of the allegations of undisclosed control and the Greenheart Transactions.
Confirmation of Sales Situation	Document addressed to Sino-Forest from customers in the BVI Model, which confirm the total standing timber sold pursuant to a sales contract.
Dacheng	Guangxi Dacheng Timber Co., Ltd., a Sino-Forest supplier. Involved in the Dacheng Transactions.
Dongkou	Dongkou Shuanglian Wood Co., Ltd., a Sino-Forest customer.

Term or Person	Description
Du Aiguo	Former Sino-Forest employee. Shareholder in Dongkou, a Sino-Forest customer.
E&Y	Ernst & Young LLP, Sino-Forest's auditors.
<i>Fapiao</i>	Official tax receipts issued by the Chinese Tax Bureau for the purchase of goods or services.
Farmers' Authorizations	See Villagers' Resolutions.
Forestry Bureau Confirmations	Documents prepared by Sino-Forest and chopped by Forestry Bureaus that Sino-Forest relied on as proof of standing timber ownership in the BVI Model.
Forestry Bureaus	Offices of the Chinese state forestry authority.
Fortune Universe	Fortune Universe Limited, a Greenheart Resources shareholder and a BVI company involved in the Greenheart Transactions.
Gao Fajun	Former Sino-Forest employee. Shareholder in Haosen and Meishan, Sino-Forest customers, and Guangxi Chihui Forestry Co. Ltd., a Sino-Forest supplier.
Gengma Dai	Gengma Dai and Wa Tribe Autonomous County Forestry Co., Ltd., a Sino-Forest supplier involved in the Gengma #1 and Gengma #2 Transactions.
Greenheart Resources	Greenheart Resources Holdings Limited, a company in which Sino-Forest purchased a controlling interest, later renamed Greenheart Group Limited.
Hao, Gavin	Chinese Forestry Consultant with the pulp and forestry consulting firm RISI. Qualified and testified in the hearing as an expert in the Chinese forestry industry.
Haosen	Guangxi Pingle Haosen Forestry Development Co., Ltd., a Sino-Forest customer. Involved in the 450 Transactions.
Harvesting/Sales Confirmations	Documents relied on by Sino-Forest to evidence completed sales in the WFOE Model.
He Yongning	Shareholder in Juncheng, a Sino-Forest supplier.
Henderson, Steven	Chartered Professional Accountant at PwC, advisor to the Independent Committee. Involved in creating the work plan for the Independent Committee advisors and led the Canadian PwC team involved in the Independent Committee advisory process. Testified in the hearing.
HK Sonic Jita	Hong Kong Sonic Jita, the parent company of the Sino-Forest supplier Yuda Wood.
Horsley, David	Former Senior Vice-President and CFO of Sino-Forest. Settled with the Commission prior to the start of the hearing, and testified in the hearing.
Hu Liang Mei	In a close personal relationship with Allen Chan. Involved in the Greenheart Transactions.
Huang Ran	Former Sino-Forest employee. Shareholder in HK Sonic Jita, the parent company of Yuda Wood, a Sino-Forest supplier. Legal Representative of Yuda Wood. Shareholder in Yuangao, Taiyuan, Guangxi Chihui Forestry Co. Ltd., and Jiangxi Province Senchangtai Forestry Co. Ltd., Sino-Forest suppliers.
Huang, Dr. Robin Hui	Professor in the Faculty of Law at the Chinese University of Hong Kong. Qualified and testified in the hearing as an expert in translation of the term <i>wai wei gong si</i> from Chinese characters into English.
Hyde, James	Member of the Sino-Forest Board of Directors from 2004 and throughout the Material Time. Was Chair of the Audit Committee and the Corporate Governance Committee and was a member of the Compensation and Nominating Committee. Following the Muddy Waters Report, was appointed a member of the Independent Committee. Testified in the hearing.
ICFR	Internal controls over financial reporting.
Independent Committee	A committee of independent directors of Sino-Forest Board of Directors appointed to examine and review the allegations made in the Muddy Waters Report.

Term or Person	Description
Investors	Investors from which Sino-Forest raised approximately US \$3.0 billion between February 2003 and October 2010 through issuances of debt and equity securities.
Jiang Nanyan (Nancy)	Lei Guangyu's secretary.
Jiayu Wood	Hunan Jiayu Wood Products Co., Ltd., a Sino-Forest WFOE subsidiary located in Hunan Province.
Jingtian	Jingtian & Gongcheng Attorneys at Law, Chinese counsel who provided legal opinions to Sino-Forest.
Jun He	Jun He Law Offices, Chinese legal counsel. An advisor to the Independent Committee.
Juncheng	Dao County Juncheng Forestry Development Co., Ltd., a Sino-Forest supplier.
Kun'an	Guangxi Hezhou City Kun'an Forestry Co., Ltd., a Sino-Forest supplier.
Lam, Marco	Sino-Forest employee.
Lei Guangyu	Friend of Chan. Involved in the Greenheart Transactions. Testified in the hearing.
Li Hua	Legal representative of Bohu, a Sino-Forest supplier.
Lim, Alvin	Financial Controller at Sino-Forest.
Lincang	Lincang City Forest Inventory, Planning & Design Team, a survey company engaged by Sino-Forest in connection with the Gengma #1 Transactions.
Liu, Jinrong	Managing partner of Global Law Office in Beijing, China. Qualified and testified in the hearing as an expert in Chinese law, regulation, and government practices as they relate to specific matters at issue in the hearing.
Liu Zhiwei	Former Sino-Forest employee. Shareholder in Dongkou, a Sino-Forest customer.
Lok Ho Ting	Involved in the Greenheart Transactions.
Lok, Jim	Hong Kong-based businessperson who was Consul General for Hong Kong to Suriname. Director and General Manager of Super View International Holding Limited, the predecessor company to Greenheart Resources.
Long, Anthony	Senior Forensic Accountant in the Enforcement Branch of the Commission. Testified in the hearing.
Lu Qiding	Former Vice-President, Wood Resources of Sino-Panel (China) Investments Ltd. Head of Sino-Panel's Resource Department, reported to Ip.
Lui, Tommy	Shareholder in Greenheart Resources.
Mainland China	The People's Republic of China exclusive of Hong Kong.
Man, Josephine	Chartered Accountant. Former Senior Audit Manager and Audit Planner at E&Y. Audited Sino-Forest's financial statements from 2007 to 2010. Testified in the hearing.
Maoxiang	Yongzhou City Maoxiang Forestry Development Co. Ltd., a Sino-Forest supplier involved in the 450 Transactions.
Maradin, Thomas	Vice-President, Risk Management of Sino-Forest. Testified in the hearing.
March 15 Report	<i>Report on 2008 Internal Control Certification Project</i> , March 15, 2009, a report prepared by Mr. Maradin to the Audit Committee summarizing the progress on remediating internal control deficiencies.
Martin, W. Judson	Member of the Sino-Forest Board of Directors from 2006-2010. Was a member of the Audit Committee, the Compensation and Nominating Committee (of which he was Chair) and the Corporate Governance Committee and was Lead Director from 2007 until 2010. Following Allen Chan's resignation in August 2011, was appointed CEO of Sino-Forest. Testified in the hearing.

Term or Person	Description
Meishan	Guangxi Rongshui Meishan Wood Products Factory, a Sino-Forest customer involved in the 450 Transactions.
MFA	Master Framework Agreement, agreements Sino-Forest entered into with suppliers to purchase standing timber.
Monday Morning Meetings	Weekly Sino-Forest senior management meetings held on Monday mornings mainly to discuss Sino-Forest's strategy and development and to update Chan and senior management on the progress of operations.
Montsford	Montsford Limited, a Greenheart Resources shareholder and a BVI company involved in the Greenheart Transactions.
Muddy Waters Report	A report released by Muddy Waters, LLC on June 2, 2011, alleging fraudulent conduct by Sino-Forest that amounted to a "Ponzi scheme".
Murphy, Michael	Managing Director, Asia Pacific Practice of AlixPartners in Hong Kong. Qualified and testified in the hearing as an expert in Chinese business practices and how they relate to business regulations in China.
Murray, Simon	Member of the Sino-Forest Board of Directors and early investor in Greenheart Resources.
Omicorp	Omicorp Limited, a widely held company listed on the HKSE that was a 60% shareholder in Greenheart Resources and involved in the Greenheart Transactions in which Sino-Forest purchased a controlling interest.
Peerenboom, Dr. Randall	Qualified and testified in the hearing as an expert in the field of Chinese law and cultural practices in China within a comparative global and Asia context.
Plantation Fibre	Term used in Sino-Forest's disclosure to indicate revenue from standing timber and harvested logs.
Pomeroy, James	Vice President of PwC, advisor to the Independent Committee. Testified in the hearing.
Poon, Kai Kit (K.K.)	Co-founder and President of Sino-Forest. Director of Sino-Forest from 2004 to 2008.
Pöyry	Pöyry Forest Industry, the forestry consulting company Sino-Forest retained annually during the Material Time to prepare a valuation of its standing timber holdings.
PRC	Plantation Rights Certificates, official Chinese government documents that provide proof of forestry rights ownership in Mainland China.
PwC	PricewaterhouseCoopers, an advisor to the Independent Committee.
Qi Shuxiong	Former Sino-Forest employee. 80% shareholder of the survey company Zhanjiang Southern.
SAFE	State Administration of Foreign Exchange, the Chinese regulatory body responsible for overseeing the conversion of foreign currency into renminbi.
SAIC	State Administration for Industry and Commerce, the Chinese regulatory body that oversees corporate filings.
<i>Second IC Report</i>	<i>Second Interim Report of the Independent Committee of the Board of Directors of Sino-Forest Corporation</i> , November 3, 2011, the second of three reports the Independent Committee released in the course of its investigation.
Shao, Maggie	Senior Forensic Accountant in the Enforcement Branch of the Commission. Testified in the hearing.
Shen Siguo	Former Sino-Forest employee. Shareholder in Taiyuan.
Shun'xuan	Yunnan Shun'xuan Forestry Co., Ltd., a Sino-Forest supplier.
Sino-Capital Global	Sino-Capital Global Inc., a BVI subsidiary of Sino-Forest involved in the Greenheart Transactions.

Term or Person	Description
Sino-Forest	Sino-Forest Corporation, a commercial forest plantation operator in China and an Ontario reporting issuer during the Material Time.
Sino-Panel	Sino-Panel (Asia) Inc., a BVI subsidiary of Sino-Forest and the parent company of the approximately 48 subsidiary companies in the Sino-Panel Group.
Sino-Panel (Gengma)	Sino-Panel (Gengma) Co., Ltd., a Sino-Forest WFOE subsidiary involved in Gengma #1 Transactions and Gengma #2 Transactions.
Sino-Panel (Guangxi)	Sino-Panel (Guangxi) Development Co., Ltd., a Sino-Forest WFOE subsidiary involved in the 450 Transactions.
Sino-Panel (Hezhou)	Sino-Panel (Hezhou) Co., Ltd., a Sino-Forest WFOE subsidiary involved in the Dacheng Transactions.
Sino-Panel (Jianghua)	Sino-Panel (Jianghua) Co., Ltd., a Sino-Forest WFOE subsidiary involved in the 450 Transactions.
Sino-Panel (Luzhai)	Sino-Panel (Luzhai) Co., Ltd., a Sino-Forest WFOE subsidiary involved in the 450 Transactions.
Sino-Panel (Yunnan)	Sino-Panel (Yunnan) Limited, a Sino-Forest BVI subsidiary involved in Gengma #1 Transactions and Gengma #2 Transactions.
Sino-Panel Group	Sino-Panel (Asia) Inc. and its approximately 48 subsidiary companies with operations in nine provinces in China, headed by Ip.
Sino-Wood	Sino-Wood Partners, Limited, a Hong Kong-incorporated subsidiary of Sino-Forest.
Standing logs	A term used in the hearing to describe unharvested trees priced for sale at the expected volume of logs that those trees will yield.
Standing timber	A term used to describe the ownership of unharvested trees in a given specified area, but does not include ownership of the land on which the trees are growing.
Suri-Wood	Suri-Wood Inc., a Sino-Forest BVI subsidiary involved in the Dacheng Transactions.
Survey Reports	Reports produced by a survey company produced for plantations purchased by Sino-Forest, and listed as attachments to Sino-Forest's BVI purchase contracts.
Taiyuan	Guangxi Rongshui Taiyuan Wood Co., a Sino-Forest supplier involved in the Gengma #2 Transactions.
Tian Jianguo	Former Sino-Forest employee. Shareholder in Kun'an, a Sino-Forest supplier.
Tse, Daphne	CFO of Greenheart Resources.
Van Oppen, David	Shareholder in Greenheart Resources.
Villagers' Resolutions	Authorizations from villagers for the transfer of forestry land owned by a village collective in Mainland China, and listed as attachments to Sino-Forest's BVI purchase contracts. Alternatively translated as "Farmers' Authorizations".
WFOEs	Wholly foreign-owned enterprises, companies incorporated in Mainland China that are owned by foreign companies, such as Sino-Forest.
WFOE Model	One of Sino-Forest's two main business models whereby Sino-Forest incorporated subsidiary companies in Mainland China to directly purchase and sell timber forestry plantation rights in Mainland China.
Wong, Kenny	Sino-Forest employee who reported to Hung.
Wu Ruiming	Former Sino-Forest employee. Shareholder in Shun'xuan, a Sino-Forest supplier.
Xinqi	Gaoyao City Xinqi Forestry Development Co, Ltd., a Sino-Forest customer involved in the 450 Transactions.
Xu Ni	Vice-President of Legal Affairs at Sino-Forest.

**Reasons: Decisions, Orders and Rulings**

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<b>Term or Person</b>	<b>Description</b>
Yang Jun	Former Sino-Forest employee. Worked for Huang Ran. Responsible for finance at Kun'an, Yuda Wood, and Yuangao, Sino-Forest suppliers.
Yu Degang	Former Sino-Forest employee. Shareholder in Kun'an, Maoxiang, and Shun'xuan, Sino-Forest suppliers.
Yuangao	Guangxi Hezhou City Yuangao Forestry Development Co., Ltd., a Sino-Forest supplier involved in the Dacheng Transactions and the 450 Transactions.
Yuda Wood	Huaihua City Yuda Wood Co., Ltd., Sino-Forest's largest supplier to BVI subsidiaries between 2007 and 2010, involved in the Gengma #1 Transactions and the Gengma #2 Transactions.
Zeng, John	Involved in the Greenheart Transactions. Sino-Forest's external counsel, and represented Chan during his interview by Staff in connection with this matter.
Zhanjiang Southern	Zhanjiang Southern Forestry Projects Quality Supervision Co. Ltd., a survey company employed by Sino-Forest to prepare Survey Reports for BVI purchases.
Zhao, Albert	Senior Vice-President of Sino-Forest. Responsible for operations of Sino-Wood and its subsidiaries. Responsible for BVI standing timber sales.

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## Chapter 4

# Cease Trading Orders

### 4.1.1 Temporary, Permanent & Rescinding Issuer Cease Trading Orders

Company Name	Date of Temporary Order	Date of Hearing	Date of Permanent Order	Date of Lapse/Revoke

THERE IS NOTHING TO REPORT THIS WEEK.

### Failure to File Cease Trade Orders

Company Name	Date of Order	Date of Revocation
Aydon Income Properties Inc.	13 July 2017	

### 4.2.1 Temporary, Permanent & Rescinding Management Cease Trading Orders

Company Name	Date of Order	Date of Lapse

THERE IS NOTHING TO REPORT THIS WEEK.

### 4.2.2 Outstanding Management & Insider Cease Trading Orders

Company Name	Date of Order or Temporary Order	Date of Hearing	Date of Permanent Order	Date of Lapse/ Expire	Date of Issuer Temporary Order
Performance Sports Group Ltd.	19 October 2016	31 October 2016	31 October 2016		

Company Name	Date of Order	Date of Lapse

THERE IS NOTHING TO REPORT THIS WEEK.

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## Chapter 7

# Insider Reporting

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This chapter is available in the print version of the OSC Bulletin, as well as as in Carswell's internet service SecuritiesSource (see [www.carswell.com](http://www.carswell.com)).

This chapter contains a weekly summary of insider transactions of Ontario reporting issuers in the System for Electronic Disclosure by Insiders (SEDI). The weekly summary contains insider transactions reported during the seven days ending Sunday at 11:59 pm.

To obtain Insider Reporting information, please visit the SEDI website ([www.sedi.ca](http://www.sedi.ca)).



## Chapter 11

# IPOs, New Issues and Secondary Financings

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### INVESTMENT FUNDS

**Issuer Name:**

AGF American Growth Class  
AGF Canadian Large Cap Dividend Class  
AGF Canadian Large Cap Dividend Fund  
AGF Canadian Stock Fund  
AGF Diversified Income Class  
AGF Diversified Income Fund  
AGF Dividend Income Fund  
AGF Elements Balanced Portfolio  
AGF Elements Balanced Portfolio Class  
AGF Elements Conservative Portfolio  
AGF Elements Conservative Portfolio Class  
AGF Elements Global Portfolio  
AGF Elements Global Portfolio Class  
AGF Elements Growth Portfolio  
AGF Elements Growth Portfolio Class  
AGF Elements Yield Portfolio  
AGF Elements Yield Portfolio Class  
AGF Emerging Markets Bond Fund  
AGF Emerging Markets Class  
AGF Emerging Markets Fund  
AGF Equity Income Focus Fund  
AGF Fixed Income Plus Class  
AGF Fixed Income Plus Fund  
AGF Flex Asset Allocation Fund  
AGF Floating Rate Income Fund  
AGF Global Balanced Fund  
AGF Global Bond Fund  
AGF Global Convertible Bond Fund  
AGF Global Dividend Class  
AGF Global Dividend Fund  
AGF Global Equity Class  
AGF Global Equity Fund  
AGF Global Sustainable Growth Equity Fund  
AGF High Yield Bond Fund  
AGF Income Focus Fund  
AGF Monthly High Income Fund  
AGF Tactical Income Fund  
AGF Total Return Bond Class  
AGF Total Return Bond Fund  
AGF Traditional Income Fund  
AGF U.S. Sector Class  
AGF U.S. Small-Mid Cap Fund  
Principal Regulator – Ontario

**Type and Date:**

Amendment #2 to Final Simplified Prospectus dated July 17, 2017

Received on July 17, 2017

**Offering Price and Description:**

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**Underwriter(s) or Distributor(s):**

AGF Funds Inc.

**Promoter(s):**

AGF Investments Inc.

Project #2596084

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**Issuer Name:**

Fiera Capital Balanced Fund  
Fiera Capital Bond Fund  
Fiera Capital Core Canadian Equity Fund  
Fiera Capital Defensive Global Equity Fund  
Fiera Capital Equity Growth Fund  
Fiera Capital Global Equity Fund  
Fiera Capital High Income Fund  
Fiera Capital International Equity Fund  
Fiera Capital U.S. Equity Fund  
Principal Regulator – Quebec

**Type and Date:**

Combined Preliminary and Pro Forma Simplified Prospectus dated July 11, 2017

NP 11-202 Preliminary Receipt dated July 13, 2017

**Offering Price and Description:**

Series AH Units and FH Units

**Underwriter(s) or Distributor(s):**

-

**Promoter(s):**

Fiera Capital Corporation

Project #2649089

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**Issuer Name:**

Norrep High Yield Class of Norrep Opportunities Corp.  
Norrep High Income Fund  
Principal Regulator – Alberta

**Type and Date:**

Amendment #1 to Final Simplified Prospectus dated July 14, 2017

Received on July 17, 2017

**Offering Price and Description:**

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**Underwriter(s) or Distributor(s):**

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**Promoter(s):**

Norrep Investment Management Group Inc.

Project #2633398

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**Issuer Name:**

Allegro Aggressive Canada Focus Portfolio  
Allegro Aggressive Portfolio  
Allegro Conservative Portfolio  
Allegro Moderate Aggressive Canada Focus Portfolio  
Allegro Moderate Aggressive Portfolio  
Allegro Moderate Conservative Portfolio  
Allegro Moderate Portfolio  
Alto Aggressive Canada Focus Portfolio  
Alto Aggressive Portfolio  
Alto Conservative Portfolio  
Alto Moderate Aggressive Canada Focus Portfolio  
Alto Moderate Aggressive Portfolio  
Alto Moderate Conservative Portfolio  
Alto Moderate Portfolio  
Alto Monthly Income and Enhanced Growth Portfolio  
Alto Monthly Income and Global Growth Portfolio  
Alto Monthly Income and Growth Portfolio  
Alto Monthly Income Portfolio  
IG AGF Canadian Balanced Fund  
IG AGF Global Equity Fund  
IG AGF U.S. Growth Fund  
IG Beutel Goodman Canadian Balanced Fund  
IG Beutel Goodman Canadian Equity Fund  
IG Beutel Goodman Canadian Small Cap Fund  
IG FI Canadian Allocation Fund  
IG FI Canadian Equity Fund  
IG FI U.S. Large Cap Equity Fund  
IG Fiera Canadian Small Cap Fund (Formerly IG AGF Canadian Diversified Growth Fund)  
IG Franklin Bissett Canadian Equity Fund  
IG Mackenzie Canadian Equity Growth Fund  
IG Mackenzie Cundill Global Value Fund  
IG Mackenzie Dividend Growth Fund  
IG Mackenzie Floating Rate Income Fund  
IG Mackenzie Income Fund  
IG Mackenzie Ivy European Fund  
IG Mackenzie Strategic Income Fund  
IG Putnam Emerging Markets Income Fund  
IG Putnam Low Volatility U.S. Equity Fund  
IG Putnam U.S. Growth Fund  
IG Putnam U.S. High Yield Income Fund  
IG Templeton International Equity Fund  
Investors Canadian Balanced Fund  
Investors Canadian Bond Fund  
Investors Canadian Corporate Bond Fund  
Investors Canadian Equity Fund  
Investors Canadian Equity Income Fund  
Investors Canadian Growth Fund  
Investors Canadian High Yield Income Fund  
Investors Canadian Large Cap Value Fund  
Investors Canadian Money Market Fund  
Investors Canadian Natural Resource Fund  
Investors Canadian Small Cap Fund  
Investors Canadian Small Cap Growth Fund  
Investors Core Canadian Equity Fund  
Investors Core U.S. Equity Fund  
Investors Cornerstone I Portfolio  
Investors Cornerstone II Portfolio  
Investors Cornerstone III Portfolio  
Investors Dividend Fund  
Investors European Equity Fund  
Investors European Mid-Cap Equity Fund

Investors Fixed Income Flex Portfolio  
Investors Global Bond Fund  
Investors Global Dividend Fund  
Investors Global Financial Services Fund  
Investors Global Fixed Income Flex Portfolio  
Investors Global Fund  
Investors Global Real Estate Fund  
Investors Global Science & Technology Fund  
Investors Greater China Fund  
Investors Growth Plus Portfolio  
Investors Growth Portfolio  
Investors Income Plus Portfolio  
Investors International Equity Fund  
Investors Low Volatility Canadian Equity Fund  
Investors Low Volatility Global Equity Fund  
Investors Mortgage and Short Term Income Fund  
Investors Mutual of Canada  
Investors North American Equity Fund  
Investors Pacific International Fund  
Investors Pan Asian Equity Fund  
Investors Quebec Enterprise Fund  
Investors Retirement Growth Portfolio  
Investors Retirement Plus Portfolio  
Investors Summa SRI Fund  
Investors U.S. Dividend Growth Fund  
Investors U.S. Dividend Registered Fund  
Investors U.S. Large Cap Value Fund  
Investors U.S. Money Market Fund  
Investors U.S. Opportunities Fund  
Maestro Balanced Portfolio  
Maestro Growth Focused Portfolio  
Maestro Income Balanced Portfolio  
Principal Regulator – Manitoba

**Type and Date:**

Final Simplified Prospectus dated June 30, 2017  
NP 11-202 Receipt dated July 14, 2017

**Offering Price and Description:**

Mutual Fund Trust Units, Series RDSP Units, Classic Series Units, Premium Series Units, Series A, Series B, Series C, Series JDSC, Series JNL, Series A, Series B, Series C, Series JDSC, Series A-RDSP and Series B-RDSP Units, Series TNL, Series TDSC, Series TC, Series TJDSC, Series TJNL, Series U and Series Tu Units @ Net Asset Value

**Underwriter(s) or Distributor(s):**

INVESTORS GROUP SECURITIES INC.  
Investors Group Financial Services Inc.  
Investors Group Financial Inc.

**Promoter(s):**

I.G. INVESTMENT MANAGEMENT, LTD.

**Project #2636004**

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**Issuer Name:**

Allegro Balanced Growth Canada Focus Portfolio Class  
Allegro Balanced Growth Portfolio Class  
Allegro Balanced Portfolio Class  
Allegro Growth Canada Focus Portfolio Class  
Allegro Growth Portfolio Class  
Allegro Income Balanced Portfolio Class  
IG AGF Global Equity Class  
IG AGF U.S. Growth Class  
IG Beutel Goodman Canadian Equity Class  
IG FI Canadian Equity Class  
IG FI U.S. Large Cap Equity Class  
IG Fiera Canadian Small Cap Class (formerly IG AGF Canadian Diversified Growth Class)  
IG Franklin Bissett Canadian Equity Class  
IG Mackenzie Canadian Equity Growth Class  
IG Mackenzie Cundill Global Value Class  
IG Mackenzie Emerging Markets Class  
IG Mackenzie Global Precious Metals Class  
IG Mackenzie Ivy European Class  
IG Mackenzie Ivy Foreign Equity Class  
IG Putnam Low Volatility U.S. Equity Class  
IG Putnam U.S. Growth Class  
IG Templeton International Equity Class  
Investors Canadian Equity Class  
Investors Canadian Growth Class  
Investors Canadian Large Cap Value Class  
Investors Canadian Money Market Class (formerly Investors Managed Yield Class)  
Investors Canadian Small Cap Class  
Investors Canadian Small Cap Growth Class  
Investors Core Canadian Equity Class  
Investors Core U.S. Equity Class  
Investors Dividend Class  
Investors European Equity Class  
Investors European Mid-Cap Equity Class  
Investors Global Class  
Investors Global Consumer Companies Class  
Investors Global Financial Services Class  
Investors Global Health Care Class  
Investors Global Infrastructure Class  
Investors Global Natural Resources Class  
Investors Global Science & Technology Class  
Investors Greater China Class  
Investors International Equity Class  
Investors International Small Cap Class  
Investors Low Volatility Canadian Equity Class  
Investors Low Volatility Global Equity Class  
Investors North American Equity Class  
Investors Pacific International Class  
Investors Pan Asian Equity Class  
Investors Québec Enterprise Class  
Investors Summa SRI Class  
Investors U.S. Large Cap Value Class  
Investors U.S. Opportunities Class  
Investors U.S. Small Cap Class  
Maestro Balanced Portfolio Class  
Maestro Growth Focused Portfolio Class  
Maestro Income Balanced Portfolio Class  
Principal Regulator – Manitoba

**Type and Date:**

Final Simplified Prospectus dated June 30, 2017  
NP 11-202 Receipt dated July 14, 2017

**Offering Price and Description:**

Series A, Series B, Series JDSC, Series JNL and Series U Shares, Series TDSC, Series TNL, Series TJDSC, Series TJNL and Series TU @ Net Asset Value

**Underwriter(s) or Distributor(s):**

INVESTORS GROUP SECURITIES INC.

Investors Group Financial Services Inc.

Investors Group Financial Inc.

Investors Financial Services Inc.

**Promoter(s):**

I.G. INVESTMENT MANAGEMENT, LTD.

**Project #2636043**

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**Issuer Name:**

BetaPro Canadian Gold Miners -2x Daily Bear ETF (formerly Horizons BetaPro S&P/TSX Global Gold Bear Plus ETF)  
BetaPro Canadian Gold Miners 2x Daily Bull ETF (formerly Horizons BetaPro S&P/TSX Global Gold Bull Plus ETF)  
BetaPro NASDAQ-100® -2x Daily Bear ETF (formerly Horizons BetaPro NASDAQ-100® Bear Plus ETF)  
BetaPro NASDAQ-100® 2x Daily Bull ETF (formerly Horizons BetaPro NASDAQ-100® Bull Plus ETF)  
BetaPro S&P 500® -2x Daily Bear ETF (formerly Horizons BetaPro S&P 500® Bear Plus ETF)  
BetaPro S&P 500® 2x Daily Bull ETF (formerly Horizons BetaPro S&P 500® Bull Plus ETF)  
BetaPro S&P 500® Daily Inverse ETF (formerly Horizons BetaPro S&P 500® Inverse ETF)  
BetaPro S&P/TSX 60 -2x Daily Bear ETF (formerly Horizons BetaPro S&P/TSX 60 Bear Plus ETF)  
BetaPro S&P/TSX 60 2x Daily Bull ETF (formerly Horizons BetaPro S&P/TSX 60 Bull Plus ETF)  
BetaPro S&P/TSX 60 Daily Inverse ETF (formerly Horizons BetaPro S&P/TSX 60 Inverse ETF)  
BetaPro S&P/TSX Capped Energy -2x Daily Bear ETF (formerly Horizons BetaPro S&P/TSX Capped Energy Bear Plus ETF)  
BetaPro S&P/TSX Capped Energy 2x Daily Bull ETF (formerly Horizons BetaPro S&P/TSX Capped Energy Bull Plus ETF)  
BetaPro S&P/TSX Capped Financials -2x Daily Bear ETF (formerly Horizons BetaPro S&P/TSX Capped Financials Bear Plus ETF)  
BetaPro S&P/TSX Capped Financials 2x Daily Bull ETF (formerly Horizons BetaPro S&P/TSX Capped Financials Bull Plus ETF)  
Principal Regulator – Ontario

**Type and Date:**

Final Long Form Prospectus dated July 13, 2017

NP 11-202 Receipt dated July 17, 2017

**Offering Price and Description:**

Class A units @ Net Asset Value

**Underwriter(s) or Distributor(s):**

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**Promoter(s):**

HORIZONS ETFs MANAGEMENT (CANADA) INC.

**Project #2637975**

**Issuer Name:**

BetaPro Crude Oil -2x Daily Bear ETF (formerly Horizons BetaPro NYMEX® Crude Oil Bear Plus ETF)  
BetaPro Crude Oil 2x Daily Bull ETF (formerly Horizons BetaPro NYMEX® Crude Oil Bull Plus ETF)  
BetaPro Gold Bullion -2x Daily Bear ETF (formerly Horizons BetaPro COMEX® Gold Bullion Bear Plus ETF)  
BetaPro Gold Bullion 2x Daily Bull ETF (formerly Horizons BetaPro COMEX® Gold Bullion Bull Plus ETF)  
BetaPro Natural Gas -2x Daily Bear ETF (formerly Horizons BetaPro NYMEX® Natural Gas Bear Plus ETF)  
BetaPro Natural Gas 2x Daily Bull ETF (formerly Horizons BetaPro NYMEX® Natural Gas Bull Plus ETF)  
BetaPro Silver -2x Daily Bear ETF (formerly Horizons BetaPro COMEX® Silver Bear Plus ETF)  
BetaPro Silver 2x Daily Bull ETF (formerly Horizons BetaPro COMEX® Silver Bull Plus ETF)  
Principal Regulator – Ontario

**Type and Date:**

Final Long Form Prospectus dated July 13, 2017  
NP 11-202 Receipt dated July 17, 2017

**Offering Price and Description:**

Class A units @ Net Asset Value

**Underwriter(s) or Distributor(s):**

-

**Promoter(s):**

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**Project #2637990**

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**Issuer Name:**

CIBC Asia Pacific Fund  
CIBC Asia Pacific Index Fund  
CIBC Balanced Fund  
CIBC Balanced Growth Passive Portfolio  
CIBC Balanced Index Fund  
CIBC Balanced Passive Portfolio  
CIBC Canadian Bond Fund  
CIBC Canadian Bond Index Fund  
CIBC Canadian Equity Fund  
CIBC Canadian Equity Value Fund  
CIBC Canadian Index Fund  
CIBC Canadian Real Estate Fund  
CIBC Canadian Resources Fund  
CIBC Canadian Short-Term Bond Index Fund  
CIBC Canadian Small-Cap Fund  
CIBC Canadian T-Bill Fund  
CIBC Conservative Passive Portfolio  
CIBC Dividend Growth Fund  
CIBC Dividend Income Fund  
CIBC Emerging Markets Fund  
CIBC Emerging Markets Index Fund  
CIBC Energy Fund  
CIBC European Equity Fund  
CIBC European Index Fund  
CIBC Financial Companies Fund  
CIBC Global Bond Fund  
CIBC Global Bond Index Fund  
CIBC Global Equity Fund  
CIBC Global Monthly Income Fund  
CIBC Global Technology Fund  
CIBC International Equity Fund  
CIBC International Index Fund  
CIBC International Small Companies Fund  
CIBC Latin American Fund  
CIBC Managed Aggressive Growth Portfolio  
CIBC Managed Balanced Growth Portfolio  
CIBC Managed Balanced Portfolio  
CIBC Managed Growth Portfolio  
CIBC Managed Income Plus Portfolio  
CIBC Managed Income Portfolio  
CIBC Managed Monthly Income Balanced Portfolio  
CIBC Money Market Fund  
CIBC Monthly Income Fund  
CIBC Nasdaq Index Fund  
CIBC Precious Metals Fund  
CIBC Short-Term Income Fund  
CIBC U.S. Broad Market Index Fund  
CIBC U.S. Dollar Managed Balanced Portfolio  
CIBC U.S. Dollar Managed Growth Portfolio  
CIBC U.S. Dollar Managed Income Portfolio  
CIBC U.S. Dollar Money Market Fund  
CIBC U.S. Equity Fund  
CIBC U.S. Index Fund  
CIBC U.S. Small Companies Fund  
Principal Regulator – Ontario

**Type and Date:**

Final Simplified Prospectus dated July 5, 2017  
NP 11-202 Receipt dated July 17, 2017

**Offering Price and Description:**

Class A, Premium Class, Class O, Class T4, Class T8, Institutional Class, Class D and Class F Units



**Underwriter(s) or Distributor(s):**

CIBC Securities Inc.

**Promoter(s):**

Canadian Imperial Bank of Commerce

Project #2628240

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**Issuer Name:**

Educators North American Diversified Fund

Principal Regulator – Ontario

**Type and Date:**

Amendment #1 to Final Simplified Prospectus dated June 30, 2017

NP 11-202 Receipt dated July 11, 2017

**Offering Price and Description:**

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**Underwriter(s) or Distributor(s):**

Educators Financial Group Inc.

**Promoter(s):**

Educators Financial Group Inc.

Project #2609937

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**Issuer Name:**

Horizons Crude Oil ETF (formerly Horizons NYMEX® Crude Oil ETF)

Horizons Gold ETF (formerly Horizons COMEX® Gold ETF)

Horizons Natural Gas ETF (formerly Horizons NYMEX® Natural Gas ETF)

Horizons Silver ETF (formerly Horizons COMEX® Silver ETF)

Principal Regulator – Ontario

**Type and Date:**

Final Long Form Prospectus dated July 13, 2017

NP 11-202 Receipt dated July 17, 2017

**Offering Price and Description:**

Class A units @ Net Asset Value

**Underwriter(s) or Distributor(s):**

-

**Promoter(s):**

HORIZONS ETFs MANAGEMENT (CANADA) INC.

Project #2637997

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**Issuer Name:**

Investors Canadian Money Market Class (formerly

Investors Managed Yield Class)

iProfile Canadian Equity Class

iProfile Canadian Equity Pool

iProfile Emerging Markets Class

iProfile Emerging Markets Pool

iProfile Fixed Income Pool

iProfile International Equity Class

iProfile International Equity Pool

iProfile U.S. Equity Class

iProfile U.S. Equity Pool

Principal Regulator – Manitoba

**Type and Date:**

Final Simplified Prospectus dated June 30, 2017

NP 11-202 Receipt dated July 14, 2017

**Offering Price and Description:**

Series I and Series TI Units, Series I and Series TI Shares

@ Net Asset Value

**Underwriter(s) or Distributor(s):**

INVESTORS GROUP SECURITIES INC.

Investors Group Financial Services Inc.

**Promoter(s):**

I.G. INVESTMENT MANAGEMENT, LTD.

Project #2636137

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NON-INVESTMENT FUNDS

**Issuer Name:**

Chemtrade Logistics Income Fund  
Principal Regulator – Ontario

**Type and Date:**

Preliminary Short Form Prospectus dated July 14, 2017  
NP 11-202 Preliminary Receipt dated July 14, 2017

**Offering Price and Description:**

\$84,011,000 5.50% Convertible Unsecured Subordinated  
Debentures due 2020  
\$74,584,000 5.75% Convertible Unsecured Subordinated  
Debentures due 2021

**Underwriter(s) or Distributor(s):**

-

**Promoter(s):**

-

**Project #2649711**

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**Issuer Name:**

Rogers Sugar Inc.  
Principal Regulator – British Columbia

**Type and Date:**

Preliminary Short Form Prospectus dated July 14, 2017  
NP 11-202 Preliminary Receipt dated July 14, 2017

**Offering Price and Description:**

\$60,180,000.00 – 10,200,000 Subscription Receipts each  
representing the right to receive one RSI Share and  
\$50,000,000 Sixth Series 5.00% Extendible Convertible  
Unsecured Subordinated Debentures  
Price: \$5.90 per Subscription Receipt  
Price: \$1,000 per Offered Debenture

**Underwriter(s) or Distributor(s):**

TD SECURITIES INC.  
BMO NESBITT BURNS INC.  
NATIONAL BANK FINANCIAL INC.  
SCOTIA CAPITAL INC.  
RBC DOMINION SECURITIES INC.  
CIBCWORLDMARKETS INC.  
DESJARDINS SECURITIES INC.

**Promoter(s):**

-

**Project #2648795**

**Issuer Name:**

Alio Gold Inc.  
Principal Regulator – British Columbia

**Type and Date:**

Final Short Form Prospectus dated July 12, 2017  
NP 11-202 Receipt dated July 12, 2017

**Offering Price and Description:**

\$50,000,000.00 – 8,000,000 Units, Price: \$6.25 per Offered  
Unit

**Underwriter(s) or Distributor(s):**

CORMARK SECURITIES INC.  
CLARUS SECURITIES INC.  
RAYMOND JAMES LTD.  
BMO NESBITT BURNS INC.

**Promoter(s):**

-

**Project #2646789**

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**Issuer Name:**

Cautivo Mining Inc.  
Principal Regulator – Ontario

**Type and Date:**

Final Long Form Prospectus dated July 10, 2017  
NP 11-202 Receipt dated July 11, 2017

**Offering Price and Description:**

Distribution of 3,253,588 Common Shares of Cautivo  
Mining Inc. as a Return of Capital

- and -

Distribution of Rights to Subscribe for up to 11,904,761  
Common Shares of Cautivo Mining Inc.

**Underwriter(s) or Distributor(s):**

Eight Capital

**Promoter(s):**

Sierra Metals Inc.

**Project #2573488**

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**Issuer Name:**

Firm Capital Mortgage Investment Corporation  
Principal Regulator – Ontario

**Type and Date:**

Final Shelf Prospectus dated July 17, 2017  
NP 11-202 Receipt dated July 17, 2017

**Offering Price and Description:**

\$250,000,000.00 – Common Shares, Preferred Shares,  
Debt Securities, Subscription Receipts, Warrants, Units

**Underwriter(s) or Distributor(s):**

-

**Promoter(s):**

-

**Project #2648575**

**Issuer Name:**

StorageVault Canada Inc.  
Principal Regulator – Ontario

**Type and Date:**

Final Short Form Prospectus dated July 12, 2017  
NP 11-202 Receipt dated July 12, 2017

**Offering Price and Description:**

\$135,001,600.00 – 50,944,000 Common Shares, Price:  
\$2.65 per Common Share

**Underwriter(s) or Distributor(s):**

NATIONAL BANK FINANCIAL INC.  
GMP SECURITIES L.P.  
CORMARK SECURITIES INC.  
RAYMOND JAMES LTD.  
BMO NESBITT BURNS INC.  
CIBC WORLD MARKETS INC.  
SCOTIA CAPITAL INC.  
TD SECURITIES INC.  
CANACCORD GENUITY CORP.  
INDUSTRIAL ALLIANCE SECURITIES INC.

**Promoter(s):**

-

**Project #2645646**

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**Issuer Name:**

TransAlta Renewables Inc.  
Principal Regulator – Alberta

**Type and Date:**

Final Shelf Prospectus dated July 12, 2017  
NP 11-202 Receipt dated July 12, 2017

**Offering Price and Description:**

\$1,000,000,000.00 – Common Shares, Preferred Shares,  
Warrants, Subscription Receipts, Debt Securities

**Underwriter(s) or Distributor(s):**

-

**Promoter(s):**

-

**Project #2644447**

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**Issuer Name:**

WPT Industrial Real Estate Investment Trust  
Principal Regulator – Ontario

**Type and Date:**

Final Short Form Prospectus dated July 11, 2017  
NP 11-202 Receipt dated July 11, 2017

**Offering Price and Description:**

US\$115,071,750.00 – 8,955,000 Units. Price: US\$12.85  
per Unit

**Underwriter(s) or Distributor(s):**

DESJARDINS SECURITIES INC.  
CIBC WORLD MARKETS INC.  
RBC DOMINION SECURITIES INC.  
BMO NESBITT BURNS INC.  
NATIONAL BANK FINANCIAL INC.  
SCOTIA CAPITAL INC.  
TD SECURITIES INC.  
GMP SECURITIES L.P.  
INDUSTRIAL ALLIANCE SECURITIES INC.  
CANACCORD GENUITY CORP.

**Promoter(s):**

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**Project #2644419**

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## Chapter 12

# Registrations

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### 12.1.1 Registrants

Type	Company	Category of Registration	Effective Date

THERE IS NOTHING TO REPORT THIS WEEK.

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## Chapter 13

# SROs, Marketplaces, Clearing Agencies and Trade Repositories

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### 13.1 SROs

#### 13.1.1 MFDA – New MFDA Policy No. 8 (Proficiency Standard for Approved Persons Selling ETFs) – OSC Staff Notice of Commission Approval

##### OSC STAFF NOTICE OF COMMISSION APPROVAL

##### THE MUTUAL FUND DEALERS ASSOCIATION OF CANADA (MFDA)

##### NEW POLICY NO. 8 (PROFICIENCY STANDARD FOR APPROVED PERSONS SELLING ETFs)

The Recognizing Regulators of the Mutual Fund Dealers Association of Canada (MFDA) have approved or not objected to the new MFDA Policy No. 8. The new policy will establish minimum standards that are intended to ensure that Approved Persons trading ETFs have the education, training and experience that a reasonable person would consider necessary to perform the activity competently.

The proposed new MFDA Policy No. 8 was published for comment on June 30, 2016 for a 90 day comment period. Six comment letters were received. A copy of the MFDA proposed amendments, including the MFDA's summary of and responses to the comment letters, can be found on our website at <http://www.osc.gov.on.ca>. The amendments are effective immediately.

In addition, the British Columbia Securities Commission, the Alberta Securities Commission, the Financial and Consumer Affairs Authority of Saskatchewan, the Financial and Consumer Services Commission of New Brunswick, the Manitoba Securities Commission, the Nova Scotia Securities Commission, and the Prince Edward Island Office of the Superintendent of Securities Office did not object to or approved the amendments.

**13.3 Clearing Agencies**

**13.3.1 CDS – Technical Amendments to CDS Procedures – T+2 – Notice of Effective Date**

**NOTICE OF EFFECTIVE DATE**

**TECHNICAL AMENDMENTS TO CDS PROCEDURES – T+2**

The Ontario Securities Commission is publishing *Notice of Effective Date – Technical Amendments to CDS Procedures – T+2*. The CDS procedure amendments were reviewed and approved by CDS's strategic development review committee (SDRC) on May 25, 2017.

A copy of the CDS notice is published on our website <http://www.osc.gov.on.ca>.



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