

Court File No.  
CV-12-9666-00CL

ONTARIO  
SUPERIOR COURT OF JUSTICE  
(Commercial List)

BETWEEN:

SINO-FOREST CORPORATION

Plaintiff



- and -

MUDDY WATERS, LLC, CARSON C. BLOCK, and  
JOHN DOE INVESTMENT FIRM 1 through  
JOHN DOE INVESTMENT FIRM 100

Defendants

**STATEMENT OF CLAIM**

TO THE DEFENDANTS:

A LEGAL PROCEEDING HAS BEEN COMMENCED AGAINST YOU by the Plaintiffs. The claim made against you is set out in the following pages.

IF YOU WISH TO DEFEND THIS PROCEEDING, you or an Ontario lawyer acting for you must prepare a statement of defence in Form 18A prescribed by the *Rules of Civil Procedure*, serve it on the Plaintiffs' lawyer or, where the Plaintiffs do not have a lawyer, serve it on the Plaintiffs, and file it, with proof of service, in this court office, WITHIN TWENTY DAYS after this statement of claim is served on you, if you are served in Ontario.

If you are served in another province or territory of Canada or in the United States of America, the period for serving and filing your statement of defence is forty days. If you are served outside of Canada and the United States of America, the period is sixty days.

Instead of serving and filing a statement of defence, you may serve and file a notice of intent to defend in Form 18B prescribed by the Rules of Court. This will entitle you to ten more days within which to serve and file your statement of defence.

IF YOU FAIL TO DEFEND THIS PROCEEDING, JUDGMENT MAY BE GIVEN AGAINST YOU IN YOUR ABSENCE AND WITHOUT FURTHER NOTICE TO YOU. IF YOU WISH TO DEFEND THIS PROCEEDING BUT ARE UNABLE TO PAY LEGAL FEES, LEGAL AID MAY BE AVAILABLE TO YOU BY CONTACTING A LOCAL LEGAL AID OFFICE.

Date Issued: March <sup>29<sup>th</sup></sup> 2012

Issued by Natasha Brown  
Local registrar

**Natasha Brown  
Registrar**

Address of Court office:  
330 University Avenue  
7<sup>th</sup> Floor  
Toronto, Ontario  
M5G 1E6 <sup>1R7, n3</sup>

TO: MUDDY WATERS, LLC  
1559 Michael Lane  
Pacific Palisades, CA  
90272

*Additional Service To:*

1158 Luo Chuan Middle Road  
Building 1, Floor 3  
Shanghai, China  
200072

*And additional service to its Registered Agent:*

Silver Shield Services Inc.  
3315 Highway 50  
PO Box 3540  
Silver Springs, NV  
89429

AND TO: CARSON BLOCK  
1559 Michael Lane  
Pacific Palisades, CA  
90272

*Additional Service To:*

1158 Luo Chuan Middle Road  
Building 1, Floor 3  
Shanghai, China  
200072

AND TO: JOHN DOE INVESTMENT FIRM 1

*through*

JOHN DOE INVESTMENT FIRM 100

**CLAIM**

1. The plaintiff, Sino-Forest Corporation ("Sino-Forest"), claims against the defendants:
  - a. general damages in the amount of \$3.5 billion for defamation and unlawful interference with economic relations;
  - b. in the alternative, an accounting of any and all profits made by the defendants in connection with any trades of Sino-Forest securities, including without limitation from short-sales of Sino-Forest common shares realized on or after June 2, 2011, and to the extent that such amounts are greater than any amount of general damages awarded, disgorgement or such other equitable remedy in relation to the wrongful profits;
  - c. special damages in the amount of \$100 million for costs associated with the investigation of the tortious false allegations made by certain of the defendants as described below;
  - d. punitive damages in the amount of \$400 million;
  - e. to a permanent injunction prohibiting the further republication of the defamatory words referred to herein;
  - f. costs of this action on a full indemnity basis as a result of the nature of the tortious activity perpetrated by the defendants;
  - g. prejudgment and postjudgment interest in accordance with the *Courts of Justice* Act, R.S.O. 1990, c. C-43; and

- h. such further and other relief as counsel may request and as this Honourable Court may permit.

## **I. OVERVIEW**

2. Muddy Waters LLC ("Muddy Waters") and Carson Block ("Block"), along with the other defendants, devised an unlawful scheme whereby various hedge funds would secure a short position in Western-listed companies with substantial business interests in the People's Republic of China (the "PRC" or "China"), and then would commit what is popularly described as a "bear attack" on those companies.
3. The large and increased short position on the company would increase downward pressure on the stock price, which pressure ultimately would be released upon the issuance of a report containing sensational allegations of fraud, corruption, and illegal activity. The allegations in the report would not need to be true: they would only need to have the appearance or veneer of truth, to have their desired effect. That desired effect would be a cataclysmic effect on the stock price of the group's target and the resulting enrichment of the short-selling group.
4. Muddy Waters and Block road-tested this strategy on two companies: Orient Paper Inc. ("Orient Paper") and RINO International Corporation ("RINO"). After alleging that both of these companies were frauds, Muddy Waters and Block realized that their reports could have devastating effects on the stock. Whereas Block only expected a minor effect, stating in an interview that "maybe the stock would trade down a point or so", the effect on both companies was much more profound: Orient Paper's stock declined by 55% in two days, and RINO's stock declined by more than 60% in two weeks.
5. Even where the target provided evidence showing the statements to be false, the market

overhang on the stock remained. In other words, the truth of the statements did not matter at all: it was sufficient to simply make the allegations of fraud.

6. Muddy Waters and Block tried this strategy again with two other Chinese-based companies, with the same effect. Having seen the power that Muddy Waters' and Block's reports could have, the stage was set for the defendants' biggest bear attack yet: Sino-Forest.

7. Prior to any involvement by the defendants, Sino-Forest was one of Canada's most valuable forestry companies, and the largest single forestry company throughout the PRC. Sino-Forest's CEO was appointed as the vice-president of the China National Forestry Industry Federation, an affiliate of a PRC state entity, and was later named as the "China Forestry Person of the Year" by the same state entity. The company's market capitalization grew to \$6 billion. By every measure, Sino-Forest was a Chinese-Canadian success story.

8. At the height of that success, the defendants developed their scheme to commit a bear attack on Sino-Forest. With the assistance, knowledge and concurrence of the other defendants, Muddy Waters and Block worked on an incendiary "research" report, which was designed for the singular purpose of driving down the price of the shares of Sino-Forest. Inflammatory language was used to sensationalize the report, and to obtain the greatest amount of exposure in the market: the report used the word "fraud" no fewer than 39 times, and sensationally described Sino-Forest as a "multi-billion dollar ponzi scheme ... accompanied by substantial theft."

9. Through such inflammatory and defamatory language, selective use of information, and through suggestion and innuendo, the report was not designed to inform the investing public, but rather, to scare them into believing that Sino-Forest was a criminal and fraudulent enterprise.

10. The defendants shared drafts of the report prior to its issuance. During that time, Muddy

Waters and Block received assistance from the other defendants, and secured their assent with respect to the contents of the report. In furtherance of their common design, the defendants all then acquired short positions and sold any long positions already held in Sino-Forest.

11. The short position in Sino-Forest increased astronomically in the six weeks leading up to June 2, 2011, ultimately to a point where there were twice as many shorts as normal. This increased short position had immediate effects on Sino-Forest's share price, causing it to decrease by 25% in a month, necessitating a press release from Sino-Forest stating that the company was unaware of any reason for the decline in the stock price.

12. On June 2, 2011, Muddy Waters and Block released the report (the "Muddy Waters Report"). The common scheme of the defendants worked exactly as intended: the stock price plummeted overnight. By the time the dust settled, the defendants had single-handedly wiped out \$3.5 billion in shareholder value and Sino-Forest goodwill. By covering their short positions after the market decline, the defendants made hundreds of millions of dollars and perhaps more.

13. Sino-Forest made all reasonable efforts to mitigate the damage caused by the defendants, and other market participants further sought to explain that the Muddy Waters Report was filled with erroneous information and misstatements. However, just as was the case with the first two companies that Muddy Waters and Block targeted, the overhang could not be eliminated.

14. Moreover, in an effort to hold on to the "gains" achieved through the evisceration of Sino-Forest's stock price, Muddy Waters and Block actively disputed facts as presented by Sino-Forest in interviews and in subsequent reports. Then, having succeeded in their bear attack and having financially crippled Sino-Forest, Muddy Waters and Block went on to their next victims, undeterred.

15. The statements contained in the Muddy Waters Report are defamatory, and were made for the predominant purpose of injuring Sino-Forest and interfering with its economic relations. Sino-Forest is entitled to damages for its loss of reputation caused by the defendants, the market manipulation they perpetrated, and the unlawful scheme they carried out.

## **II. THE PARTIES**

16. The plaintiff Sino-Forest is a company amalgamated under the laws of Ontario and continued under the laws of Canada with offices located in Toronto, Ontario, Mississauga, Ontario, Hong Kong, Special Administrative Region, PRC, and throughout the PRC. At all material times, Sino-Forest was the leading commercial forest plantation operator in the PRC.

17. Sino-Forest is a publicly traded company whose shares were, at all relevant times, listed on the Toronto Stock Exchange under the symbol "TRE". As at June 30, 2011, there were 246.1 million common shares issued and outstanding. At all relevant times the overwhelming majority of Sino-Forest's shares were held by individuals and entities resident in North America.

18. The defendant Muddy Waters is a limited liability corporation incorporated under the laws of Nevada, U.S.A. Block is listed as its managing member, whose location is identified as being in Shanghai PRC. Muddy Waters' registered agent in Nevada lists an address in Silver Springs, Nevada. Muddy Waters has also listed its business address in court filings in California as being located in Pacific Palisades, California, U.S.A.

19. The defendant Carson Block is an individual who is a resident of Pacific Palisades, California, Shanghai, and Hong Kong. Block is a former corporate lawyer who used to practice with the law firm Jones Day in Shanghai, China, advising clients on merger and acquisition matters and foreign direct investment issues.



20. After leaving Jones Day, Block founded YBS Investment Consulting, a Singapore-based advisory firm. In his role as Managing Director at YBS Investment Consulting, among other things, Block advised companies and investment firms on China-related investments.

21. By 2007, Block had developed sufficient expertise in Chinese business that he co-authored a book, *Doing Business in China for Dummies* (the "Block Dummies Book"). In that book, Block explained his intricate knowledge of Chinese business methods and governmental regulations: "Finding your way through the maze takes time. China's certainly like no market that you've ever done business in before. ... When you first start doing business in China, you may think you've landed on another planet!"

22. Block founded Muddy Waters but holds himself out as the "Director of Research" at the company.

23. The defendants John Doe Investment Firm 1 through John Doe Investment Firm 100 are hedge funds, investment funds and private investors who were either provided copies of the Muddy Waters Report, or were advised of the contents of the Muddy Waters Report, prior to its issuance, and who thereafter either wrongfully sold long positions held in Sino-Forest or wrongfully acquired short positions in Sino-Forest.

### **III. THE UNLAWFUL BEAR ATTACK SCHEME**

24. Through his various activities in China, Block learned that business practices were significantly different in China as compared to the West. Among other things, Block knew that businesses in China tended to be much more opaque than in the West. That opacity exists for reasons endemic to China: there is a jealous protection of corporate secrets in the face of a cut-throat competitive environment, and there is a reasonable fear of government regulators in an

environment of constantly shifting regulation. Information that identifies business partners is carefully guarded, and wealth and financial success routinely understated.

25. Block also knew the role the Chinese government plays in business. Block knew that businesses had many reporting requirements, and further knew that those reporting requirements would vary from government branch to government branch, province to province, and county to county. Block further knew that companies in China tend to report the least amount of information legally required, so as to avoid undue attention. Whereas Western companies might parade their successes, the business culture in China is to not draw undue attention, wherever possible.

26. That knowledge gave rise to the defendants' unlawful scheme. On a date known only to the defendants, Muddy Waters and Block devised a scheme to "expose" what they would describe as fraud, by exploiting the differences between Western and Chinese business culture in ways not easily understood by Western investors.

27. They, along with the other defendants, would target individual companies, obtain some information from governmental filings that would, to a Western investor, have an appearance of legitimacy, and then allege fraud in the company, with that "smoking gun" evidence in hand.

28. To profit from that scheme, the defendants would "short" the stock of the target. To short a stock, a person borrows stock from a third party, and sells it into the market. The short-seller agrees to replace that stock by buying it in the marketplace at a later date (sometimes known as "closing a short position"). The investor hopes for a decline in the price of the stock, and profits from the spread between the original sale price and the later replacement price. In essence, shorting involves a gamble that the price of the stock will decrease.

29. But in the case of the defendants, their scheme did not involve any gamble: their own conduct would cause the price of their target's stock to decrease. The large and increased short position on the company would increase downward pressure on the stock. This is because increased short positions demonstrate, among other things, a lack of confidence in the marketplace, which results in increased selling pressure.

30. The selling pressure would eventually be released by the defendants issuing a report alleging fraud and criminal conduct of the issuer. Simply alleging fraud was insufficient to guarantee any long-term effect on the shares of the victim, but by selectively choosing information from governmental filings, exaggerating the import of that "evidence", and making sensational allegations of fraud and criminal conduct, the detrimental effect could be virtually assured. Moreover, the extreme nature of the allegations would be such that the average reader would think that the authors must be correct, with the natural assumption being that nobody would make such extreme defamatory statements unless they were backed up with solid evidence.

31. Muddy Waters and Block first road-tested this strategy on Orient Paper. In a report issued on June 28, 2010, Muddy Waters and Block alleged that \$30 million had been misappropriated, and that Orient Paper had overstated its revenue by 27 times in 2008 and 40 times in 2009. It further alleged that Orient Paper overvalued its assets by at least ten times. It declared that "We are confident that [Orient Paper] is a fraud."

32. The stock price of Orient Paper declined by 55% in two days, and never recovered, even after the independent firms of Deloitte, Loeb & Loeb and TransAsia Lawyers conducted a four-month investigation and concluded that they had found no evidence to support Muddy Waters and Block's claim.

33. Muddy Waters and Block then trained their sights on RINO, China MediaExpress Holdings ("CME"), and Duoyuan Global Water Inc. ("DGW"). Wherever Muddy Waters and Block looked, they found fraud. They found "complicated accounting fraud" with RINO; stock manipulation fraud with CME; and DGW was a "massive fraud". After releasing a report on each of these entities, the result was predictable and consistent: RINO's stock price declined by 60% in two days; CME's stock price declined by 35% in less than a day; and DGW's stock price declined by almost 30% in two weeks.

34. After alleging that all of these companies were frauds, Muddy Waters and Block realized that their reports could have even more devastating effects on the stock price than anticipated, regardless of the truth of their allegations. Muddy Waters and Block were ready for the big leagues, and along with the other defendants, determined to take down Sino-Forest as their next victim.

#### **IV. THE DEFAMATORY AND FRAUDULENT MUDDY WATERS REPORT**

35. On June 2, 2011, after consulting extensively with the other defendants and obtaining their assent and concurrence, Muddy Waters and Block released the Muddy Waters Report. The essence of the Muddy Waters Report, which is incorporated herein by reference, is set out in the six bullets that are shown on the front page of the report:

- Like Madoff, TRE [Sino-Forest's trading symbol] is one of the rare frauds that is committed by an established institution. In TRE's case, its early start as an RTO fraud, luck, and deft navigation enabled it to grow into an institution whose "quality management" consistently delivered on earnings growth.
- TRE, which was probably conceived as another short-lived Canadian-listed resources pump and dump, was aggressively committing fraud since its RTO in 1995.
- The foundation of TRE's fraud is its convoluted structure whereby it runs

most of its revenues through "authorized intermediaries" ("AI"). AIs supposedly process TRE's tax payments, which ensures that TRE leaves its auditors far less of a paper trail.

- On the other side of its books, TRE massively exaggerates its assets. We present smoking gun evidence that TRE overstated its Yunnan timber investments by approximately \$900 million.
- TRE relies on Jakko Poyry to produce reports that give it legitimacy. TRE provides fraudulent data to Poyry, which produces reports that do nothing to ensure that TRE is legitimate.
- TRE's capital raising is a multi-billion dollar ponzi scheme, and accompanied by substantial theft.

36. Throughout the Muddy Waters Report, Muddy Waters and Block characterize Sino-Forest as nothing short of a criminal enterprise, using the word "fraud" or some derivation thereof on 39 occasions, "Ponzi scheme" on six occasions, and "theft" on three occasions. Muddy Waters and Block alleged that the fraud was "stratospheric in size", that Sino Forest "was always a fraud", and that it was "committing fraud from the very beginning."

37. The Muddy Waters Report accentuated its accusations with extreme language designed to influence its readers. "Solving this fraud was not easy", the authors declared. They claimed that the "institutional fraud" they purported to have uncovered, "will now end". Assets were not simply overstated, according to the authors, they were "massively exaggerated". The evidence the authors claimed to have located was not in any way ambiguous, rather, it was conclusive: "We have smoking gun evidence". The authors said that they had "clear evidence" that Sino-Forest "falsified its books". Funds were not just stolen, according to the authors: instead, Sino-Forest had a "propensity for theft."

38. As set out in greater detail below, the "smoking gun evidence" obtained was nothing of the sort. In some instances, Muddy Waters and Block relied on some documents in the publicly-

available files of the PRC State Administration for Industry and Commerce ("SAIC") to support propositions while ignoring other documents in those same files that showed their claims were not accurate. In other instances, the authors either misread the documents or misstated what they actually said.

39. In the report, Muddy Waters and Block consistently preyed on Western notions that are completely at odds with Chinese business practices. For example, Muddy Waters and Block were fully aware that many businesses in China downplay their size, for example, by maintaining modest offices, by filing the minimal amount of paperwork necessary or by filing paperwork that understates the size of the business, or by only funding the company with the minimum amount of registered capital and providing substantial follow-on contributions later which do not need to be registered. The purpose of downplaying the size of the business is understood and accepted in China: to not attract attention from governmental authorities. Muddy Waters and Block knew all of this, yet instead they relied on such selective evidence to suggest, among other things, that Sino-Forest's business partners did not really exist or that the transactions with those entities did not really happen.

40. Further, Muddy Waters and Block knew full well that Sino-Forest, like all foreign companies, was not permitted to own land in the PRC. As stated in the Block Dummies Book, "You're not allowed to own land in China -- you may only own rights to use the land for a period of time. And the types of rights vary..." Muddy Waters and Block knew that only one form of those varying rights involved a public registration system. Yet such filings were held out by Muddy Waters and Block as representing the totality of the forestry assets, not just a subset.

41. As set out below, the allegations made in the Muddy Waters Report are defamatory and made with reckless disregard as to their truth. The predominant purpose of the allegations in the

Muddy Waters Report, the categorical manner in which such allegations were made, and the invective and hyperbole contained therein, was to drive the stock price down as much as possible, so as to financially and wrongfully harm Sino-Forest to the benefit the defendants.

**A. *The Leizhou Joint Venture***

**1. The Defamatory Statements**

42. Under the heading "TRE Was Always a Fraud" in the Muddy Waters Report, Muddy Waters and Block wrongly alleged that Sino Forest was "engaged in aggressive fraud from the time it went public." At the time when it went public, most of Sino-Forest's revenue was derived from an equity joint venture ("EJV") with the Leizhou Forestry Bureau. The Muddy Waters Report wrongly and recklessly alleged that:

- (a) the revenue numbers reported "were fabricated";
- (b) Sino-Forest "breached its commitment to contribute equity capital to the EJV";
- (c) the wood chip business of the Leizhou EJV was "fictitious";
- (d) Leizhou Forestry Bureau was only required to vend into the joint venture 3,533 hectares of forestry assets, not the 20,000 hectares of forestry assets reported in Sino-Forest's public statements;
- (e) the Leizhou Forestry Bureau did not reimburse Sino-Forest \$12.43 million as alleged, "improperly adding \$12.43 to TRE's shareholders' equity ... [which] would become the blueprint for TRE's massive fraud"; and
- (f) wrongly wound down the joint venture after its conversion to a wholly foreign-owned enterprise ("WFOE") rather than using the existing structure to carry out the wood chip and processed wood business.

## 2. The Defamatory Meaning of the Statements

43. The plain meaning (and actual words) of the statements made by Muddy Waters and Block regarding the Leizhou EJV described above was that Sino-Forest was "always a fraud" whose very existence as a business was initiated on misstatements to its shareholders and falsification of Sino-Forest's financial statements.

44. Without limiting the generality of the natural and ordinary meaning and/or innuendo in the statements described above, Muddy Waters and Block intended the statements to mean, and the statements were interpreted by the readers of the Muddy Waters Report to mean:

- (a) Sino-Forest engaged in fraudulent and deceptive acts;
- (b) Sino-Forest intentionally breached its contractual agreements with the Leizhou Forestry Bureau;
- (c) Sino-Forest lied to its shareholders about the nature and activities of its business;
- (d) Sino-Forest's public statements contain "fabricated" data and false information;  
and
- (e) Sino-Forest violated securities laws and committed offences under the *Criminal Code*.

45. The defamatory words described above constitute libel against Sino-Forest. The statements were intended to, and did, have a tendency to lower the reputation of the plaintiff in the estimation of others and in particular, Sino-Forest's shareholders. The defamatory words were intended to, and did, bring Sino-Forest into disrepute, rendered it contemptible and lowered its standing in the community.



### 3. Actual Malice

46. The defamatory words referred to above were made with actual malice and with reckless disregard as to whether they were true or false. Muddy Waters and Block made the impugned statements described above without conducting any reasonable steps whatsoever to determine whether such statements were true or conducting sufficient diligence that would be expected before leveling such incendiary accusations.

47. Without limiting the generality of the foregoing, Muddy Waters and Block acted with actual malice by failing to contact the plaintiff to ascertain whether any of the facts contained in the Muddy Waters Report relating to the defamatory words described above were true. The defendants further acted with reckless disregard by failing to confirm any of the facts relating to the Leizhou EJV with persons who would know whether or not such statements were true.

48. Instead, the defendants selectively relied on a very limited number of documents in the SAIC file without mentioning other documents that supported the contrary conclusion, or alternatively, took insufficient steps to determine whether the documents relied upon were accurate or capable of sustaining the conclusions set out in the Muddy Waters Report.

49. For example, the Muddy Waters Report pointed to the Leizhou EJV's PRC Capital Verification Report contained in the SAIC file, which showed inventory levels at approximately \$1,100 at a particular point in time in October 2005. From this, Muddy Waters proclaimed that this "is hardly the level required to support an operation making weekly shipments of woodchips of approximately \$400,000, as claimed by TRE." Muddy Waters and Block used this fact to defame Sino-Forest, alleging that it was "phenomenally inflating the sales of woodchips".

50. But Block, who has since admitted to the press that he knows nothing about the forestry

business (saying "I don't need to know trees to know fraud"), failed to even explain the limited purpose of such PRC Capital Verification Reports, and the limited utility of reports contained in SAIC files, both of which are well-known in China. As Block himself explained in the Block Dummies Book, "[k]eep in mind that local practices at the approval authorities can vary quite a bit. Different MOFCOM and AIC branches usually use different forms. In addition, some branches may require certain formalities that others do not." Moreover, Block and Muddy Waters failed to point out the limited utility of a point-in-time snapshot of one subset of inventory holdings of an operating business.

51. Most importantly, however, was Muddy Waters' and Block's omission of material information contained in documents that they had in their possession, being the 1997 Audit Report. This report was included as an appendix to the Muddy Waters Report (used in support of other assertions), but no English translation was provided. The 1997 Audit Report, dated February 3, 1997, demonstrated that as at January 1, 1996, Sino-Forest had RMB 13,427,048 (approximately CAD \$2.1 million) in inventory. This fact was not pointed out in the report, further demonstrating the actual malice with which the defamatory statements were made.

52. The defendants further acted with actual malice by failing to point out, as is well-known in the PRC, that SAIC filings are unreliable for a number of reasons, including different filing requirements in different branches, the well understood willingness of some parties to understate the scope of their activities in public filings, and the fact that the system is still at an early stage in the PRC and as a matter of practice, legislation reflecting such policy will only be enforced as and when the regulators choose to do so.

53. Muddy Waters and Block further acted with actual malice by failing to make due enquiry of Sino-Forest into allegations that it breached its agreement to contribute its full amount of

equity capital, relying entirely on a single letter filed by the Leizhou Forestry Bureau written years after the fact, and treating statements in such letter as though they were proven truth. Neither Muddy Waters nor Block sought any information from Sino-Forest about whether such statements were in fact accurate.

***B. Criticisms of Corporate Structure and Business Model***

**1. Defamatory Statements**

54. Under the heading "'AI' Really Means 'Artificial Intermediary'", Muddy Waters and Block stated that (a) Sino-Forest "invented" sales figures; (b) used a corporate structure "to commit fraud"; (c) at the minimum, the company was "running substantial and unnecessary legal risks"; (d) the business model described in Sino-Forest's public statements "does not really exist".

55. The Muddy Waters Report proclaimed that "[i]n a legitimate public company, management would be summarily dismissed for using TRE's AI structure, if it had not already been arrested." The model was said to "violate fiduciary duties" and was "blatantly illegal in the PRC".

56. The transactions involving this model were sufficiently large, Muddy Waters and Block claimed, that management was "possibly committing offenses that could land them lifetime prison sentences." The Muddy Waters Report continued by saying that Sino-Forest was "lying about selling such large volumes of timber to the AIs".

57. The Muddy Waters Report further criticized the use of British Virgin Islands ("BVI") companies, described by the authors as an "unjustifiable black hole", "convoluted" and "the favourite domicile of Chinese seeking opacity".

## 2. Defamatory Meaning

58. The plain meaning and/or innuendo of the statements made by Muddy Waters and Block regarding the Authorized Intermediary ("AI") business model and corporate structure was that Sino-Forest was committing illegal acts, and misleading or outright deceiving its shareholders.

59. Without limiting the generality of the natural and ordinary meaning and/or innuendo in the statements described above, Muddy Waters and Block intended the statements to mean, and the statements were interpreted by readers of the Muddy Waters Report to mean that:

- (a) Sino-Forest engaged in criminal, illegal, and fraudulent acts;
- (b) Sino-Forest's management was, at best, conducting itself in a manner which should result in summary termination as a result of their alleged breaches of fiduciary duty;
- (c) Sino-Forest lied to its stakeholders about the nature of its business and the manner in which it was being conducted;
- (d) Sino-Forest was trying to hide from its stakeholders the true nature of its business activities and designed a corporate structure to facilitate that deception;
- (e) Sino-Forest's public statements contain false information;
- (f) The business model and corporate structure designed by Sino-Forest had no legitimate business purpose but rather was used to facilitate fraudulent, illegal and immoral acts; and
- (g) Sino-Forest violated securities laws and committed offences under the *Criminal Code* and under the laws of the PRC.

60. The defamatory words relating to management described above were defamatory against Sino-Forest, and not just its management, by virtue of the fact that management is sufficiently closely identified with Sino-Forest in the public mind that the accusation would be understood to be defamatory of the corporation, and attacks against management necessarily affect the business reputation of Sino-Forest.

61. The defamatory words described above constitute libel against Sino-Forest. The statements were intended to, and did, have a tendency to lower the reputation of the plaintiff in the estimation of others and in particular, Sino-Forest's shareholders. The defamatory words were intended to, and did, bring Sino-Forest into disrepute, rendered it contemptible and lowered its standing in the community.

### **3. Actual Malice**

62. The defamatory words referred to above were made with actual malice and with reckless disregard as to whether they were true or false. Muddy Waters and Block made the impugned statements described above without conducting any reasonable steps whatsoever to determine whether such statements were true or conducting sufficient diligence that would be expected before leveling such incendiary accusations.

63. Without limiting the generality of the foregoing, Muddy Waters and Block acted with actual malice by failing to contact any governmental authorities to determine whether they take issue with Sino-Forest's business model. Sino-Forest was the largest single forest company in China, and its Chief Executive Officer had a high profile in China. Because of those facts, coupled with the level of scrutiny by the Chinese government of all businesses (and in particular foreign-owned businesses), it defies credulity to suggest that the Chinese government was unaware of Sino-Forest's business practices and business model.

64. Muddy Waters and Block were fully aware of the numerous SAFE inspections conducted by the government of foreign enterprises, which inspections have never resulted in any complaints by the Chinese government about the Sino-Forest business model.

65. Moreover, the nature of Sino-Forest's business model was fully disclosed in public filings, such that any Chinese government official with access to the Internet would have known about Sino-Forest's business model. In failing to make due enquiry of the relevant government authorities and/or Sino-Forest, Muddy Waters and Block acted recklessly as to the truth of their statements, particularly in light of the extremely implausible nature of the allegations made by them.

66. Muddy Waters and Block further acted with actual malice by failing to consult with qualified and competent legal counsel to verify its claims that such a business structure is "blatantly illegal", as they claimed. Given the extreme nature of this allegation, additional diligence was necessary, but was not conducted, reflecting the authors' reckless disregard as to the truth of the statements.

67. Moreover, the authors failed to point out the many appropriate business reasons for using a BVI structure and failed to explain that more than 75% of all blue-chip companies listed on the Hong Kong Stock Exchange use BVI holding structures.

### ***C. Lei Guangyu and Shenzhen Hongji Enterprises***

#### **1. Defamatory Statements**

68. Under the heading "Everybody's All-Intermediary: Lei Guangyu", Muddy Waters and Block stated that (a) both Lei Guangyu ("Guangyu"), the president of Shenzhen Hongji Enterprises (Holdings) Ltd. ("Hongji") and Hongji were "related to TRE"; (b) Hongji "is engaged

in irregular transactions" with Sino-Forest; and (c) Hongji was engaging in non-arms length transactions with Sino-Forest, when Sino-Forest was describing such transactions as being with arms-length persons.

## 2. Defamatory meaning

69. The plain meaning and/or innuendo of the statements made by Muddy Waters and Block regarding Guangyu and Hongji was that Sino-Forest was holding out these persons as third party arms-length authorized intermediaries, when they were not.

70. Without limiting the generality of the natural and ordinary meaning and/or innuendo in the statements described above, Muddy Waters and Block intended the statements to mean, and the statements were interpreted by the readers of the Muddy Waters Report to mean that:

- (a) Sino-Forest engaged in fraudulent acts and used Guangyu and Hongji to facilitate such fraudulent acts;
- (b) Sino-Forest lied to its shareholders about the nature of its business dealings with Guangyu and Hongji and the manner in which those business dealings were being conducted;
- (c) Sino-Forest and Hongji were engaging in irregular and questionable corporate transactions;
- (d) Sino-Forest's public statements contain false information; and
- (e) Sino-Forest violated securities laws and committed offences under the *Criminal Code*.

71. The defamatory words described above constitute libel against Sino-Forest. The statements were intended to, and did, have a tendency to lower the reputation of the plaintiff in

the estimation of others and in particular, Sino-Forest's shareholders. The defamatory words were intended to, and did, bring Sino-Forest into disrepute, rendered it contemptible and lowered its standing in the community.

### **3. Actual Malice**

72. The defamatory words referred to above were made with reckless disregard of whether they were true or false. Muddy Waters and Block made the impugned statements described above without conducting any reasonable steps whatsoever to determine whether such statements were true or conducting sufficient diligence that would be expected before leveling such incendiary accusations.

73. Without limiting the generality of the foregoing, Muddy Waters and Block acted with actual malice by claiming that Hongji was a related party to Sino-Forest. In support of this claim, the Muddy Waters Report claimed that Lei Guangyu was the signatory for Fortune Universe Ltd. and Spirit Land Ltd., "which held a combined 7.41% of Greenheart [Group Ltd.]". It is further stated that Sino-Forest had a 12.73% stake in Greenheart. Muddy Waters failed to mention that Greenheart is a publicly traded company, and neither Sino-Forest nor the other companies mentioned had a controlling interest in Greenheart: they were both minority shareholders of a public company.

74. Two minority shareholders of a publicly traded company cannot be considered "related parties" by virtue of that relationship alone, under any definition of "related party" known in the marketplace.

75. Even if such an unreasonably expansive definition of "related party" were employed, there would still be no basis for saying that Sino-Forest "is" related by virtue of this minority



shareholding in a public company, because as Muddy Waters and Block acknowledge, Sino-Forest sold that position in 2007.

76. Muddy Waters and Block further acted with reckless disregard to the truth by claiming that Sino-Forest and Hongji "engaged in irregular transactions", by virtue of a single account payable owing by Sino-Forest to Hongji at the end of 2005. The authors of the Muddy Waters Report made no effort to ask either Sino-Forest or Hongji about the reason for the accounts payable, when there are any number of legitimate business reasons known to Muddy Waters and Block for an accounts payable to be owing (goods returned, pre-paid shipments cancelled, etc.).

***D. Sales Relating to Yunnan Timber Sales***

**1. Defamatory Statements**

77. Under the heading "Gengma, Yunnan: Illegal Logging or Fraud? Timber Sales are Beyond PRC Quota", Muddy Waters and Block stated that Sino-Forest's public statements that it had sold \$507.9 million of standing timber either represented illegal logging or fraud, because (a) such sales could not be from existing contracted holdings of timber because Sino-Forest had only 20,000 hectares of such holdings in Yunnan, "not the 200,000 ha claimed by the Company"; and (b) as such, the harvest area necessary for such sales was 25,000 hectares, which "by far exceeds the permitted logging quota" where Sino-Forest's operations and land holdings are located, in that such a sale would exceed five years of logging quotas.

78. The Muddy Waters Report cast further doubt on the veracity of the sales numbers reported, which Muddy Waters and Block said "could only be achieved through an [sic] miracle of political, labor, and logistics worthy of the last Great Chairman, Chairman Mao." The authors claimed that the labour required for such logging would need to be a "miraculous feat of human

labor", and transportation would have been largely impossible. The authors therefore concluded that unless the sale was "fulfilled illegally ... and accomplished with an army of Chinese farmers and shipped out via a secret under-ground train tunnel running below mountains, it either never happened or was greatly over-inflated."

## 2. Defamatory Meaning

79. The plain meaning and/or innuendo of the statements made by Muddy Waters and Block regarding the \$507.9 million sales of standing timber in 2010 was that the numbers were entirely fictitious, or at their highest, represented illegal logging in excess of quotas.

80. Without limiting the generality of the natural and ordinary meaning and/or innuendo in the statements described above, Muddy Waters and Block intended the statements to mean, and the statements were interpreted by the readers of the Muddy Waters Report to mean that:

- (a) Sino-Forest engaged in criminal, illegal, and fraudulent acts;
- (b) Sino-Forest deceived its shareholders about the nature of its sales of standing timber in the Yunnan area;
- (c) At its highest, Sino-Forest logged in excess of quota in 2010 and committed illegal acts as a result;
- (d) Sino-Forest's public statements contain false information; and
- (e) Sino-Forest violated securities laws and committed offences under the *Criminal Code* and/or the laws of the PRC.

81. The defamatory words described above constitute libel against Sino-Forest. The statements were intended to, and did, have a tendency to lower the reputation of the plaintiff in the estimation of others and in particular, Sino-Forest's shareholders. The defamatory words

were intended to, and did, bring Sino-Forest into disrepute, rendered it contemptible and lowered its standing in the community.

### **3. Actual Malice**

82. The defamatory words referred to above were made with actual malice and with reckless disregard of whether they were true or false. Muddy Waters and Block made the impugned statements described above without conducting any reasonable steps whatsoever to determine whether such statements were true or conducting sufficient diligence that would be expected before leveling such incendiary accusations.

83. Among other things, Muddy Waters and Block recklessly mischaracterized the entire legal regime applicable to selling *standing* timber (which deliberate or reckless error is found throughout the Muddy Waters Report), by suggesting that a quota for logging would somehow be applicable to the sale of *standing* timber. Logging restrictions and quotas do not apply to the sale of standing timber. They apply to the harvesting and removal of fallen timber. Muddy Waters and Block either deliberately misstated the nature of the business operations, or they so fundamentally misunderstood those business operations that they were reckless in the extreme to even hazard comment on them.

84. As a result, as Muddy Waters and Block knew or ought to have known, the transportation and logging efforts ("worthy of Chairman Mao") are entirely irrelevant to the sale of standing timber. No logs are transported when standing timber is sold, and no labour is used to chop down trees when standing timber is sold and the timber remains standing.

#### ***E. Purchases of Timber Holdings in Yunnan***

##### **1. Defamatory Statements**

85. Under the heading "TRE's \$800 Million Yunnan Scam Shows Timber Holdings are Forged", Muddy Waters and Block claimed that they had located "smoking gun evidence" to show that Sino-Forest had "overstated" purchases from its Yunnan supplier, Gengma Dai and Wa Tribes Autonomous Region Forestry Co. Ltd. ("Gengma") "by approximately \$800 million". The Muddy Waters Report further categorically states that "TRE did not enter into agreements to acquire such a large amount of forest, and at such a high unit price". It states that "TRE is overstating the per hectare cost by about four times", and that the scale of the transaction "contradict[s] reality".

## 2. Defamatory Meaning

86. The plain meaning and/or innuendo of the statements made by Muddy Waters and Block regarding the purchase of timber from Gengma was that the numbers used and publicly disclosed were entirely fictitious or grossly overstated.

87. Without limiting the generality of the natural and ordinary meaning and/or innuendo in the statements described above, Muddy Waters and Block intended the statements to mean, and the statements were interpreted by the readers of the Muddy Waters Report to mean that:

- (a) Sino-Forest deceived its shareholders about the nature of its purchases of standing timber in the Yunnan area;
- (b) Sino-Forest falsely stated the quantum of standing timber purchased and the price at which such timber was purchased;
- (c) Sino-Forest's public statements contain false information; and
- (d) Sino-Forest violated securities laws and committed offences under the *Criminal Code*.

88. The defamatory words described above constitute libel against Sino-Forest. The statements were intended to, and did, have a tendency to lower the reputation of the plaintiff in the estimation of others and in particular, Sino-Forest's shareholders. The defamatory words were intended to, and did, bring Sino-Forest into disrepute, rendered it contemptible and lowered its standing in the community.

### **3. Actual Malice**

89. The defamatory words referred to above were made with actual malice and with reckless disregard of whether they were true or false. Muddy Waters and Block made the impugned statements described above without conducting any reasonable steps whatsoever to determine whether such statements were true or conducting sufficient diligence that would be expected before leveling such incendiary accusations.

90. Among other things Muddy Waters and Block premised the allegations on either a deliberate or grossly negligent misreading of the master forestry agreement, which by its own terms relates to forestry purchases of not just Lincang City, but also all surrounding areas of the Yunnan Province (including cities of Lijiang, Dali, Pu'er and elsewhere in Yunnan). It was not, as alleged by Muddy Waters and Block, applicable only to purchases made in Lincang City.

91. Muddy Waters and Block exacerbated that misstatement with a further misconception that Lincang City records would show all forestry transactions, which they do not. Most particularly, Muddy Waters and Block failed to point out that trading of standing timber on a standalone basis is not registered with forestry bureaus or other PRC government agencies and thus not included in formal government statistics.

92. Muddy Waters and Block further acted with malice by suggesting that Gengma would be

the sole supplier under the agreement, when the authors made no enquiry into whether Gengma would have facilitated timber sales by third parties, which it did. The authors further assumed that the entirety of timber would be purchased from Lincang City, ignoring the possibility of plantations in other counties and cities. Muddy Waters and Block further failed to point out that the Master Framework Agreement with Gengma is to be fulfilled over a long period of time, as long as ten years.

93. In its Second Interim Report, the Independent Committee to the Board of Directors of Sino-Forest Corporation (the "IC") determined that, subject to the scope limitations described therein, contrary to the allegations made by Muddy Waters and Block, Sino-Forest had registered title to 17.9% of its disclosed timber holdings by area, and contractual or other rights to approximately 81.3% of its disclosed timber holdings by area. The IC reported that it or its advisors had reviewed originals or copies of purchase contracts for the acquisition by Sino-Forest of virtually all of its disclosed timber holdings as at December 31, 2010. Such timber holdings included Sino-Forest's plantations purchased from Gengma, which Muddy Waters and Block claimed were dramatically overstated.

#### ***F. Other Suppliers for Timber Sales***

##### **1. Defamatory Statements**

94. Under the heading "TRE's Dodgy Timber Agents", Muddy Waters and Block claimed that "four other agents are highly unlikely to have sold anything close to TRE's claim of a combined \$2.9 billion". The Muddy Waters Report reviews selective facts relating to Zhanjiang Bo Hu Wood Co. Ltd., Zhangzhou Lu Sheng Forestry Development Limited, and Jiangxi Zhonggan to conclude that these suppliers (mischaracterized as "agents" throughout the Muddy Waters Report) "are highly unlikely to have sold the \$2.9 billion TRE claims to have bought".

## 2. Defamatory Meaning

95. The plain meaning and/or innuendo of the statements made by Muddy Waters and Block regarding its timber suppliers was that these suppliers either were not real entities, or if they were, had insufficient operations to sell the timber assets that Sino-Forest stated publicly it had purchased, and as such, Sino-Forest was not accurately stating what it had purchased.

96. Without limiting the generality of the natural and ordinary meaning and/or innuendo in the statements described above, Muddy Waters and Block intended the statements to mean, and the statements were interpreted by the readers of the Muddy Waters Report to mean that:

- (a) Sino-Forest deceived its shareholders about the nature of its purchases of standing timber;
- (b) Sino-Forest falsely stated the quantum of standing timber purchased;
- (c) Sino-Forest either established or associated with companies that were said or implied to have operations of a scale and nature that did not really exist;
- (d) Sino-Forest's public statements contain false information; and
- (e) Sino-Forest violated securities laws and committed offences under the *Criminal Code*.

97. The defamatory words described above constitute libel against Sino-Forest. The statements were intended to, and did, have a tendency to lower the reputation of the plaintiff in the estimation of others and in particular, Sino-Forest's shareholders. The defamatory words were intended to, and did, bring Sino-Forest into disrepute, rendered it contemptible and lowered its standing in the community.

### 3. Actual Malice

98. The defamatory words referred to above were made with actual malice and with reckless disregard of whether they were true or false. Muddy Waters and Block made the impugned statements described above without conducting any reasonable steps whatsoever to determine whether such statements were true or conducting sufficient diligence that would be expected before leveling such incendiary accusations.

99. Without limiting the generality of the foregoing, the defendants acted with actual malice by failing to contact the plaintiff to ascertain whether any of the facts contained in the Muddy Waters Report relating to the defamatory words described above were true. The defendants further acted with reckless disregard by failing to confirm any of the facts relating to Sino-Forest's AIs with persons who would know whether or not such statements were true.

100. Instead, the defendants misleadingly relied on selective facts without revealing other facts either known to Muddy Waters and Block or which could have been discovered with minimal diligence. For example, in expressing that they were "skeptical" of Sino-Forest's claims about the \$646.6 million in purchases from Zhanjiang Bo Hu Wood Co. Ltd. ("Bo Hu"), the Muddy Waters Report authors attempted to paint Bo Hu as a shell company, "incorporated only one month before [Sino-Forest] entered into this massive contract." Muddy Waters and Block made no enquiries as to whether Bo Hu had affiliates or predecessor companies, which in fact it had had for many years. At the time of the agreement with Sino-Forest, Bo Hu was consolidating all of those operations into the business that was the counterparty to the contract with Sino-Forest.

101. Muddy Waters and Block also made no enquiry to Bo Hu or Sino-Forest about the reasons why its principal registered an apartment building as its registered office for a very short period of time (Bo Hu was transferring from an old office to a new one), instead cheekily



claiming in a caption to a picture of an apartment building, "How many \$200 million companies are in this apartment complex?"

102. Similarly, Muddy Waters and Block claimed that Zhangzhou Lu Sheng Forestry Development Company Limited ("Lu Sheng") was another "Dodgy Timber Agent" because, among other things, Sino-Forest and Lu Sheng had entered into a contract "with a total of seven pages with no terms regarding liability – it seems to be an unlikely billion dollar contract."

103. The Muddy Waters Report fails to point out that the agreement was a memorandum of understanding, covering a ten-year period, which expressly stated that under the agreement, the parties would enter into "a series of specific contracts", and such specific contracts would contain more detailed terms. Muddy Waters and Block further claimed Lu Sheng "did not have any wood or forestry related license at the time it entered into the contract", when the very documents attached to the Muddy Waters Report demonstrated that Lu Sheng's business license expressly included timber plantations as being within the scope of the company's business.

104. Further, Muddy Waters and Block claimed that two of the suppliers were managed by a senior Sino-Forest executive, Lam Hon Chiu, without making any enquiry to either Lam Hon Chiu or Sino-Forest as to whether he was in fact employed by Sino-Forest. Had either been asked by Muddy Waters and Block, Muddy Waters and Block would have learned that Lam Hon Chiu was not a senior executive of Sino-Forest, having ceased working for the company on July 17, 2007 (years before the "related party" company was even incorporated).

## ***G. Lack of Capital to Fund Claimed Timber Purchases***

### **1. Defamatory Statements**

105. Under the heading "The Capital Hole", Muddy Waters and Block claimed that "Chinese

government records show a capital hole that makes claimed timber purchases impossible". Again relying on SAIC filings, the authors of the Muddy Waters Report said that they had totaled all of Sino-Forest's equity injections and approved debt injections, and determined that Sino-Forest had an onshore (within the PRC but excluding Hong Kong) capital need of \$1.590 billion but capital and debt injections into the PRC of between \$668 million and \$1.213 billion, and as a result Sino-Forest had "a capital hole of \$377 million to \$922 million. It could not have purchased the trees it claimed to have." This led the authors to conclude and declare "Therefore, TRE's claimed investments and revenues are fraudulent."

## **2. Defamatory Meaning**

106. The plain meaning and/or innuendo of the statements made by Muddy Waters and Block regarding its equity and debt injections was that they were insufficient to meet the capital needs of Sino-Forest and as such the purchases that Sino-Forest publicly stated it had made, and the revenues derived therefrom, were false.

107. Without limiting the generality of the natural and ordinary meaning and/or innuendo in the statements described above, Muddy Waters and Block intended the statements to mean, and the statements were interpreted by the readers of the Muddy Waters Report to mean that:

- (a) Sino-Forest deceived its shareholders about the nature of its purchases of standing timber;
- (b) Sino-Forest falsely stated the quantum of standing timber purchased;
- (c) Sino-Forest either established or associated with companies that were said or implied to have operations of a scale and nature that did not really exist;
- (d) Sino-Forest's public statements contain false information; and

- (e) Sino-Forest violated securities laws and committed offences under the *Criminal Code*.

108. The defamatory words described above constitute libel against Sino-Forest. The statements were intended to, and did, have a tendency to lower the reputation of the plaintiff in the estimation of others and in particular, Sino-Forest's shareholders. The defamatory words were intended to, and did, bring Sino-Forest into disrepute, rendered it contemptible and lowered its standing in the community.

### **3. Actual Malice**

109. The defamatory words referred to above were made with actual malice and with reckless disregard as to whether they were true or false. Muddy Waters and Block made the impugned statements described above without conducting any reasonable steps whatsoever to determine whether such statements were true or conducting sufficient diligence that would be expected before leveling such incendiary accusations.

110. Among other things, Muddy Waters and Block did not use operating cash flow figures from Sino-Forest's financial statements. They further included a number of items that they knew or ought to have known should not be considered when considering cash flow, such as expenses from an income statement and investments in working capital assets in Hong Kong that have been funded by capital raised at the parent level.

111. Muddy Waters and Block further acted with reckless disregard to the truth by failing to make due enquiry of Sino-Forest as to the inclusion in their calculations \$700 million worth of selling, general and administrative expenses and interest over the relevant period of time, which were not funded by onshore cash flow. Had reasonable enquiries been made, Muddy Waters and

Block would have learned that those amounts were funded at the parent company level, outside of the PRC (excluding Hong Kong).

112. Similarly, Muddy Waters and Block further acted with reckless disregard to the truth by failing to make due enquiry of Sino-Forest as to the existence of fund-raising exercises undertaken at the parent level outside of the PRC (excluding Hong Kong).

#### ***H. Muddy Waters' Conclusions on Sino-Forest***

##### **1. Defamatory Statements**

113. The Muddy Waters Report makes two final conclusions. First, under the heading "Glimpses of How TRE Steals the Money", Muddy Waters and Block alleged that Sino-Forest's agents "mainly serve as a tunnel to move money for TRE". Second, under the heading "The Multi-Billion Dollar Ponzi Scheme", the authors stated that Sino-Forest had successive capital raises in increasingly larger amounts, purported to use those funds to buy forestry assets, which are valued at a higher amount through the company's valuator, which leads to a higher asset value that is used as collateral for future capital raises. The result, Muddy Waters and Block claimed, was "a classic Ponzi scheme".

##### **2. Defamatory Meaning**

114. The plain meaning and/or innuendo of the statements made by Muddy Waters and Block was that Sino-Forest is a criminal organization that has no legitimate business operations. Without limiting the generality of the natural and ordinary meaning and/or innuendo in the statements described above, Muddy Waters and Block intended the statements to mean, and the statements were interpreted by the readers of the Muddy Waters Report to mean that:

- (a) Sino-Forest deceived its shareholders about the nature of its business;

- (b) Sino-Forest and its management are criminals;
- (c) Sino-Forest's public statements contain false information; and
- (d) Sino-Forest violated securities laws and committed offences under the *Criminal Code*.

115. The defamatory words relating to management described above were defamatory against Sino-Forest, and not just its management, by virtue of the fact that management is sufficiently closely identified with Sino-Forest in the public mind that the accusation would be understood to be defamatory of the corporation, and attacks against management necessarily affect the business reputation of Sino-Forest.

116. The defamatory words described above constitute libel against Sino-Forest. The statements were intended to, and did, have a tendency to lower the reputation of the plaintiff in the estimation of others and in particular, Sino-Forest's shareholders. The defamatory words were intended to, and did, bring Sino-Forest into disrepute, rendered it contemptible and lowered its standing in the community.

### **3. Actual Malice**

117. The defamatory words referred to above were made with actual malice and with reckless disregard of whether they were true or false. Muddy Waters and Block made the impugned statements described above without conducting any reasonable steps whatsoever to determine whether such statements were true or conducting sufficient diligence that would be expected before leveling such incendiary accusations.

118. Among other things, one of the means by which Sino-Forest was said to have "stolen" the money was by having funds provided to Sino-Forest's "undisclosed subsidiary, Huaihua City

Yuda Wood Co. Ltd." ("Yuda"). Muddy Waters and Block had no reasonable basis for stating that Yuda is a Sino-Forest subsidiary, which it is not.

119. To the extent that Muddy Waters' and Block's conclusions that Sino-Forest was a "multi-billion dollar Ponzi scheme" were based on conclusions drawn by defamatory statements described in subheadings A through H above (collectively defined herein as the "Defamatory Statements") that were motivated by actual malice, such conclusions were themselves motivated by actual malice as they were made by Muddy Waters and Block with actual knowledge that such statements were false, or in the alternative, Muddy Waters and Black acted with reckless disregard as to whether or not such statements were true.

#### **IV. PUBLICATION**

120. Prior to releasing the Muddy Waters Report, Muddy Waters and Block either released the Muddy Waters Report or conveyed its contents to certain friends, colleagues, and other persons unknown, for the purpose of assisting those individuals with their own portfolios, either by selling any long position in Sino-Forest or by acquiring short positions.

121. Each of the persons unknown, referred to as the defendants John Doe Investment Firm 1 through 100 in this pleading, were sophisticated market participants who had actual knowledge that the statements contained in the Muddy Waters Report were defamatory and motivated by actual malice, with the predominant purpose of such report being to drive down the price of the shares of Sino-Forest.

122. Particulars of those communications, the publication of the Defamatory Statements prior to their official release on June 2, 2011, and the identity of the recipients of the communications and the publication of the Defamatory Statements are known only to the defendants. Particulars

will be provided prior to trial.

123. On June 2, 2011, Muddy Waters and Block published the Muddy Waters Report and the Defamatory Statements contained therein by means of Muddy Waters' internet site at [www.muddywatersresearch.com](http://www.muddywatersresearch.com). Muddy Waters and Block further disseminated the Muddy Waters Report to persons around the world, including media outlets in Canada, directly.

124. Subsequent to the publication of the Muddy Waters Report and the Defamatory Statements contained therein, Muddy Waters' principal Block made the rounds in the media, giving interviews to many news organizations, wherein the Defamatory Statements were repeated in whole or in part.

125. The Defamatory Statements were republished in numerous media outlets in the press, radio, television, and the Internet, including extensively throughout Ontario, which is where Sino-Forest has offices and where most of its Canadian shareholders reside. Among other things, Block gave interviews with the *Globe & Mail*, the *Financial Post* and *Bloomberg*, among others.

126. The Muddy Waters Report and the Defamatory Statements were intended to be read, heard and watched by persons in Ontario and throughout Canada, most notably existing Sino-Forest shareholders, and the Muddy Waters Report and Defamatory Statements were in fact read, heard and watched by persons in Ontario and throughout Canada.

127. The Muddy Waters Report is syndicated, meaning that it can be found using search engines such as Google. It continues to be available and accessible online today.

## **V. LIABILITY OF JOHN DOE INVESTMENT FIRMS**

128. The historical average short positions held in Sino-Forest shares were between 30 million

and 40 million shares. However, beginning in late April 2011 and extending up to the date of the Muddy Waters Report, there was a significant spike in shorting activity. Immediately prior to the release of the Muddy Waters Report, short positions had more than doubled their historical average, with 86.2 million shares shorted.

129. Principal among those shorting the Sino-Forest shares were the defendants, John Doe Investment Fund 1 through 100. These defendants are persons whose specific identity is unknown to the plaintiff and who: (a) received an advance copy of the Muddy Waters Report and/or received sufficient information about the contents of the Muddy Waters Report to make an informed investment decision; (b) prior to the release of the Muddy Waters Report, either sold long positions in Sino-Forest shares held by these defendants or acquired short positions in Sino-Forest; and (c) as a result, wrongfully profited from Muddy Waters' and Block's unlawful scheme.

130. The unknown defendants assented to the release of the Muddy Waters Report and took positions in the stock market, relying on the release of the Muddy Waters Report. They concurred with the contents of the report and are liable as joint tortfeasors for defamation and intentional interference with Sino-Forest's economic relations.

131. The John Doe Investment Fund defendants knew or ought to have known that the Muddy Waters Report contained the Defamatory Statements and knew that the predominant purpose of the Muddy Waters Report was to inflict economic harm on Sino-Forest and its shareholders. Moreover, by selling their long positions in Sino-Forest shares or by acquiring short positions, these defendants sought to, and did, aggravate the damages to Sino-Forest and its shareholders.



## **VI. DAMAGES**

132. The plaintiff pleads that the words referred to above are defamatory of the plaintiff and, as a result of the Defamatory Statements and the unlawful scheme developed by the defendants described above, the plaintiff has suffered damages in its credit, character and reputation, and in the practice of its profession, and has been falsely disparaged and the plaintiff has suffered damages thereby.

133. The plaintiff pleads that the defendants' conduct prior to, during and after publication of the defamatory statements has aggravated damages.

### **1. Damages to Reputation**

134. Prior to the publication of the Defamatory Statements contained in the Muddy Waters Report, the plaintiff had a positive reputation in the business and investor community, and enjoyed a significant amount of goodwill and confidence.

135. As a direct and foreseeable result of the release of the Muddy Waters Report, Sino-Forest has suffered significant negative effects on the reputation and business of Sino-Forest. Since its release, significant resources have been expended by directors, officers and employees, relating to allegations made in the Muddy Waters Report, diverting such resources from Sino-Forest's normal course of business.

136. Sino-Forest has also had difficulty in obtaining access to financing credit in Hong Kong and in the PRC as a direct and foreseeable result of the Muddy Waters Report. In some cases Sino-Forest was required to use its cash reserves to pay down credit facilities that were withdrawn or curtailed. Sino-Forest was required to conserve cash, and as such largely avoided making any new cash purchases of assets despite having had attractive buying opportunities.

137. Further, as a direct and foreseeable result of the Muddy Waters Report, Sino-Forest and its subsidiaries have had an extremely difficult time collecting outstanding receivables, reflecting a perceived uncertainty about the business. Conversely, Sino-Forest now is receiving increased demands on accounts payable owing by Sino-Forest.

138. Further, Sino-Forest has suffered from downgrades on its long-term corporate credit ratings from certain credit agencies, while being removed altogether from others. This has materially increased the cost of any further borrowings.

139. The damage to the Company's goodwill and reputation is reflected in the decline in Sino-Forest's stock price. Prior to the publication of the Muddy Waters Report, the share price of Sino-Forest had a 20-day volume weighted average price (VWAP) of \$19.58. This represented a total market capitalization of \$4.81 billion.

140. Immediately upon and as a direct result of the Muddy Waters Report and the Defamatory Statements contained therein, the share price of Sino-Forest declined to a closing price of \$5.23 on June 3, 2011 – a more than \$15 per share drop in price. This resulted in the evaporation of more than \$3.5 billion in share price, almost literally overnight, solely as a direct and foreseeable result of Muddy Waters' and Block's statements. There were no business reasons for the precipitous decline in share value: this was singularly the damage to the goodwill and reputation of Sino-Forest caused by the defendants.

141. The plaintiff seeks recovery of the \$3.5 billion in damages to Sino-Forest's reputation that was caused by the defendants.

## **2. Damages Relating to Investigation and Regulatory and Civil Proceedings**

142. In addition to the damages to reputation as evidenced by the drop in share price, which

was wholly attributable to the Muddy Waters Report, the plaintiff has suffered other damages in the form of legal and other professional costs in investigating the allegations contained in the Muddy Waters Report, including the costs of the IC and its advisors, responding to investigations by the Ontario Securities Commission, the Royal Mounted Canadian Police and the Hong Kong Securities and Futures Commission, all of which were begun solely and as a direct and foreseeable result of the Muddy Waters Report, and in defending class proceedings in Canada and the United States that largely mirror the allegations contained in the Muddy Waters Report. Such damages continue to increase daily and full particulars will be provided prior to trial.

### **3. Punitive Damages**

143. The plaintiff pleads that the defendants' conduct is outrageous and reprehensible, showing no signs of concern for the harm caused by their deliberate and irresponsible communications both directly in the Muddy Waters Report and generally through the media to advance their own interests and was calculated to improperly enhance the defendants' own interests at the expense of the plaintiff, thereby warranting the imposition of punitive damages.

144. Particulars are as follows:

- (a) The conduct of the defendants is particularly blameworthy because it alleges outright criminal acts, including fraud, theft, and other illegal acts;
- (b) The statements made by the defendants were made without sufficient basis in fact and the defendants could have no justification whatsoever for making the defamatory statements. The defamatory statements were motivated by actual malice;
- (c) The statements made by the defendants were laced with hyperbole and

inflammatory language designed for the predominant purpose of affecting a selling panic among retail and institutional investors of Sino-Forest, all of which was to benefit the defendants;

- (d) Even after the IC released three reports, including its major report regarding the central allegations in the Defamatory Statements, Muddy Waters and Block still continued to defame Sino-Forest through the continued publication of the Muddy Waters Report, which publication continues through to the date of this pleading.

#### **4. Sino-Forest's Efforts to Mitigate Damages**

145. The plaintiff has taken all reasonable efforts and steps to mitigate its damages, including by the appointment of the IC and the IC's publication of three reports, including the Second Report, which largely debunked virtually all of the significant allegations raised in the Muddy Waters Report.

146. However, notwithstanding the efforts by Sino-Forest and the IC to mitigate the damages, much of the harm caused by the defendants is not capable of being remedied. The damage that the defendant has caused to investor confidence, and to Sino-Forest's relations with suppliers and authorized intermediaries is significant and has largely crippled Sino-Forest's day-to-day operations.

147. Even efforts by independent third parties to reverse the harm caused by the Muddy Waters Report have not been successful. Dundee Securities publicly described the Muddy Waters Report to be a "pile of crap" and numerous other analysts have poked numerous holes in the Muddy Waters Report.

148. Another analyst who had read certain of the "smoking gun" documents that Muddy

Waters and Block either negligently misread or deliberately misdescribed, commented that "we don't know what caused the disconnect at Muddy Waters but it's not evidence that is smoking in their office."

149. However, the reputational harm to Sino-Forest caused by the defendants has not been remedied by these supportive statements from independent third parties.

## **5. Waiver of Tort**

150. In the alternative to the cause of action in defamation described above, to the extent that the Honourable Court determines that waiver of tort is a separate cause of action, by virtue of the facts described above, the defendants are liable under the doctrine of waiver of tort. As set out above, the defendants have engaged in unlawful conduct, including conduct contrary to sections 126.1 and 126.2 of the *Securities Act*, R.S.O. 1990, c. S-1, and as a direct result of that unlawful conduct, have obtained profits that ought to be disgorged in equity.

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

- (a) The profits received by the defendants were acquired in circumstances that the defendants may not in good conscience retain them;
- (b) The integrity of the capital markets would be undermined if the court did not require an accounting;

- (c) The actions taken by the defendants described above could not have been taken absent the defendants' tortious conduct; and
- (d) The defendants engaged in wrongful conduct as particularized above.

152. Moreover and in the alternative to the damages sought above, this is an appropriate case for an order requiring the defendants to disgorge any profits obtained through the trading of Sino-Forest securities at any time subsequent to the publication of the Defamatory Statements. An accounting for profits is appropriate in this case as an equitable remedy.

#### **VII. INJUNCTIVE RELIEF**

153. By reason of the facts set out above, the plaintiff is entitled to a permanent injunction prohibiting the further republication of the defamatory words referred to herein against the defendants. Such injunctive relief can be enforced with the assistance of U.S. courts in accordance with the *SPEECH Act*, 28 USC 4101-4105 with proof of actual malice as alleged in this claim.

154. The continued republication of the defamatory statements will cause the plaintiff further damages, including irreparable damages to the plaintiff's professional and business reputations.

#### **VIII. STATUTORY REFERENCES**

155. Section 126.1 and 126.2 of the *Securities Act*, R.S.O. 1990, c. S-1.

156. *Criminal Code*, R.S.C. 1985, c. C-46.

157. *SPEECH Act*, 28 USC 4101-4105.

#### **IX. SERVICE OUTSIDE ONTARIO**

158. The plaintiff pleads and relies upon rules 17.02(g), (h) and (i) of the *Rules of Civil*

*Procedure* with respect to service of defendants outside Ontario.

**X. VENUE**

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

160. This is an appropriate case for the Commercial List because (a) the plaintiff has a Toronto connection by virtue of having an office in Toronto and its shares trade on the Toronto Stock Exchange, located in Toronto; and (b) Section 1(i) of the *Commercial List Practice Direction*.

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SINO-FOREST CORPORATION  
Plaintiff

- and -

MUDDY WATERS, LLC et al.  
Defendants

Court File No. CV12-9666-0001

**ONTARIO  
SUPERIOR COURT OF JUSTICE**

Proceeding commenced at Toronto

**STATEMENT OF CLAIM**

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