

CREDIT DERIVATIVE TRANSACTION IN RESPECT TO SINO-FOREST CORPORATION
REQUEST FOR A DETERMINATION FROM THE AEJ DETERMINATIONS COMMITTEE

Question	Response
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<i>Is the question a General Interest Question</i>	No
<i>Reference Entity</i>	Sino-Forest Corporation, a company existing under the laws of Canada with limited liability and whose registered office is located at 90 Burnhamthorpe Road West, Suite 1208, Mississauga, Ontario, Canada L5B 3C3 (the " Company ").
<i>Transaction Type</i>	Asia Corporate and Standard Asia Corporate
<i>Question for the Determinations Committee</i>	Has a Bankruptcy Credit Event occurred on 18 December 2011 with respect to the Reference Entity under Section 4.2(b)(<i>Bankruptcy</i>) of the 2003 ISDA Credit Derivatives Definitions?
<i>Please insert details of your request. If you are requesting a determination on whether a Credit Event has occurred, please</i>	<u>Section 4.2(b) of the 2003 ISDA Credit Derivatives Definitions</u> Section 4.2(b) contains four alternative components, each of which if satisfied will establish a Bankruptcy credit event. These four separate limbs are that the Company either:

include links to press releases, press reports or other Publicly Available Information that describes the occurrence of the Credit Event

- 1) becomes insolvent;
- 2) is unable to pay its debts;
- 3) fails generally to pay its debts as they become due; or
- 4) admits in writing in a judicial, regulatory or administrative proceeding or filing its inability generally to pay its debts as they become due.

Limb 2 of Section 4.2(b) – "is unable to pay its debts"

Limb 1 and Limb 2 concern the status of the Company in whatever way that is evidenced. They are akin to the typical definitions for the state of insolvency, where Limb 1 is the state amidst a formal proceeding and Limb 2 is the informal state before court recognition and in the absence of any type of proceedings. Under English law, insolvency legislation confines the terms "insolvency" and "insolvent" to a formal proceeding, whereas it uses the phrase "unable to pay its debts" to embody the concept of a state of insolvency (see s.122(1)(f), s.123(1), s.123(2) and Sch B.1 para.11(a) of Insolvency Act 1986). The transition between Limb 1 and Limb 2 is indicated by the use of "becomes" in Limb 1 whilst the requirement for a pre-existing state of insolvency is indicated by the use of "is" in Limb 2. After this transition, a company's eventual dissolution is provided as a "Bankruptcy" credit event by the immediately preceding Section 4.2(a). One can therefore view continuity in Limb 2, Limb 1 and Section 4.2(a) in describing the stages of insolvency.

Limb 3 and Limb 4 require the identification of actual events and an objective assessment of what has factually occurred. Other sub-sections of Section 4.2 are also focused on past and specific events or acts.

In particular, it is important to distinguish between Limb 2 and Limb 3 in determining the approach as to how Limb 2 is considered. Given that Limb 3 would require an objective assessment of the Company's historic performance to identify a persistent series of two or more actual defaults, Limb 2 must involve a different, wider and more circumstantial approach. It is a subjective approach that can include examining other factors and evidence as well as both a backward-looking and forward-looking assessment as to the Company's past and

expected performance in meeting debt obligations.

It is important also to identify some other key differences between Limb 2 and the other Limbs and observe how the phrase in Limb 2 is used in insolvency legislation.

First, the word "generally" does not appear in Limb 2. Limb 2 does not require an examination of whether the Company is unable "generally" to pay debts. Given that the Company's place of incorporation is in Canada and that it would be subject to a Canadian insolvency proceeding, it is important to investigate Canadian insolvency legislation to determine how insolvency is assessed. Here, the word "generally" does not appear in Canadian insolvency legislation for the purposes of establishing the requisite test of insolvency (see s.42(1)(j) Bankruptcy and Insolvency Act 1985) nor does the word appear in the contractual language employed in Limb 3 and Limb 4 with respect to the occurrence of persistent defaults and the nature of written admissions made by the Company. The absence of this word "generally" must allow Limb 2 a different standard to that under Canadian insolvency legislation, Limb 3 or Limb 4.

Secondly, Limb 2 should also be considered without the phrase "as they become due" (unlike Limb 3 and Limb 4). This is based on an exact construction of Section 4.2(b). This is also because, under English law, insolvency legislation uses the phrase "is unable to pay its debts" and the phrase "is unable to pay its debts as they fall due" in two very different ways and a distinction must be drawn. The first phrase describes the requisite pre-existing state of insolvency that must be proved to allow a court to use its discretion to wind up a company (s.122(1)(f) Insolvency Act 1986) or grant an administration order (s.123(1)(e) s.122(1)(f) Insolvency Act 1986). The second phrase refers to one of the specific statutory tests which, if satisfied on the balance of probabilities (i.e. more likely than not), will allow that state to be deemed to exist. That test is the well-known cash-flow test (s.123(1)(e) Insolvency Act 1986) which requires one to prove to the satisfaction of the court that "the company is unable to pay its debts as they fall due". That test is accompanied by other alternative tests which include the failure to meet a written demand of GBP 750 after three weeks, the failure to satisfy a debt judgment issued by a court and the well-known balance sheet test. Any one of these tests can be used to evidence that a company "is unable to pay its debts". Limb 2 does not refer to this cash-flow test. It refers to the pre-existing state which the cash-flow test, amongst other tests, is designed to evidence. Limb 1 is engaged once that state is evidenced and recognised by any type of formal proceedings. If Limb 2 did refer specifically to the cash-flow test, this would arguably be strange given that Section 4.2(b) does not at least contain the well-known and alternative balance sheet test. In addition, the application of Limb 3 would be undermined. Therefore, Limb 2 merely describes a pre-existing state of insolvency and it can be construed on the basis that it does not require one to perform exclusively the

cash-flow test and have regard to the exact timing and concentration profile of future scheduled payments (although one of course is free to do so to assess, amongst other approaches, factors or evidence, whether that state exists).

Thirdly, it is also worth noting that the different cash-flow and balance sheet statutory tests under English law can adjust the meaning of the term "debts" (as used in the phrase contained in Limb 2) when demonstrating the company's state of insolvency. In contrast, Section 4.2(b) does not provide any specific tests to demonstrate that Limb 2 is satisfied. Instead, Limb 3 and Limb 4 are provided as more objective alternatives. Limb 2 can therefore be assessed with greater flexibility without being determined according to particular tests or the methodology dictated by such tests.

The task is therefore to identify sufficient evidence and factors demonstrating, on the balance of probabilities (i.e. it is more likely than not), that one can subjectively determine that there exists the *current* state of affairs or condition of the Company that Limb 2 is concerned with (i.e. a state of insolvency). Identifying this state prior to any formal insolvency proceeding would be consistent with the goal of the Credit Derivatives Definitions to capture arguably any indication of a deterioration in the creditworthiness or financial condition of a Reference Entity whether shown by an "Obligation Default" credit event or "Failure to Pay" credit event in respect of an Obligation Category which can be "Bond", "Loan", any "Borrowed Money" or even just "Payment". The quick and early identification of a decline in creditworthiness is also a major function of both versions of the ISDA Master Agreement.

Deterioration in creditworthiness

In view of the change in information from the announcements by the Company and a recent non-payment of interest (see further below), there are now signs that the Company has experienced a severe deterioration in its creditworthiness or financial condition.

There is now an arguable case that a state of insolvency is now in existence which the Determinations Committee must consider. It is worth examining what the Company has stated and what has recently occurred.

15 November Announcement - Information relating to condition of Company

The Company issued a press release and made an announcement on 15 November 2011 (including via the

Toronto Stock Exchange) which addressed the findings of an independent committee of the Company's board of directors which had examined allegations made in the Muddy Waters report (the "**First Announcement**").

The First Announcement provided the following information concerning the state of the Company at that time:

- (i) ***it was found that the Company's "internal processes, infrastructure and breadth of management team have not kept pace with the growth of its operations"; these were "shortcomings" which needed to be addressed and the Company had a "plan to improve governance and processes going forward"; the Company planned to add "further qualified staff" and was exploring ways to simplify its "business structure"*** – at this time, it seems there were various shortcomings that were wide-ranging and affected various aspects of the Company's operational workings. It is likely that these issues are continuing today and are still not resolved given that just five weeks has since passed. These issues may have worsened or become better understood by the board of directors as being more severe. In this First Announcement, there seems to be no indication given by the Company that any of these issues were fundamental or so pressing that the Company required immediate drastic restructuring (as compared to the sudden change of message in the Second Announcement and the Third Announcement (see below)).
- (ii) ***the Company was taking action to ensure that the Company's assets were "protected for the benefit of all stakeholders" and measures "designed to preserve value" were needed; these included a "substantial curtailment of further cash investment activities in the plantation fibre business" and the "institution of strict cash controls by management to ensure tighter controls over the Company's cash balances"***- this would suggest that, just five weeks ago, the Company was already experiencing considerable strain on its regular cash-flow or that adequate cash management and control mechanisms were not in place and this had caused considerable alarm.
- (iii) ***Appendix B – Summary Cash Flow July 1, 2011 to November 4, 2011*** - it is striking from the cash-flow statement in Appendix B of the First Announcement that, for the period just over four months of July 1, 2011 to November 4, 2011, the Company only identifies one type of in-flow being an aggregate amount of USD 24 million by way of new borrowing from onshore lenders in China (although it is unclear if this was to refinance in part loan repayments totally USD 29.9 million). All other items are financing costs, operating costs and recent professional fees in connection with the independent committee investigation – presumably these costs will continue,

particularly given the increasing litigation activity against the Company. In addition, the statement indicates that, as of November 4, 2011, the Company had USD 205.8m in cash that was outside China and not held by SAFE or used for cash collateralization of credit facilities (although it is unclear if this cash collateralization will increase going forward).

12 December Announcement – Further information relating to condition of Company

The Company issued a press release and made an announcement on 12 December 2011 (including via the Toronto Stock Exchange) to provide an update concerning the status of its efforts to release its third quarter financial results (the "**Second Announcement**").

The Second Announcement provided the following information concerning the state of the Company:

- (i) *the board of directors has determined that it must consider "all strategic options" available to the Company; it was stated that these options included recapitalization of the Company or the sale of some or all its businesses* – this would suggest that the Company had become forced to take more substantial and drastic action at a macro-level rather than specific lesser steps merely to correct operational inefficiencies identified in the First Announcement. This also represents a sudden urgency in the situation. Moreover, it is important to consider, as a matter of commercial reality, whether the Company would be able to raise sufficient cash quickly enough via a recapitalization or various asset sales, given the overall complexity and potentially lengthy due diligence process, let alone execution challenges, of these types of sizeable transactions. Can this cash-raising be readily achieved in the short-term? One should note that Australian case law has stated that the possible sale proceeds of assets must be ignored if those assets cannot be disposed of in time to meet debts or are essential to the continuance of the Company. In any event, it now appears that the board of directors considers that the Company must undertake some immediate cash-raising effort.

- (ii) *the Company had begun discussions with its stakeholders and that, given it had breached covenants of its bonds, its "ability to continue as a going concern and avoid insolvency proceedings" depended on the success of these* – this would suggest that the Company's difficulties are sufficiently comprehensive that the Company requires a dialogue with all parties who would be concerned by its insolvency without regard or preference to specific creditors or

shareholders, let alone employees, customers or suppliers.

- (iii) *the discussions will be a key element in determining the future of the Company and the courses of action available to the Company* – this would also suggest that the Company is needing to secure new funding, investment or other credit lines or that the Company is needing to negotiate payment holidays or re-schedule debts or other payments which are imminently due and payable.
- (iv) *the Company's most significant debts are four series of outstanding senior and convertible notes with an aggregate amount of principal owing being approximately USD 1.8 billion (the "Senior Notes") and loan facilities of USD 70.5 million (unaudited).*

15 December – Payment Default

It is now public knowledge in Publicly Available Information (see below) that the Company did not make an interest payment of USD 10,000,000 (the "**Payment Default**") on 15 December 2011 in respect of one of the series of its Senior Notes.

It is important to note that there is English case law authority which suggests that a failure to pay a debt which cannot reasonably be disputed may enable a court to infer that a state of insolvency exists even in the absence of a demand. Where a demand has been made and a company persists in its failure to pay, then the company will be taken to be unable to pay its debts even if it appears solvent.

Certainly, the Company does not dispute its liability to pay this sum and there is no clear evidence that the Payment Default is due to an unwillingness to pay or has any tactical purpose. It does appear that this was entirely a surprise by investors according to the Publicly Available Information and that the Company had given no indication that this sum would not be paid.

16 December - Senior Notes becoming immediately due and payable

The Company issued a further press release and made an announcement on 18 December 2011 ((including via the Toronto Stock Exchange) regarding its current position and the potential acceleration of its Senior Notes due to the technical default in not providing its third quarter financial results as required pursuant to the terms of the

Senior Notes (the "**Third Announcement**").

Default notices dated 16 December 2011 were served on the Company by the trustee of the Senior Notes.

In the Third Announcement, the Company indicated that "it does not expect to be able to file the Q3 Results and cure the default within the 30 day cure period". The Company has described that if the default notices are not withdrawn and required waivers are obtained, then the trustee under the relevant series of Senior Notes or the holders of at least 25% in aggregate principal amount of that series of Senior Notes would be entitled to accelerate that series of Senior Notes. The result of this will be that the principal of, premium (if any) and all accrued and unpaid interest on the Senior Notes will be immediately due and payable. This may occur on or after 16 January 2012. This date is in the near future.

Given that the trustee or the holders of the Senior Notes were willing to serve the default notices, then it can be argued that the trustee or the holders wish to obtain the right to accelerate the Senior Notes and are prepared to exercise that right. It will need to be considered whether it is more likely than not that the Senior Notes will be accelerated on or after 16 January 2012. If this acceleration is likely, as of 16 December 2011, to happen in the near future, then this entire debt payment would be recognised were a cash-flow test to be used to identify a state of insolvency according to English case law (see *Cheyne Finance Plc [2008] BCC 182*).

According to Appendix B contained in the First Announcement, the Company had a cash balance of USD 205.7 million as of 4 November 2011 for cash held outside China and not required for cash collateralization of credit facilities. This cash balance may now have reduced and it is very questionable whether the Company will be able to raise additional cash and pay the total amount owing under the Senior Notes if they are likely to be due and payable in the near future.

18 December Announcement – Further information relating to condition of Company

The Company issued a further press release and made an announcement on 18 December 2011 ((including via the Toronto Stock Exchange) regarding its current position and the potential acceleration of its Senior Notes due to the technical default in not providing its third quarter financial results as required pursuant to the terms of the Senior Notes (the "**Third Announcement**").

This Third Announcement indicates that the Company is suffering severe financial distress and, significantly, it

suggests the Payment Default that had occurred was not due to a mere unwillingness to pay.

The Third Announcement provided the following information concerning the present state of the Company:

- (i) ***the Third Announcement restates the Second Announcement indicating the board of directors still were forced to consider "all strategic options" available to the Company*** – this suggests the fundamental state of affairs on a macro-level had certainly not improved.
- (ii) ***the board of directors has resolved to establish a special committee of the Board on 16 December 2011 to supervise, analyse and manage the strategic options and the committee consists only of the Company's directors and no one from senior management*** – this marks an added development and underlines the seriousness of the situation.
- (iii) ***this committee has been described as a "Special Restructuring Committee"*** – this suggests negative connotations and emphasises the severe nature of the Company's difficulties. It also suggests a fundamental need for change. This is a marked departure from the First Announcement and indicates the Company's issues had escalated to being far more than improving operational inefficiencies.
- (iv) ***"creditor-protection" or "other insolvency-related proceedings" in jurisdictions in which the Reference Entity and its subsidiary carry on business are identified as options for management*** – this is a significant difference from the Second Announcement where it was never suggested that insolvency-related proceedings were an option. Now they are. This would suggest that the directors' assessment of the situation had changed and the condition of the Company had deteriorated further.

This also would suggest that formal insolvency-related proceedings are now a practical possibility and that the Company can qualify for these types of reliefs, which typically would only be possible if a state of insolvency, such as an inability to pay debts, can be readily shown to a court or otherwise described and certified by a director or officer of the Company.

In addition, as a temporal matter considering the insolvency of any company, the very rationale of Section 4.2(b) is to capture and recognise a state of insolvency that is in existence prior to the

formal and eventual occurrence of clear and specific acts or events which are addressed by other sub-Sections of 4.2, otherwise the "Bankruptcy" credit event would have a narrower function.

- (v) *the Company is in discussions with its stakeholders in respect of the courses of action available to the Company and the success of the discussions with its stakeholders will be a key element in determining the future of the Company* – this suggests the Company is still continuing to negotiate financial support which has not been forthcoming and that it is, in essence, the very success of these discussions which will *enable* the Company to continue and pay its debts and move it out of a present condition of an "inability to pay its debts". One question will be whether there is a low prospect of the Company being able to secure additional borrowing in the short-term. English case law has stated there must be a significant probability of borrowed funds being available in time to meet debts.

Payment Default and Grace Period

The Company's Payment Default still remains outstanding and, in view of the decline in creditworthiness and necessary restructuring indicated by the First Announcement, the Second Announcement and the Third Announcement, it now seems the Company is forced to use the relevant grace period under the terms of the Senior Notes in order precisely to *become able* to make payment. A grace period is only used by the board of directors of a company if time is needed to restore and improve the company's liquidity position. There is no indication that the Company is strategically choosing not to pay.

Question

In view of the Payment Default, the information in the First Announcement, the Second Announcement and the Third Announcement indicating the deterioration in the creditworthiness of the Company and the fact that the Payment Default is still persisting and is not even partially cured, the Determinations Committee is requested to consider the following:

Is it more likely than not that a state of insolvency as opposed to a mere unwillingness to pay, is now in existence with respect to the Company, as demonstrated by, collectively in whole, the Company's statements and actions, as assessed by the circumstantial approach under Limb 2 of Section 4.2(b) in contrast with the

stricter approach required under Limb 3 and other sub-sections of Section 4.2 ?

Links to Publicly Available Information

A copy of the press release which was published on the Toronto Stock Exchange is available at

First Announcement: http://tmx.quotemedia.com/article.php?newsid=46122595&qm_symbol=TRE:CA

Second Announcement: http://tmx.quotemedia.com/article.php?newsid=46814484&qm_symbol=TRE:CA

Third Announcement: http://tmx.quotemedia.com/article.php?newsid=46971150&qm_symbol=TRE:CA

Please see below articles relating to the Payment Default:

Bloomberg: <http://www.bloomberg.com/news/2011-12-15/sino-forest-s-shareholder-richard-chandler-calls-for-new-ceo-directors.html>

Reuters: <http://www.reuters.com/article/2011/12/19/us-sinoforest-idUSTRE7BI05420111219>

Reuters: <http://ca.reuters.com/article/businessNews/idCATRE7BL0EQ20111222>

Financial Times: <http://www.ft.com/intl/cms/s/0/6fe9bc7c-2632-11e1-85fb-00144feabdc0.html#axzz1gfdKoAoN>