

**ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST**

BETWEEN:

**ERNST & YOUNG INC.
in its capacity as Court Appointed Receiver
of HANFENG EVERGREEN INC.**

Plaintiff

- and -

YU XINDUO and LEI LI

Defendants

REPLY

1. The Receiver makes this Reply to the Statement of Defence of Yu and Lei. Capitalized terms not defined herein have the meanings ascribed to them in the Statement of Claim.
2. The Receiver denies each and every allegation in the Statement of Defence, unless expressly admitted herein.

YU CONTROLLED LOCAL MANAGEMENT OF HANFENG CHINA

3. Contrary to the allegations at paragraph 13 of the Defence, Yu at all material times controlled and directed Hanfeng China and its local management team, which included:
 - (a) Mr. Zhida Qi, General Manager and a director of Hanfeng China;
 - (b) Ms. Chunying Li, Accounting Manager; and
 - (c) Ms. Hongying Li, Office Manager. (together, "**Local Management**")
4. Yu's control over Hanfeng China and Local Management meant that he controlled access to Hanfeng China's accounting records, banking records, chop sets

and bank tokens. As a result, the full particulars of the Loans are within the knowledge of Yu and Li. The Receiver has been unable to obtain more detailed information about the bank loans than has been disclosed to the Court in its Reports. The Receiver has asked Yu, as legal representative, to obtain and provide information respecting the Loans, which Yu has failed to provide.

5. Contrary to the allegations at paragraph 13 of the Defence, Yu was involved in the due diligence with respect to the sale of Hanfeng China and led the negotiations leading to the sale. Yu was also involved in the Receiver's attempts to implement the Share Transfer Transaction. After the commencement of the Receivership proceedings, the Receiver engaged Yu to effect control of Hangfeng China and facilitate communication with the purchaser. As a result of Yu's relationship with the Purchaser, Yu, and Local Management inserted themselves as the liaison between the Purchaser and Receiver for a variety of activities, including:

- (a) arranging and participating in conference calls between the purported employees of the Purchaser and the Receiver;
- (b) providing contact information for purported employees of the Purchaser to the Receiver for correspondence which Yu received;
- (c) requesting, on behalf of the Purchaser, that the Receiver provide and confirm wire instructions;
- (d) requesting, on behalf of the Purchaser, that the Receiver provide documents related to Chinese regulatory approvals;
- (e) entering into the Escrow Agreement on behalf of the Receiver;
- (f) advising the Receiver that the Purchaser intended to make the required payments and providing excuses for the Purchaser's delay in remitting the required payments;

- (g) arranging and participating in conference calls between purported bank representatives and the Receiver who made representation regarding wire transfers by the Purchaser;
- (h) selecting the Chinese counsel that represented Hanfeng China in the Share Transfer Transaction; and
- (i) advising the Receiver on the status of Hanfeng China.

6. Contrary to the allegation at paragraph 14 of the Defence, Lei was a paid consultant to Hanfeng at all material times, and was the most senior management representative in the Toronto office of Hanfeng. Contrary to allegations at paragraphs 93-95 of the Statement of Defence, in addition to Yu, Lei was also a recipient and beneficiary of the Dissipated Funds.

7. Contrary to the allegation at paragraph 30 of the Defence, Yu and Lei were privy to the details of many of the Hanfeng board meetings, conversations and decisions between July 21, 2014 and August 6, 2014. Yu was present at a board meeting on July 31, 2014, and undertook to explain the receivership process in Canada to the legal counsel to Hanfeng in China, Mr. Jiechang Liu, and the legal counsel to HLJ Pengcheng.

8. During a board meeting on August 5, 2014, Yu reported that he had a conference call with HLJ Pengcheng and its legal counsel and that HLJ Pengcheng confirmed it was willing to sign the agreements in the form last circulated by Hanfeng, which identified HLJ Pengcheng as the Purchaser.

YU'S FAILURE TO COOPERATE WITH RECEIVER

9. Contrary to the allegations at paragraph 86 of the Defence, neither Yu nor Local Management under his control co-operated with the Receiver.

10. Prior to June 2015, Ms. Chunying Li purported to provide the Receiver with internal financial statements and bank statements for Hanfeng China by email on a

monthly basis. The Receiver later determined that these financial records were false as they omitted the Loans to Hanfeng China.

11. Further, Ms. Chunying Li and Yu failed to provide explanations and supporting documentation in response to requests from the Receiver. In particular:

- (a) On June 2, 2015, the Receiver emailed Ms. Chunying Li, copying Yu, requesting information and support with respect to:
 - (i) 4.8 million RMB paid to TianYu Construction and Installation Co. in February 2015;
 - (ii) Details of maintenance expenditures incurred in January, March and April, 2015; and
 - (iii) Reasons of the payment for additional temporary workers when Hanfeng China continued to maintain a workforce of 180 people and was purported inactive, according to Yu.
- (b) On June 3, 2015, the Receiver requested from Yu and Local Management weekly updates of bank account balances for Hanfeng China and non-payment of any amount greater than 50,000 RMB without the Receiver's written approval.

12. Ms. Chunying Li and Yu disregarded each of these requests and failed to provide adequate and satisfactory responses to the Receiver's inquiries.

13. Further, to date, Yu and Local Management have disregarded repeated instructions from the Receiver that no disbursements be made by Hanfeng China without the Receiver's advance approval. The last bank statements provided by Local Management for the month of June 2015 show that Hanfeng China made disbursements totalling over RMB 1 million during the same period.

14. With respect to paragraph 86(3) of the Defence, the responses provided by Ms. Chunying Li on behalf of Yu on June 24, 2015 were limited and inadequate. The

Receiver has repeatedly requested additional information, however after July 15, 2015, Yu and Local Management discontinued providing any financial information and have failed to provide any further information to date.

15. In response to paragraph 86(4) of the Defence, Yu and Local Management have failed to pay the remaining RMB 20,000 owing to Mr. Guan Liu for his services as a director, despite numerous instructions from the Receiver to do so since June 2015.

16. In response to paragraph 86(7) of the Defence, not only did Yu fail to assist in securing payment from the Purchaser, he actively undermined the Receiver's efforts to do so. In July 2015, the Receiver met with Yu in Toronto. Among other things, during that meeting the Receiver reiterated that the proceeds from the Share Transfer Transaction must be available for distribution in Canada. Notwithstanding the Escrow Account in China, and without authorization from the Receiver, Yu wrote an email to the Purchaser stating that the Receiver demanded direct remittance by the Purchaser to Canada, *regardless of Chinese regulations*. This erroneous statement was a contrivance by Yu to provide the Purchaser with a purported excuse to delay or prevent closing of the Share Transfer Transaction.

17. With respect to paragraph 86(10) of the Defence, on August 12, 2015 and August 13, 2015, the Receiver emailed Yu, Mr. Zhida Qi and Ms. Chunying Li, requiring Yu's compliance with the July 31, 2015 Order of Justice Hainey. The Receiver demanded that Yu surrender the seals and business licenses of Hanfeng China, in accordance with the Order. The Receiver also requested that Hanfeng China make no disbursements without approval and pay the remaining director fees to Mr. Guan Liu, which it has failed to do to date.

18. Despite the demand of the Receiver and the Order of Justice Hainey, Yu and Local Management did not surrender the seals, chop sets, business license and other documents requested by the Receiver. To date, Yu and Local Management have not surrendered the seals and business licenses necessary for the Receiver to appoint a new legal representative and obtain access to Hanfeng China's business.

YU REPRESENTED NEGOTIATIONS WERE WITH HLJ PENGCHENG

19. All conversations with the Purchaser and its counsel as described at paragraphs 22-30 of the Statement of Defence were orchestrated by Yu, with an intent to deceive Hanfeng as to the true identity of the Purchaser.

20. Contrary to the allegations at paragraphs 42 and 46 of the Statement of Defence, prior to and for several months after the commencement of the Receivership, Yu was responsible for substantially all of the communications with the Purchaser. After the filing date, Yu was retained by the Receiver to exercise control over Hanfeng China and complete the Share Transfer Transaction.

21. Yu knew that the individuals who claimed that they were representatives of HLJ Pengcheng to the Hanfeng Board were not in fact affiliated with HLJ Pengcheng in any way, that their statements purportedly made on behalf of HLJ Pengcheng were false, and by his conduct and by omission deliberately failed to correct these falsehoods to Hanfeng's board, its advisors and the Receiver, to intentionally deceive them.

NAME CHANGE OF PURCHASER BY YU AND LEI

22. Contrary to the allegations at paragraph 10 of the Defence, the Receiver was not appointed with respect to the sale of Hanfeng China to *Harbin Pengcheng*.

23. Contrary to the allegations at paragraphs 32 of the Statement of Defence, the scanned copies of the signature pages to the Share Transfer Agreement and related agreements delivered on August 8, 2014 were identical to the signature pages of the Share Transfer Agreement negotiated with HLJ Pengcheng and did not name and identify Harbin Pengcheng as the purchaser.

24. Later in the day on August 8, 2014, Lei separately delivered complete copies of the executed Share Transfer Transaction agreements. In those documents, Lei and Yu unilaterally changed the definition of the Purchaser from "Heilongjiang Pengcheng Fertilizer Co. Ltd" to "Heilongjiang Harbin Pengcheng Fertilizer Co. Ltd" (a corporation that Yu and Lei incorporated on August 4, 2014). Contrary to the allegation

at paragraphs 22-23 and 53-57 of the Defence, Lei represented that the executed agreements were with HLJ Pengcheng and failed to disclose the unilateral amendments with an intention to deceive Hanfeng as to the true identity of the purchaser.

25. Contrary to the allegations at paragraphs 17 and 36 of the Defence, between August 8, 2014 and at the time of the court approval of the transaction on August 20, 2014¹ Hanfeng had not discovered that Harbin Pengcheng was completely unrelated to HLJ Pengcheng, despite their almost identical names.

26. On July 10, 2015, the Receiver met with Yu in person. During that meeting, Yu also continued to represent that Harbin Pengcheng was an affiliate of HLJ Pengcheng, and knew such representations were false.

27. The Receiver did not begin to discover the implications associated with the name change of the Purchaser until July of 2015, at which time it disclosed its investigations to the Court its Second Report dated July 17, 2015.

28. Contrary to the allegations at paragraphs 49 through 53 of the Defence, Hanfeng attempted to complete the Share Transaction and complied with applicable Chinese law and regulations. Without the consent of the Receiver, Yu sent an email to the purchaser on July 13, 2016 stating that the Receiver had demanded direct remittance by the Purchaser of the remaining purchase price in Canada, regardless of Chinese regulations. This erroneous statement was a contrivance by Yu to provide the Purchaser with a purported excuse to delay or prevent the closing of the Share Transfer Transaction.

YU AND LEI'S PURPORTED COUNTERCLAIM

29. The Receiver specifically denies Yu and Lei's allegations at paragraphs 97-99 of the Defence that they have been harmed as a result of the allegations contained in

¹ On the assumption that the reference to August 20, 2016 in paragraph 17 of the Defence is a typographical error and ought to read August 20, 2014.

the Receiver's pleadings. The plaintiffs' pleadings are subject to absolute privilege. In any event, Yu and Lei have not suffered damages thereby.

30. The Receiver specifically denies Yu and Lei's allegations at paragraphs 100-101 of the Defence that Yu and Lei have suffered any damages caused by Hanfeng as alleged and further deny that they are entitled to a set off against their liability to the Receiver.

31. In response to the allegation at paragraph 101 of the Defence, the Receiver specifically denies that it has failed to mitigate its damages and denies that it has failed to take steps to liquidate Hanfeng China. The Receiver, with assistance of its advisors, took various steps to effect control over Hanfeng China and investigate its business and financial affairs, including attempts to obtain banking transaction records and loan information from Local Management and various banks, requesting the books and records from Local Management, attending at the office of Harbin Administration for Industry and Commerce to replace Yu as the legal representative of Hanfeng China, attempting to access Hanfeng China's facility in China and the preservation of Hanfeng China's assets. However, the Receiver has been precluded from preserving, liquidating or realizing on the assets of Hanfeng China as a result of Yu and Lei's failure to cooperate with the Receiver's requests regarding access to and the administration of Hanfeng China, as described herein.

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Plaintiff

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Defendants

Court File No. CV16-11325-00CL

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Proceeding commenced at Toronto

REPLY

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