

The Honorable Robert S. Lasnik

UNITED STATES DISTRICT COURT  
WESTERN DISTRICT OF WASHINGTON  
AT SEATTLE

JASON MOOMJY, Individually and On Behalf  
of All Others Similarly Situated,

Plaintiff,

v.

HQ SUSTAINABLE MARITIME  
INDUSTRIES, INC., NORBERT SPORNS,  
JEAN-PIERRE DALLAIRE, LILLIAN WANG  
LI, LADENBURG THALMANN & CO. INC.  
and ROTH CAPITAL PARTNERS, LLC,

Defendants.

Case No. 2:11-cv-00726-RSL

Master Case No. 2:11-cv-00726-RSL

**LEAD PLAINTIFF'S CLASS ACTION  
COMPLAINT**

JURY DEMAND

LEAD PLAINTIFF'S CLASS ACTION  
COMPLAINT  
(11-726-RSL)

LAW OFFICES OF  
**KELLER ROHRBACK L.L.P.**  
1201 THIRD AVENUE, SUITE 3200  
SEATTLE, WASHINGTON 98101-3052  
TELEPHONE: (206) 623-1900  
FACSIMILE: (206) 623-3384

LAW OFFICES OF  
**COHEN MILSTEIN SELLERS & TOLL, PLLC.**  
1100 NEW YORK AVENUE, N.W.  
SUITE 500, WEST TOWER  
WASHINGTON, DC 20005  
TELEPHONE: (202) 408-4600

## TABLE OF CONTENTS

I.	INTRODUCTION .....	1
II.	SUMMARY .....	1
III.	CONFIDENTIAL SOURCES .....	6
IV.	PARTIES .....	7
A.	Plaintiff .....	7
B.	Defendants .....	7
V.	SUBSTANTIVE ALLEGATIONS .....	9
A.	A Purportedly Successful Company .....	9
B.	HQSM's Auditor Cannot Confirm Account Balances, Customers, or Invoices.....	13
1.	HQSM's Auditor Cannot Confirm Bank Balances.....	13
2.	HQSM's Auditor Cannot Verify the Existence of HQSM's Customers .....	15
3.	HQSM's Auditor Concludes Invoices Are Probably "Fake" .....	16
4.	HQSM's Auditor Cannot Verify Advertising Expenses.....	18
C.	Defendant Dallaire Expresses Concerns.....	19
D.	Insiders Obstruct Audit Committee's Proposed Investigation.....	20
E.	Investors Learn of Irregularities at HQSM .....	23
1.	Postponement of the 2010 Annual Report .....	23
2.	Audit Committee Chairman's Resignation.....	24
3.	Failure to File Quarterly Report.....	26
4.	Auditor's Resignation .....	26
F.	HQSM Makes a False Statement to Regulators.....	28
G.	Additional Developments .....	29

1	1.	NYSE Amex Stock Exchange Delisting.....	29
2	2.	SEC Investigation .....	30
3	3.	Further Board Resignations .....	31
4	4.	Continued Failure to Replace Auditor and Issue Periodic Reports .....	31
5			
6	H.	Additional Indicia of Fraud.....	32
7	1.	HQSM's U.S. Office Did Virtually No Business. ....	32
8	2.	HQSM Failed to Generate Monthly Financial Statements and Access to Financial Records Was Restricted .....	32
9			
10	VI.	ADDITIONAL SCIENTER ALLEGATIONS.....	33
11	VII.	SPECIFIC MATERIALLY FALSE OR MISLEADING STATEMENTS.....	34
12	A.	Repeated Assertions of GAAP Compliance .....	34
13	B.	May 2009 Quarterly Disclosures .....	35
14	C.	June 2009 Offering Documents .....	39
15	D.	August 2009 Quarterly Disclosures .....	39
16	E.	November 2009 Quarterly Disclosures.....	41
17	F.	March 2010 Annual Disclosures.....	42
18	G.	May 2010 Quarterly Disclosures .....	44
19	H.	August 2010 Quarterly Disclosures .....	45
20	I.	August 2010 Offering Documents .....	47
21	J.	November 2010 Quarterly Disclosures.....	48
22	K.	Statements Regarding Superior Compliance Procedures .....	49
23			
24	VIII.	OFFERINGS DURING THE CLASS PERIOD.....	50
25	A.	The 2009 Offering.....	50
26	B.	The 2010 Offering.....	50

C.	No Allegation of Fraud Against Underwriters.....	51
IX.	JURISDICTION AND VENUE .....	51
X.	CLASS ACTION ALLEGATIONS .....	52
XI.	LOSS CAUSATION.....	54
XII.	PRESUMPTION OF RELIANCE.....	55
XIII.	NO SAFE HARBOR .....	56
XIV.	STATUTE OF LIMITATIONS.....	56
XV.	JURY TRIAL DEMANDED.....	57
XVI.	CAUSES OF ACTION.....	57
	COUNT I .....	57
	COUNT II.....	58
	COUNT III.....	59
	COUNT IV.....	61
	COUNT V .....	62
XVII.	PRAYER FOR RELIEF .....	64

## I. INTRODUCTION

1. Lead Plaintiff Trigon Emerging Agri-Sector Fund (“Plaintiff”) brings this class action for violations of the federal securities laws on behalf of itself and all others similarly situated (the “Class” or “Class Members”). Plaintiff seeks remedies (1) under the Securities Act of 1933 (the “Securities Act”) on behalf of all those who acquired HQ Sustainable Marine Industries, Inc. (“HQSM” or the “Company”) common stock, or warrants to purchase common stock, issued pursuant or traceable to two secondary offerings; and (2) under the Securities Exchange Act of 1934 (the “Exchange Act”) on behalf of persons who purchased or otherwise acquired the common stock of HQSM, from May 12, 2009 through and including April 1, 2011 (the “Class Period”). This Complaint is based on the investigation of counsel, which included a review of the public statements and securities filings of Defendants, press reports, reports by securities analysts, review of internal Company documents obtained by Plaintiff and interviews with former employees and a former director of HQSM.

## II. SUMMARY

2. During the Class Period, the Company and its key insiders—Defendants Norbert Sporns, Jean-Pierre Dallaire, and Lillian Wang Li (the “Individual Defendants”)—provided false information to the Company’s outside auditor as part of a fraudulent scheme to inflate HQSM’s key financial metrics, including revenue and cash on hand. When the Company’s auditor eventually discovered evidence of misconduct, HQSM and the Individual Defendants quashed attempts by the auditor and the Company’s own Audit Committee to investigate and then, according to a formal finding by the NYSE Amex Stock Exchange (formerly the American Stock Exchange), they lied to regulators about their efforts to block such an independent investigation.

1 Ultimately the Exchange delisted HQSM, leaving Class Members with nearly worthless shares  
2 of the Company's stock.

3 3. HQSM processes and sells fish, especially tilapia, and certain health and beauty  
4 products made from fish and from other materials. Although the Company's headquarters is in  
5 Seattle, virtually all of its reported employees, operations and sales are in China. Until trading  
6 was suspended on the last day of the Class Period, April 1, 2011, the Company's stock traded on  
7 the NYSE Amex Stock Exchange.

8 4. HQSM was controlled by a family triumvirate—Defendant Norbert Sporns, the  
9 Company's Chief Executive Officer ("CEO"), Sporns' wife, Defendant Lillian Wang Li, the  
10 chairman of the Company's Board of Directors, and Wang Li's brother, non-party Harry Wang  
11 Hua, the Company's Chief Operating Officer ("COO"). Together these three insiders, through  
12 their ownership of a class of super-voting shares, controlled 88% of the Company's voting  
13 power, though only 18% of its common stock. Defendant Jean-Pierre Dallaire, HQSM's Chief  
14 Financial Officer ("CFO"), also played a critical role in running the Company and preparing its  
15 financial statements.

16 5. In their public statements during the Class Period, HQSM and the Individual  
17 Defendants claimed that HQSM was positioned for explosive growth because of sharply  
18 increasing international demand for tilapia and an upsurge in demand for its health and beauty  
19 products in China. The Company's publicly disclosed financial statements, which were  
20 purportedly prepared in accordance with U.S. Generally Accepted Accounting Principles  
21 ("GAAP"), indicated that HQSM was consistently profitable, had almost no debt, and had  
22 substantial cash in the bank. This positive picture of the Company's finances artificially inflated  
23 the price of HQSM's shares and allowed the Company to raise more than twenty million dollars  
24  
25  
26

1 by offering warrants and new shares to the public, giving rise to the Securities Act claims alleged  
2 herein.

3         6. In fact, however, the Company's financial statements bore little connection to  
4 reality. According to Company documents, statements from former Company employees and  
5 other information, in March 2011 the Company's outside auditor, Schwartz, Levitsky, Feldman,  
6 LLP ("SLF"), discovered compelling evidence of fraud. SLF was unable to confirm the balances  
7 of the Company's bank accounts in China and stumbled upon an apparent scheme by HQSM  
8 insiders to forge or alter documents to misrepresent the true balances in these accounts. Notably,  
9 SLF was also unable to contact *any* of the Company's purported customers, an investigation by a  
10 law firm hired by SLF concluded that all five sales invoices provided by the Company that it  
11 reviewed for audit confirmation were "*probably fake*," and the Company acknowledged to SLF  
12 that invoices for some \$5.5 million supposedly paid for television advertising *did not exist*.<sup>1</sup> In  
13 addition to the irregularities encountered by SLF, in early April, CFO Dallaire told one of the  
14 Company's directors that a substantial amount of money appeared to be missing from one of  
15 HQSM's U.S. accounts.

16         7. In the wake of these troubling discoveries, SLF and HQSM's Audit Committee  
17 sought to determine the Company's true financial condition. But HQSM and the Individual  
18 Defendants impeded the auditors' work and refused to pay for or cooperate with an outside law  
19 firm hired by the Audit Committee to conduct an investigation, even though they had initially  
20 begrudgingly agreed to such an inquiry.

21         8. The most plausible explanation for HQSM and the Individual Defendants'  
22 repeated and largely successful efforts to block legitimate attempts to investigate these  
23

---

24 <sup>1</sup> Emphasis is added to quotations unless otherwise indicated.

1 irregularities is that such an investigation would implicate them in wrongdoing. In addition to  
 2 their refusal to cooperate with investigators, the fact that the Individual Defendants directly  
 3 controlled all aspects of the Company's day-to-day operations also suggests that they were  
 4 responsible for—or recklessly disregarded—the extraordinary irregularities that SLF found.  
 5 These irregularities apparently permeated all segments of the Company's business, and, given  
 6 their nature and scope, had likely been going on for some time.

8 9. The situation at the Company's headquarters during the Class Period—as reported  
 9 by two confidential witnesses—provides further support for an inference of intentional or  
 10 deliberately reckless misconduct. According to these witnesses, little work was done at the  
 11 headquarters, which was in the United States, and a key employee responsible for financial  
 12 matters was inexplicably denied access to Company financial information that should have been  
 13 maintained and made available to the employee in the normal course of business.

15 10. Ultimately, HQSM and the Individual Defendants' obstructionism led to the  
 16 resignation of SLF, the Audit Committee Chairman and two other independent directors, none of  
 17 whom have been replaced. The Company's outside counsel also resigned. Both the Audit  
 18 Committee Chairman and SLF wrote letters (attached as Exhibit 1 and 2) attributing their  
 19 resignations to Defendants' attempts to thwart any independent examination of the Company's  
 20 finances. The Audit Committee Chairman stated that he was "compelled by conscience" to  
 21 resign in light of the "continued resistance of management" to such an investigation. And SLF,  
 22 the Company's auditor, said it had resigned after having been "frustrated and obstructed by the  
 23 Company's delay, non-responsiveness and lack of cooperation" and upon concluding that it  
 24 "could no longer rely on the representations of the Company's management."  
 25  
 26



1           11. Because SLF refused to certify the Company's financial statements, HQSM has  
2 been unable to file its 2010 annual report. Initially, on March 16, 2011, the Company announced  
3 that the report, which was to have been filed on that date, would be delayed by no more than  
4 fifteen days. This announcement caused HQSM's stock to drop more than 15%, as investors  
5 suspected that it might indicate misconduct. Because of SLF's continued refusal to certify,  
6 however, the Company did not file within fifteen days, as it had promised, putting it in violation  
7 of NYSE Amex Stock Exchange rules. Consequently, on April 1, 2011, trading in the  
8 Company's stock was suspended, leaving shareholders stuck with nearly worthless shares.  
9

10           12. Eventually HQSM was delisted after regulators concluded that the Company had  
11 made "a material misrepresentation" to the Exchange meant to hide HQSM and the Individual  
12 Defendants' efforts to block an independent investigation of the Company's finances. The  
13 Exchange also found that the "Company or its management has engaged in operations, which ...  
14 are contrary to the public interest" (see attached Exhibit 3). HQSM announced that it would not  
15 appeal the delisting, indicating it had no reasonable grounds to dispute these factual findings.  
16

17           13. On July 6, 2011, HQSM announced that the Securities and Exchange Commission  
18 ("SEC") was investigating the circumstances which caused the Company to be unable to file its  
19 Form 10-K for 2010.  
20

21           14. HQSM, which traded for as much as \$9.92 during the Class Period, now trades in  
22 the Over-the-Counter ("OTC") market for only pennies a share.  
23  
24  
25  
26

### III. CONFIDENTIAL SOURCES

15. In addition to publicly available information, the facts set out in this Complaint are derived from certain non-public sources of information, including the following:

- A former director of HQSM during the Class Period (the “Former Director”).
- Confidential Witness 1 (“CW-1”) was an Executive Sales Marketing Assistant at HQSM and was one of only about five employees at HQSM’s Seattle headquarters for approximately a year and a half, until CW-1’s departure in early 2010. CW-1 reported to Defendant Sporns.
- Confidential Witness 2 (“CW-2”) was an Executive Vice President for Finance at HQSM for approximately two years, until approximately the third quarter of 2010. CW-2 reported to and worked directly with Defendant Dallaire, the Company’s CFO, and was one of two U.S.-based persons—Dallaire was the other—responsible for financial matters. Often accompanied by Sporns and Dallaire, CW-2 regularly made or participated in presentations to analysts and investors.
- Internal emails, which are accurate copies of certain emails (including attachments) relating to the events set out in this Complaint that were sent to or from HQSM officers, employees and board members, that were lawfully obtained by Lead Counsel in the course of its investigation into the allegations alleged herein.

#### IV. PARTIES

##### A. Plaintiff

16. Plaintiff **Trigon Emerging Agri-Sector Fund** (“Plaintiff”) is an equity investment fund that that invests in companies operating in the agricultural sector or related sectors. It purchased HQSM securities during the Class Period, as set out in its Certification which accompanied its June 27, 2011 motion for appointment as Lead Plaintiff. The Court appointed Trigon Emerging Agri-Sector Fund Lead Plaintiff on September 12, 2011. Plaintiff suffered financial harm when the value of its securities declined as a direct and proximate result of the conduct by Defendants alleged in this Complaint.

##### B. Defendants

17. Defendant **HQ Sustainable Maritime Industries, Inc.** (“HQSM”) is incorporated in Delaware and maintains its headquarters at 1511 Third Avenue, Suite 788, Seattle, Washington 98101. During the Class Period HQSM’s common stock traded on the NYSE Amex Stock Exchange. On April 1, 2011, the last day of the Class Period, trading of HQSM was suspended after HQSM failed to timely file its annual report for 2010. The NYSE Amex Stock Exchange eventually delisted HQSM. On July 8, 2011, trading in HQSM stock began on the OTC market, with the stock trading for pennies a share. Initially, the volume of OTC trading was high as investors rushed to dump shares that they had been unable to sell when trading in the stock was suspended. The Company has announced that the SEC had instituted an investigation into the circumstances that have prevented HQSM from issuing its Form 10-K for 2010.

18. Defendant **Norbert Sporns** (“Sporns”) has been Chief Executive Officer, President and a member of the Board of Directors of HQSM since March 2004. He also is one

1 of the founders of HQSM. Between June 1994 and March 2004, he worked for Sino-Sult  
 2 Canada Limited (“SSC”), a predecessor entity to HQSM. Defendant Sporns is married to  
 3 Defendant Wang Li and is an attorney. According to the Company’s November 19, 2010 proxy  
 4 statement, Sporns owns 4.5% of the Company’s common stock but, because of his additional  
 5 ownership of a class of super-voting shares, he controls 21.0% of the Company’s total  
 6 stockholder voting power.  
 7

8 19. Defendant **Lillian Wang Li** (“Wang Li”) has been Chairman of the Board of  
 9 Directors and Corporate Secretary of HQSM since March 2004. She is also is one of the  
 10 founders of HQSM. According to a proxy statement filed by HQSM in November 2010, “[s]he  
 11 is responsible for the general administration, strategic planning and financial management of  
 12 [HQSM]. She has over twenty-five years of experience in management of Chinese and Canadian  
 13 businesses, particularly with respect to financial matters.” Between June 1994 and March 2004,  
 14 she worked for SSC where her responsibilities included project development and financing.  
 15 Defendant Wang Li is married to Defendant Sporns and is the brother of non-party COO, Wang  
 16 Hua. According to the Company’s November 19, 2010 proxy statement, Wang Li owns 4.6% of  
 17 the Company’s common stock but, because of her additional ownership of a class of super-  
 18 voting shares, she controls 21.9% of the Company’s total stockholder voting power.  
 19

20 20. Defendant **Jean-Pierre Dallaire** (“Dallaire”) has been HQSM’s Chief Financial  
 21 Officer and Financial Controller since September 2004. From 2000 to 2004, he was CFO for  
 22 SSC. He holds a Master degree in Administration (Accounting) from the University of  
 23 Sherbrooke, Canada.  
 24

25 21. Defendant **Roth Capital Partners, LLC** (“Roth Capital”) underwrote a June 11,  
 26 2009 public offering of HQSM common stock (the “2009 Offering”). Roth is headquartered in

Newport Beach, California and has offices in San Diego, Los Angeles, Seattle, New York, Pennsylvania, Shanghai and Hong Kong.

22. Defendant **Ladenburg Thalmann & Co. Inc.** (“Ladenburg Thalmann”) underwrote an August 10, 2010 public offering of HQSM common stock and warrants (the “2010 Offering”). Ladenburg Thalmann has offices in the states of New York, New Jersey and Florida.

23. Defendants Sporns, Dallaire and Wang Li are sometimes referred to as the Individual Defendants. Ladenburg Thalmann and Roth Capital are sometimes referred to as the Underwriter Defendants.

## V. SUBSTANTIVE ALLEGATIONS

### A. A Purportedly Successful Company

24. In his numerous presentations to investors and in the SEC filings he signed, CEO Sporns emphasized what he described as HQSM’s strong prospects for future growth. He told an interviewer that his goal was to make the Company “the largest tilapia producer in the world” and he pointed out that demand for tilapia, which is raised in commercial fish farms, had exploded in the U.S. and elsewhere in recent years, in part because of the cost of ocean-caught seafood and the concern about pollutants which contaminate many ocean fish.

25. Together, Defendants Sporns, Wang Li and Dallaire, along with non-party COO Wang Hua, comprised HQSM’s management team. Wang Li was involved in operations, especially with respect to financial issues and, as CFO since 2004, Dallaire was principally responsible for the Company’s accounting, including the preparation of financial statements. According to the Former Director and biographical information published by the Company, China-based Wang Hua is a founder of HQSM, has been COO and a Director of the Company

1 since March 2004, and “is responsible for the establishment of the [Company’s] production  
2 facilities and their operation” and “also leads our plant management teams and our sales teams.”

3 Wang Hua is the brother of Defendant Wang Li and brother-in-law of Defendant Sporns.

4         26. Through their ownership of “Series A preferred stock”—each share of which has  
5 1,000 times the voting power of HQSM common stock—Sporns, Wang Li and Wang Hua  
6 together controlled 87.5% of the voting power of the Company’s outstanding stock, according to  
7 the Company’s most recent proxy statement. The husband and wife team of Sporns and Wang  
8 Li together controlled 42.9% of the shareholder voting power while Wang Hua controlled 44.6%  
9 of the total shareholder vote even though he only owned 9.2% of the Company’s common stock.  
10 Given their voting power and their positions within the corporation, these three Defendants were  
11 effectively able to hire and fire other directors and Company employees, including Defendant  
12 Dallaire, at will.  
13

14         27. HQSM did not directly raise tilapia, but, according to its public statements, it  
15 purchased and processed tilapia grown by affiliated fish farmers on the Chinese island of Hainan.  
16 The Company also sold fish food to these farmers. HQSM touted its comparative advantages in  
17 raising tilapia: a favorable climate, cheap labor and abundant government subsidies.  
18

19         28. To diversify earnings, HQSM also developed a line of health and beauty products  
20 for sale in China which were produced in part from tilapia.  
21

22         29. Notwithstanding its stated intent of expanding into the U.S. market, a goal Sporns  
23 repeatedly emphasized, almost all of the Company’s employees, operations and sales were in  
24 China.

25         30. As required by the federal securities laws, HQSM filed with the SEC a Form 10-  
26 K annual report each year that included audited financial statements that its top officers certified

1 were prepared in accordance with GAAP. Furthermore, after each quarter (except for the quarter  
2 ending in December, which was covered by the annual report) the Company filed Form 10-Q  
3 quarterly reports, which included unaudited financial statements for the relevant quarter that  
4 were also purportedly prepared in accordance with GAAP.

5  
6 31. Investors were attracted to HQSM because Sporns' portrait of a bright future was  
7 backed up by purportedly GAAP-compliant financial statements prepared under the supervision  
8 of SLF, a respected accounting firm. According to these financial statements, the Company was  
9 consistently profitable and revenue was trending upward—from \$39 million in 2006 to \$55  
10 million in 2007, \$68 million in 2008, \$72 million in 2009 and \$63 million during the first three  
11 quarters of 2010.

12  
13 32. HQSM's impressive cash balances were especially reassuring. According to the  
14 Company's financial statements, it had \$47 million in cash and cash equivalents on hand at the  
15 end of 2007, \$55 million at the end of 2008, \$37 million at the end of 2009 and \$64 million on  
16 September 30, 2010. Moreover, according to a draft of the Company's 2010 year-end financial  
17 statements that Defendants Dallaire emailed to members of HQSM's Audit Committee on March  
18 8, 2011, the Company had over \$67 million of cash and cash equivalents on December 31, 2010.  
19 Throughout the Class Period the Company reported that it had virtually no debt.

20  
21 33. Based on its cash holdings alone, HQSM seemed a bargain. On September 30,  
22 2010, when the Company reported that it had \$64 million in cash and cash equivalents, its stock  
23 closed at \$3.01 per share. Since the Company had about 17.9 million shares outstanding on that  
24 date, its total market value was \$53.9 million, some ten million dollars less than what it said it  
25 had in the bank.  
26

34. Investors had reason to trust the accuracy of the Company's reported cash and cash equivalent balances. The determination of many accounting metrics involves considerable application of judgment by management and outside auditors, which may allow for manipulation. But this is not the case when it comes to cash and cash equivalents, terms which the accounting literature defines unambiguously. The Accounting Standards Codification—an authoritative publication of the Financial Accounting Standards Board—defines cash as “currency on hand,” “demand deposits with banks or other financial institutions” and similar accounts “that have the general characteristics of demand deposits.” Cash equivalents are defined as “short-term, highly liquid investments that” are both “[r]eadily convertible to known amounts of cash [and] [s]o near their maturity that they present insignificant risk of changes in value in interest rates.” And, as investors well know, auditors are required to confirm a company's reported cash and cash equivalent balances directly with the financial institutions holding these balances before they certify a company's financial statements.

35. Because of its purportedly strong financial position, HQSM was able to raise funds by offering additional stock to U.S. investors. In a June 2009 public offering the Company earned gross proceeds of approximately \$11.9 million by selling common stock. In an August 2010 public offering it raised gross proceeds of approximately \$11.6 million by selling common stock and warrants to purchase common stock. And in late 2010 and early 2011, the Company was planning a third public offering—it intended to list the shares of its health and beauty products subsidiary on the Hong Kong Exchange and sell a portion of that subsidiary to investors.

36. HQSM and the Individual Defendants understood the importance the markets placed on corporate integrity and accurate financial statements. On a November 9, 2010



1 conference call with investors and securities analysts, Sporns emphasized the Company's  
 2 compliance with the law and applicable accounting rules:

3  
 4 HQS[M] corporate governance practices have been maintained at  
 5 high levels from the outset.... Our auditors travel wherever is  
 6 required to audit our records on a first-hand basis. Our directors,  
 7 including independent directors, are leaders in their respective  
 8 industries and bring valuable independent oversight to our  
 9 decisions. Western-educated management focused on execution  
 and independent oversight, combined with an unqualified SOX  
 404 compliance record. This distinguishes our company from  
 many newly-listed Asian companies challenged by the rigors of  
 being publicly traded.

10 37. The Company also highlighted to investors its ethics policy, which asserted that  
 11 "[i]ntegrity .... characterizes everything we do. In fact, it is our first core value."

12 **B. HQSM's Auditor Cannot Confirm Account Balances, Customers, or Invoices**

13 38. But HQSM was not the successful company with a bright future and a  
 14 commitment to integrity that it portrayed itself to be. Irregularities discovered by its outside  
 15 auditor near the end of the Class Period provide overwhelming evidence that the Company and  
 16 Individual Defendants engaged in fraud. According to information obtained from internal  
 17 emails, among other sources, the Company's auditor, SLF, discovered substantial evidence of  
 18 fraud in March 2011, while performing due diligence in connection with its audit of HQSM's  
 19 2010 financial statements.

21 **1. HQSM's Auditor Cannot Confirm Bank Balances**

22 39. In March 2011, Armando S. Valeri, the SLF partner principally responsible for  
 23 HQSM's 2010 audit, told the Former Director of concerns stemming from SLF's use of routine  
 24 procedures to confirm the Company's end of 2010 bank balances in China. SLF needed to verify  
 25  
 26

1 these balances to confirm the accuracy of the cash on hand amount indicated in the Company's  
2 2010 financial statements.

3 40. In February or March 2011, confirmation forms had been sent to HQSM's  
4 Chinese bank (which the internal emails indicate was the Industrial and Commercial Bank of  
5 China Limited ("ICBC")), asking it to confirm that HQSM's account balances at the end of 2010  
6 matched the amount indicated in HQSM's books and records. ICBC was to return the  
7 confirmations via messenger service to an agent of SLF in China. As is standard practice in such  
8 audit confirmations, the information from the bank was to come directly from the bank to SLF so  
9 that no other party could forge or alter the confirmations.  
10

11 41. At least one confirmation arrived at the offices of SLF's Chinese representative,  
12 ostensibly coming from ICBC and apparently having been delivered directly to the office by the  
13 courier service that SLF expected would be used to deliver the confirmation. However, when  
14 SLF checked the tracking information on the website for the courier service, SLF saw that the  
15 courier service had not in fact delivered the confirmation from the bank directly to SLF's agent,  
16 but had instead delivered it to another location. SLF called the courier service and confirmed  
17 that the information on its website—that it had *not* delivered the confirmation from the bank  
18 directly to SLF's representative—was correct. This event called into question the accuracy of  
19 the bank confirmation because the chain of custody of the confirmation had been broken.  
20

21 42. In the wake of this disturbing discovery, SLF decided to expand the scope of its  
22 audit due diligence. Later, SLF referred to this incident in its publicly filed June 13, 2011 letter  
23 explaining its subsequent decision to resign from the HQSM account: "During the course of the  
24 FY2010 audit, SLF encountered difficulties in confirming the cash balances in the Company's  
25  
26

1 bank accounts.... To address this, SLF exercised its best judgment to extend its audit  
2 procedures.”

3 43. SLF attempted to verify HQSM’s bank balances directly with the ICBC, without  
4 any involvement of HQSM, and, according to the Former Director, was initially told by the bank  
5 that it would provide such verification. Subsequently, however, the bank refused to do so. A  
6 March 31, 2011 email from SLF partner Valeri to Defendant Dallaire notes that “[y]esterday  
7 night we had further discussion with the Provincial head office of ICBC. We were not able to  
8 obtain the information we need from them and are currently revisiting the matter to consider our  
9 alternatives.”

10 44. SLF was never able to confirm the Company’s cash balances. According to  
11 SLF’s letter, at the time of its resignation, “the Company prevented SLF from satisfactorily  
12 completing the full confirmation process of the cash balances in the Company’s bank accounts in  
13 the PRC.”

## 14 2. HQSM’s Auditor Cannot Verify the Existence of HQSM’s Customers

15 45. SLF also caused confirmation forms to be sent to several of HQSM’s customers  
16 in connection with SLF’s 2010 audit. In accordance with normal audit practice, these  
17 confirmations set out the balance these customers owed to HQSM at the end of 2010 according  
18 to HQSM’s books and asked the customers to confirm this amount. According to the Former  
19 Director, SLF inadvertently made a mistake in one of the numbers in one of the confirmations,  
20 transposing digits in the number that reflected the amount owed. The customer returned the  
21 confirmation form with the incorrect, transposed number certified as correct. SLF found the  
22 confirmation of an erroneous balance to be suspicious.  
23  
24  
25  
26

1           46. SLF also attempted to speak directly with HQSM's customers to confirm their  
 2 business with the Company. According to a March 21, 2011 email from Valeri to Dallaire, SLF  
 3 attempted to call a number of HQSM's supposed customers, but "was not able to speak to any of  
 4 them." Sporns subsequently provided SLF with a new customer list, but SLF's efforts fared no  
 5 better. In a March 30 email Valeri told Audit Committee chairman Intrater: "[w]e called  
 6 customers from the updated list provided by Norbert [Sporns], with no answer or numbers  
 7 were not connected or not valid."

9           47. This inability to contact *any* customers was especially disturbing since HQSM  
 10 distributed most of its products to a relative handful of large wholesalers, each of which should  
 11 have been easy to contact. In its 2009 10-K, the Company explained that "[w]e have derived,  
 12 and over the near term we expect to continue to derive, a significant portion of our sales from a  
 13 limited number of customers. For example, our five largest customers accounted for a total of  
 14 40.6% of our consolidated sales."

16           48. Ultimately, SLF was unable to confirm the accuracy of the sales to customers  
 17 recorded in HQSM's books. In its June 13 letter SLF explained that it "was unable to  
 18 satisfactorily complete ... verification procedures on *the existence of* customers."

### 19           **3. HQSM's Auditor Concludes Invoices Are Probably "Fake"**

20           49. In late March and early April 2011, SLF was also unable to verify five Value  
 21 Added Tax ("VAT") invoices that HQSM had provided to SLF as proof of revenue. As a  
 22 January 4, 2011 article in *The South China Morning Post* explains, in China VAT invoices "are  
 23 printed, endorsed and distributed to corporate taxpayers by the authorities." Each invoice has a  
 24 number assigned by the tax authorities. Companies must record their sales on such invoices,  
 25 which are used to calculate how much tax the company owes.  
 26

50. SLF asked Jingtian & Goncheng, a Chinese law firm, to investigate the authenticity of five of HQSM's invoices. According to a March 26, 2011 memorandum from that law firm to SLF, the law firm concluded, after an investigation, that "all of [the] 5 VAT invoices are *probably fake*" (emphasis in original). The memorandum noted that the invoices lacked a stamp from the tax authorities that appears on legitimate VAT invoices. Moreover, in a telephone call, the tax authorities advised the law firm that the five invoices are "not in conformity with those records kept in [sic] taxation authorities, which means, they are *fake invoices*," according to the memorandum. Moreover, the memorandum goes on to note that checking the invoices on the tax authorities' Internet database produced a similar message: "It is a *fake* invoice."

51. In a March 27 email addressed to Defendant Sporns (and on which Defendant Dallaire was copied) Valeri asked for an explanation of the apparent falsity of these invoices. The following day Sporns responded with an email consisting almost entirely of irrelevant extracts from an academic paper about proposed improvements in the administration of China's VAT system; the paper said nothing about why the tax authorities would not have a record of VAT invoices that they supposedly issued. Defendant Sporns, who had complained that SLF should not have asked a law firm to investigate the matter, also noted that HQSM had an urgent need to file its 10-K, and suggested that it was inappropriate for the auditors to allow this issue to cause further delay. Valeri replied to Defendant Sporns in an email later that day that "[t]he article extracted ... does not directly related [sic] to the issue we are encountering for HQSM's sales invoice[s] in China. It seems that this article is of limited value in assessing HQ[SM]'s situation."

52. Intrater, the Chairman of HQSM's Audit Committee, criticized Defendant Sporns' failure to resolve SLF's concerns regarding the invoices in a March 29 email:

What the hell are you doing by trying to chastise the auditors?

Based on our dire and unusual situation, they certainly have the latitude to have a professional third party [the law firm] go onto a public website and enter in invoices that are supposed to be registered on that site.

What's more distressing to me is that instead of trying to answer why all 5 invoices are seemingly "fake" (at least by the third-party's and auditors' understanding), you, again, cite rules and regulations about confidentiality and papers about how VAT invoices are not a good idea for China!

The auditors need to be shown evidence of the validity of our books and records and not (adversarial) lectures about their business conduct.

Please focus on that as this process is rapidly devolving into a worse situation.

53. Notwithstanding Intrater's plea, this issue was not resolved to SLF's satisfaction.

#### **4. HQSM's Auditor Cannot Verify Advertising Expenses**

54. SLF was also unable to verify some \$5.5 million that HQSM supposedly spent on television advertising. In a March 21, 2011 email SLF's Valeri told Defendant Dallaire that "invoices to support payment to three TV stations had not yet been provided" to SLF and that the audit for 2010 could not be completed without resolving this "critical" issue, as well as the others, set forth above.

55. The amount at issue accounted for almost all of what HQSM claimed to have spent on advertising in 2010—according to the draft 2010 financial statements circulated by Defendant Dallaire in March 2011, HQSM's advertising expenses for the entire year totaled \$5.7 million.

1           56. Later in the day on March 21, 2011, Michael Yip, an outside contractor who  
 2 worked closely with HQSM personnel in China on accounting issues, responded to Valeri's  
 3 question regarding the TV advertising. Yip claimed that these advertising expenses were  
 4 legitimate, but that the television stations had never issued invoices to HQSM, despite the  
 5 millions of dollars involved. Yip copied Defendants Sporns and Dallaire on this email and also  
 6 assured Valeri that his response had been "read, understood and agreed [to] by [HQSM's]  
 7 management."

9           57. SLF subsequently contacted the television stations to which HQSM had  
 10 supposedly paid for advertising. SLF encountered an obstacle in confirming the expenditure  
 11 reported by the Company. In a March 30 email to Audit Committee Chairman Intrater, Valeri  
 12 wrote: that "[w]e also called the TV stations and have appeared to have identified an issue with  
 13 the confirmations." Thus, this "critical" item for purposes of the audit also remained  
 14 unconfirmed.  
 15

### 16 **C. Defendant Dallaire Expresses Concerns**

17           58. In early April 2011, Defendant Dallaire, the Company's CFO, told the Former  
 18 Director that he (Dallaire) had recently learned that the Company's U.S. bank account with Bank  
 19 of New York Mellon held several hundred thousand dollars less than Dallaire thought should be  
 20 in the account. Defendant Dallaire claimed he did not know what had happened to the missing  
 21 funds. He added that he did not have the authority to withdraw money from this account but that  
 22 Defendants Sporns or Wang Li did have such authority.  
 23

24           59. At about this time, Defendant Dallaire told the Former Director that, although he  
 25 was nominally responsible for HQSM's finances and financial reporting, his ability to verify the  
 26 accuracy of the Company's financial statements was limited. Dallaire confessed that he was

1 dependent on the numbers he received from the Company's China-based accounting personnel  
 2 and that he was largely unable to communicate directly with these individuals because he did not  
 3 speak Chinese.

4 **D. Insiders Obstruct Audit Committee's Proposed Investigation**

5 60. On March 29, 2011, HQSM's Audit Committee, concerned about SLF's findings  
 6 during the audit process, engaged the law firm of Latham & Watkins "to conduct an independent  
 7 inquiry into the concerns that developed during the audit process as to the possible breach of  
 8 procedures relating to the verification or confirmation of company accounts and customer  
 9 positions and the extent to which that possible breach extended beyond a handful of incidents,"  
 10 according to Audit Committee Chairman Intrater's subsequent resignation letter. Intrater's letter,  
 11 addressed to Defendant Sporns, notes that initially Sporns had "pledged [his] cooperation" with  
 12 the inquiry.  
 13

14 61. Nevertheless, despite Defendant Sporns' promise to cooperate, Intrater's April 6,  
 15 2011 letter describes a different response from Defendant Sporns and other insiders at a March  
 16 31, 2011 Board of Directors meeting:  
 17

18 [T]he members of the management team who serve on the board,  
 19 including you [Sporns], Lillian [Wang] Li and Harry [Wang] Hua,  
 20 initially declined to vote affirmatively on two basic but key  
 21 resolutions, one to retain Troutman Sanders as counsel to the  
 22 company with an enlarged mandate to assist the internal inquiry  
 23 and the second pledging the company's cooperation in the internal  
 24 inquiry. When I and some of the other independent directors asked  
 25 for the reasons for the management team's troubling decision to  
 26 refuse to vote for these two important and essential resolutions, the  
 reasons given—namely that a resolution mandating cooperation  
 was "insulting" and that Troutman Sanders had only been serving  
 as securities counsel—were not compelling. Unfortunately, it took  
 me and some of the other independent directors to convince you  
 and the management team to vote for these resolutions.



62. In the days immediately following the March 31 Board of Directors meeting, Latham asked that it be paid a retainer and that it be provided with basic information related to the issues under review. An April 5, 2011 email from Audit Committee Chairman Intrater sets out the relatively straightforward information gathering (and preserving) steps that Latham & Watkins requested that management undertake:

- “Identify all company bank accounts and locations, provide statements of the current balance in each account.”
- “Identify the signatories or persons authorized to draw on the accounts. Provide balance statements for the past year for all accounts.”
- “Identify the [Company’s] 20 largest customers, including location and point of contact. Provide a billing and payment history for each customer, plus copies of invoices, shipping records/bills of lading, and any remaining accounts receivable.”
- “Identify the funds raised in the last 5 public offerings/PIPEs. Identify how the funds have been used or spent.”
- “Provide an organizational chart, list of company facilities and locations, and list of employees’ work locations, telephone numbers and email addresses.”
- “Identify the location and ... all servers or other information technology platforms. Confirm that a preservation notice has been sent to all company employees directing the preservation of email, electronic records and electronic data.”
- “Provide the VAT invoices that have been identified by the auditors as problematic, plus the underlying customer invoices/proof of sales.”

63. Despite their reluctant vote to support the investigations at the March 31 meeting, HQSM and the Individual Defendants refused to pay Latham, Troutman Sanders or SLF and also refused to provide the information Latham requested. Intrater tried to contact Defendant Sporns to have the requested information provided and the outstanding invoices paid, but was unsuccessful. As he explained in his April 6, 2011 resignation letter:

Instead of responding promptly to these requests and assisting in the conduct of the internal inquiry at a point when every day counted, you instead became unavailable to me and some others on the board. It has now been five days since I last heard from you, even though you have, during the same period, interacted with selected members of the board of directors. ***All of the requests directed to the company have gone unanswered and no retainer fees have been paid. As a result of these delays, the internal inquiry has yet to begin.***

....Management also has not complied with any of the requests made by me or counsel conducting the independent inquiry—including the most rudimentary demands, such as for an organizational chart—nor has it paid the necessary retainers for Latham & Watkins or Troutman Sanders....

64. Although Defendant Sporns refused to communicate with Intrater, Defendant Sporns nevertheless took an additional step to impede the proposed investigation. Intrater's letter explains:

On Monday, management for the company instructed Troutman Sanders not to file any notice of claim with the company's insurance carriers under the company's directors' and officers' liability policies, contrary to Troutman's advice. This decision together with other factors, prompted Troutman Sanders, which ... has served as company counsel for some time, to withdraw. This will now mean a significant delay in the independent inquiry as new counsel steps into the picture.

65. HQSM and the Individual Defendants continued their stone-walling after Intrater's April 6, 2011 resignation. As SLF described in its June 13, 2011 letter:

After the resignation of the Chairman of the Audit Committee, *the Company's management became increasingly non-responsive, uncooperative and non-communicative with SLF*. In fact, there had been little direct communication between the Company's management and SLF from early April 2011 through SLF's resignation on May 26, 2011.

#### **E. Investors Learn of Irregularities at HQSM**

66. Investors had no indication of fraud at HQSM until mid-March, when HQSM failed to file its annual report as scheduled. But, even after this delay, Defendants continued to conceal the true facts through the end of the Class Period and beyond.

##### **1. Postponement of the 2010 Annual Report**

67. The first disclosure that HQSM would not timely issue its Form 10-K annual report for 2010 was a Company press release issued at 8:08 a.m. Eastern Time on March 16, 2011, which announced that the Company would "postpone the release of [its] fourth quarter and fiscal year 2010 earnings" report and a related conference call, both of which the Company had announced, only a week earlier, would take place on March 16. The Company said that it would file Form 12b-25 with the SEC, which would give it a 15-day extension to file its 10-K annual report and certified financial statements. The Company assured investors that it "fully expects to be able to file within the additional time allowed" and that "[d]etails regarding the specific [earnings] release date and conference call will be provided in a forthcoming news release."

68. HQSM falsely suggested that this postponement was nothing more than the result of routine paperwork delays: "The postponement in filing is due to delays in compiling information for the preparation of the financial statements." The true reason that the Form 10-K could not be timely filed, however, was that, having discovered evidence of apparent fraud, SLF had refused to certify the Company's financial statements without conducting further, more

1 robust audit procedures. A company cannot file a Form 10-K without certified financial  
2 statements.

3 69. On the news of this delay in filing the Form 10-K, HQSM stock dropped sharply  
4 on one of the heaviest trading days in the Class Period, closing at \$3.26 on March 16, 2011,  
5 down 15.1% from its close on March 15 at \$3.84. As the fifteen-day deadline for filing the  
6 previous year's financial statements approached without the promised announcement of a filing  
7 date for the Company's 10-K, the price of HQSM common stock dropped further, closing at  
8 \$2.78 on Friday April 1. (On May 26, 2009 the stock had reached a Class Period high of \$9.92.)

10 70. On April 1, 2011 the Company announced that it would not meet the fifteen-day  
11 deadline because of "difficulties and delays in obtaining and verifying certain information." It  
12 claimed that it "expect[ed] to complete the audit within approximately 30 days." Again, the  
13 undisclosed reason for the delay was SLF's refusal to certify HQSM's financial statements.

15 71. The NYSE Amex Stock Exchange responded on the same day—April 1—to the  
16 Company's failure to timely file its 10-K by suspending trading in HQSM shares shortly after the  
17 trading day began. As a result of this suspension, Class Members were unable to sell their  
18 HQSM shares and these shares became virtually worthless. Trading in HQSM stock would  
19 remain suspended until July 8, 2011, when the Company's shares began trading on the OTC  
20 market for mere pennies a share.

## 22 **2. Audit Committee Chairman's Resignation**

23 72. On April 11, 2011, the Company filed a Form 8-K with the SEC that announced  
24 that Audit Committee Chairman Intrater had resigned five days earlier. It was also compelled to  
25 file the text of Intrater's resignation letter, in which Intrater disclosed that, "over the last few  
26 weeks" serious questions had been raised about the accuracy of the Company's financial records.

1 The letter also described in detail HQSM and the Individual Defendants' successful efforts to  
 2 thwart an independent inquiry into this matter. Intrater said he felt compelled to resign because  
 3 Defendants' "delay and resistance" to resolving these issues had caused him to "lose faith in the  
 4 management of the company."

5 73. Intrater summarized his reasons for resigning as follows:

6  
 7 This series of events, beginning gradually during the difficulties in  
 8 the audit process and then increasing over the last week, ***the***  
 9 ***uncooperative conduct of the management team*** at the [March 31,  
 10 2011] board of directors meeting, and now the current failure to  
 11 communicate with me at a point when every second counts,  
 12 ***coupled with a pattern of decisions by management that are***  
 13 ***difficult for me to understand***, have left the company without its  
 14 long-standing outside counsel at a crucial moment, have failed to  
 15 advance the audit process and have failed even to initiate, let alone  
 16 move forward, the independent inquiry, leads me to the conclusion  
 that I can no longer be effective in my efforts to help the company  
 move forward. My interest in seeing this process through to its  
 completion remains unwavering, but ***the continued resistance of***  
***management to these necessary steps has made it impossible to***  
***advance this effort. Accordingly, I am compelled by conscience***  
***to resign*** from the board of directors and the audit committee,  
 effective immediately.

17 74. In the body of the 8-K that accompanied Intrater's letter the Company suggested  
 18 that Intrater's statements were false: "Management of the Company substantially disagrees with  
 19 Mr. Intrater's characterization of the circumstances representing these differences and  
 20 disagreements [between the Company and Intrater]. The Company is in the process of preparing  
 21 its responses to the contents of the Resignation Letter and intends to file them as soon as possible  
 22 by amending this filing."

24 75. To date, the Company has not filed any response to Intrater's resignation letter  
 25 notwithstanding its stated commitment to do so.

76. Investors had reason to give special weight to Intrater's views on the Company's finances—in addition to being Chairman of the Audit Committee, he was the Company's designated "financial expert." SEC and NYSE Amex Stock Exchange rules required HQSM to have a person who qualifies as such an expert on the audit committee. Intrater is, and was during his tenure on HQSM's Board of Directors, CEO of Columbus Nova, a private investment firm. According to the proxy statement filed by HQSM in November 2010, Intrater qualified as a "financial expert" because of his "past employment experience in finance or accounting, requisite professional certification in accounting, or other comparable experience or background" and was a person of "financial sophistication."

### 3. Failure to File Quarterly Report

77. On May 19, 2011, HQSM announced that it would not timely file its required 10-Q quarterly report for the period ending March 31, 2011 "for the same reasons" it had been unable to file its Form 10-K annual report.

### 4. Auditor's Resignation

78. On June 2, 2011, the Company announced in a Form 8-K SEC filing that SLF had resigned as the Company's outside auditor on May 26 because of SLF's "inability to proceed due to the lack of support from management in SLF efforts to complete the audit [for 2010]." However, presumably concerned about investor reaction, HQSM also included language in this 8-K suggesting that SLF's stated reason for its resignation was false and that the real issue was SLF's supposed lack of licensing to operate in China and its insistence on new verification procedures that had not been used in the past.

79. On June 14, 2011, however, HQSM was compelled to file a copy of a letter received from SLF (dated the previous day) which provided a detailed explanation of SLF's

1 position that HQSM's June 2, 2011 explanation of the reasons for SLF's resignation were  
 2 misleading. SLF explained that it had insisted upon additional verification procedures because,  
 3 using normal audit procedures, "*SLF encountered difficulties in confirming the cash balances*  
 4 *in the Company's bank accounts and verifying the existence of customers.*" Moreover, SLF  
 5 pointed out that the June 2 Form 8-K had neglected to note that another factor leading to SLF's  
 6 resignation was HQSM's failure to pay bills owed to SLF.  
 7

8 80. SLF also disclosed that the reason it could not obtain the Chinese audit license  
 9 that HQSM claimed it needed was because HQSM's management had blocked SLF from getting  
 10 such a license. To obtain such a license SLF needed written consent from HQSM and its  
 11 subsidiaries, but "[t]he Company refused to provide any such consents." SLF also expressed its  
 12 view that there had been no need for such a license and that the issue was merely an excuse  
 13 raised by HQSM to keep SLF from doing its job:  
 14

15 *the purported licensing issue did not impede SLF's ability to*  
 16 *conduct the FY2010 audit.* Rather, the Company raised this  
 17 purported issue for the first time late in the FY2010 audit process  
 18 only when SLF sought to conduct the planned audit procedure to  
 19 visit the Company's banks in the PRC [People's Republic of  
 20 China] to verify the existence of the cash balances in the  
 21 Company's bank accounts. As a result of raising this purported  
 22 issue, the Company prevented SLF from satisfactorily completing  
 23 the full confirmation process of the cash balances in the  
 24 Company's bank accounts in the PRC. It is notable that the  
 25 Company had never before raised the purported licensing issue in  
 26 the PRC. Further, none of the banks or customers in the PRC from  
 which SLF was seeking direct confirmation of bank account and  
 accounts receivables balances, respectively, raised this purported  
 licensing issue; rather, it was raised only by the Company....



**F. HQSM Makes a False Statement to Regulators**

81. SLF's June 13 letter also disclosed that on May 2, 2011, HQSM had sent a letter to the NYSE Amex Stock Exchange regulatory staff in which the Company falsely asserted that former Audit Committee Chairman Intrater had acted without the approval of either the Board of Directors or the Audit Committee when he hired Latham & Watkins to conduct an independent inquiry of HQSM. The letter was apparently an attempt to mislead the regulators, who were investigating whether the Company should continue to be listed on the Exchange in light of its failure to timely file its annual report and the allegations set forth in Intrater's resignation letter. The Company did not publicly file this letter or provide a copy to SLF, presumably so they would not contradict it, but SLF learned the substance of the letter.

82. SLF noted that the Company's claim that Intrater had acted unilaterally:

is inconsistent with SLF's contemporaneous understanding, as well as communications with current and former members of the Audit Committee. On May 25, 2011, Mr. [Fred] Bild, a member of the Company's Audit Committee, confirmed to SLF that the Audit Committee and later the Board of Directors had, in fact, authorized the independent review on March 31, 2011.

83. Bild also told SLF that HQSM and the Individual Defendants had drafted a falsified version of the Board minutes:

Mr. Bild advised SLF that the final minutes of the March 31 Board meeting ... previously had been drafted by Company's management *so as not to accurately reflect such approval* (when, in fact, according to Mr. Bild and others, the Audit Committee and later the Board of Directors had approved the independent review on March 31).

84. On July 13, 2011, the NYSE Amex Stock Exchange staff stated publicly that its investigation had concluded that "Latham & Watkins was engaged by the audit committee to conduct an independent review of the Company's audit situation and that the independent review



1 was unanimously approved by the Company's board." and that the Company's assertion to the  
 2 contrary was "a material misrepresentation" made by the Company to the Exchange.

### 3 **G. Additional Developments**

#### 4 **1. NYSE Amex Stock Exchange Delisting**

5 85. On July, 1, 2011, HQSM filed an 8-K which disclosed that the NYSE Amex  
 6 Stock Exchange had rejected a plan proposed by the Company to bring it back into compliance  
 7 with certain rules of the Exchange. Approval of such a plan was a prerequisite for the  
 8 Company's continued listing on the Exchange. HQSM also announced in this Form 8-K that the  
 9 NYSE Amex Stock Exchange, which had suspended trading of the Company's shares on April 1,  
 10 2011, had proposed delisting the Company's stock for specified violations of the Exchange's  
 11 rules. The Company was entitled to appeal this decision, but said that it would not do so,  
 12 guaranteeing that the delisting would occur.  
 13

14 86. On July 13, 2011, the NYSE Amex Stock Exchange filed a "Determination and  
 15 Notification of Removal from Listing and/or Registration Under Section 12(b) of the Securities  
 16 Exchange Act of 1934" (attached as Exhibit 3) which enumerated the same violations that had  
 17 been enumerated in the Company's July 1 Form 8-K and confirmed that, effective July 25,  
 18 HQSM would be delisted. The filing said that the Exchange had acted because HQSM had  
 19 violated four specific rules of the Exchange:  
 20

21 (a) *The Company failed to file its Form 10-K* for the year ended  
 22 December 31, 2010 and Form 10-Q for the period ended March 31,  
 23 2011 with the SEC.

24 (b) The Company is subject to delisting pursuant to Section 132(e)  
 25 of the Company Guide, which provides that a listed company may  
 26 be delisted "if any communication...to the Exchange contains a  
 material misrepresentation." The Company informed the Staff in a  
 letter dated May 2, 2011 that the former chairman of the  
 Company's audit committee had initiated an independent review of

the Company's audit process by Latham & Watkins without authorization by the audit committee or the board of directors. Based upon a review of information provided by the Company and the Company's former independent auditor, Schwartz Levitsky Feldman LLP ("SLF"), Latham & Watkins was engaged by the audit committee to conduct an independent review of the Company's audit situation and that the independent review was unanimously approved by the Company's board.

(c) The Company is noncompliant with Section 803B(4) of the Company Guide which requires that the audit committee of each issuer must have the specific audit committee responsibilities, authority and procedures necessary to comply with Rule 10A-3(b)(4) and (5) under the Securities Exchange Act of 1934 ... concerning responsibilities relating to authority to engage advisors and funding for compensation to be paid to such advisors as determined by the audit committee. Specifically, *Company management refused to make the retainer payment required in connection with the engagement of Latham & Watkins which was approved by the Company's audit committee.*

(d) The ... Company or its management has engaged in operations, which, in the opinion of Staff, are contrary to the public interest. The Company appears to have consistently acted to obstruct SLF in conducting an audit and, in doing so, acted in a manner that is inconsistent with the public interest in having listed companies make timely filings of required financial information that has been audited in accordance with generally accepted auditing standards.

87. Congress, in 15 U.S.C. § 78s, has designated exchanges such as the NYSE Amex Stock Exchange as Self Regulatory Organizations and has charged such organizations with enforcing compliance by companies listed on their exchange with the exchange's own rules and with the certain provisions of the federal securities laws.

## 2. SEC Investigation

88. In an 8-K filed on July 6, 2011, HQSM announced that it had been "recently notified by the staff of the SEC that it has initiated a formal, nonpublic investigation into the circumstances related to the delays in the Company's filing of its Annual Report on Form 10-K for the fiscal period ended December 31, 2010."

1           **3. Further Board Resignations**

2           89. HQSM's July 6, 2011, Form 8-K also announced that independent directors Fred  
3 Bild and Kevin Fitzsimmons had resigned from the Board effective June 29, 2011, leaving only a  
4 single independent director on the Company's Board, a Chinese citizen who apparently has long-  
5 established ties to Defendants Sporns and Wang Li. Bild also resigned from the Audit  
6 Committee. The Company claimed that it was "actively seeking to fill the vacancies on the  
7 Board and its standing committees as soon as practical." As of the date of this Complaint, these  
8 vacancies remain open.  
9

10           **4. Continued Failure to Replace Auditor and Issue Periodic Reports**

11           90. Although SLF resigned as auditor in May 2011, HQSM has not replaced it. In  
12 fact, since the Company's June 2011 claim that it was "in the process of searching for a new  
13 independent registered auditing firm," it has not made any SEC filings or other public statements  
14 explaining why no auditor has been hired, or even whether it still intends to hire an auditor.  
15

16           91. The Company's failure to replace SLF, and its resultant inability to file its 2010  
17 10-K annual report and subsequent quarterly filings, has had significant negative consequences  
18 for HQSM. In addition to ensuring that it would be delisted from the NYSE Amex Stock  
19 Exchange, the Company's failure to file these required reports obligated it to cancel its shelf  
20 registration statement, which had been in force since early 2010. Cancellation of this registration  
21 statement means that the Company can no longer raise money by selling securities in the U.S.  
22 markets. Moreover, although the Company trades on the OTC Market, because of its  
23 delinquency it cannot be listed on the OTC Bulletin Board, one of the principal OTC market  
24 quotation systems.  
25  
26

**H. Additional Indicia of Fraud**

92. Although the discovery of major discrepancies during the audit of HQSM's 2010 financial statements, and HQSM and the Individual Defendants' subsequent efforts to obstruct any investigation into these discrepancies, provides compelling evidence of fraud, there are additional facts which provide further support to the conclusion that the Company and the Individual Defendants engaged in fraud.

**1. HQSM's U.S. Office Did Virtually No Business.**

93. The strange situation at HQSM's headquarters in Seattle during the Class Period also suggests that the Company was not a fully legitimate enterprise. CW-1 described a general atmosphere of "weirdness" at the Company's headquarters, explaining that "it seemed like the company was never doing anything" and that, despite Defendant Sporns' repeated emphasis on the importance of the U.S. market, the office almost never received calls relating to the sales of the Company's products. CW-1 added that "I never saw any actual business being conducted there. It was pretty obvious they didn't sell any product." CW-1 was never assigned specific duties and generally had little work to do. CW-1 concluded that HQSM was hiring people "just to have bodies in the office."

**2. HQSM Failed to Generate Monthly Financial Statements and Access to Financial Records Was Restricted**

94. HQSM's refusal to give CW-2, the Company's number two financial officer at its headquarters, full access to the Company's financial records also supports the inference that HQSM and the Individual Defendants were not accurately maintaining the Company's books. As soon as CW-2 joined the Company in approximately the third quarter of 2008, CW-2 asked the Company's top executives to provide him with monthly reports on the Company's key metrics, such as product processing capacity, sales, and profit and loss numbers. However,

1 according to CW-2, Defendants Sporns, Dallaire and Wang Li rejected this request. *Instead,*  
 2 *financial metrics were provided to CW-2 only one week before the Company filed its quarterly*  
 3 *financial statements with the SEC* and CW-2 “never saw detailed information” about the  
 4 Company. CW-2 renewed the request for monthly financial data approximately six months after  
 5 starting to work for HQSM, but it was again rejected by the Individual Defendants. CW-2 found  
 6 the denial of this request to be, in CW-2’s experience, completely atypical: “HQ[SM] was not  
 7 being run like a normal company.... Normally, you would have internal numbers every month....  
 8 How can you know if you need to raise costs? You can’t function (in this manner) as a  
 9 company.” CW-2 conferred with others at the Company who similarly believed that HQSM’s  
 10 business model simply “did not make sense.”

12 95. CW-2 left the Company voluntarily, in part because CW-2 was concerned about  
 13 the possibility of fraud at HQSM. CW-2 was invited to work for the Company as a consultant in  
 14 early 2011, but declined the offer.

16 96. CW-1 confirmed that CW-2 did not have access to the Company’s financial  
 17 records, access that a person in CW-2’s position should have had.

## 18 VI. ADDITIONAL SCIENTER ALLEGATIONS

19 97. As alleged herein, HQSM and the Individual Defendants acted with scienter in  
 20 that they knew that the public documents and statements issued or disseminated in the name of  
 21 the Company or in their own names were materially false and misleading or were extremely  
 22 reckless in not so knowing; knew that such statements or documents would be issued or  
 23 disseminated to the investing public or were extremely reckless in not so knowing; and  
 24 knowingly, or acting with extreme recklessness, substantially participated or acquiesced in the  
 25 issuance or dissemination of such statements or documents as primary violations of the federal  
 26

1 securities laws. As set forth elsewhere herein in detail, Defendants knew or were deliberately  
 2 reckless in not knowing the true facts regarding HQSM that were concealed as a result of the  
 3 fraud alleged herein.

4 98. Given the scale of the fraud alleged herein, and the degree to which it affected  
 5 HQSM's central business operations, there is a strong inference that Defendants knew of the  
 6 misconduct alleged herein or, at a minimum, were deliberately reckless in not so knowing.  
 7 Moreover, HQSM and the Individual Defendants' efforts to block any independent investigation  
 8 of the irregularities identified by SLF, even though the Company had a strong interest in  
 9 resolving these issues so it could continue to be listed on the NYSE Amex Stock Exchange,  
 10 which greatly facilitated the Company's ability to raise new funds by the issuance of additional  
 11 stock, suggests that HQSM and the Individual Defendants participated in or, at a minimum,  
 12 knew or recklessly disregarded the misconduct alleged herein.  
 13  
 14

## 15 **VII. SPECIFIC MATERIALLY FALSE OR MISLEADING STATEMENTS**

### 16 **A. Repeated Assertions of GAAP Compliance**

17 99. During each of the 10-K annual and 10-Q quarterly reports filed from May 11,  
 18 2009 through the end of the Class Period, HQSM and the Individual Defendants asserted that  
 19 HQSM complied with GAAP. GAAP are those principles recognized by the accounting  
 20 profession, the SEC and the PCAOB as the conventions, rules and procedures necessary to  
 21 define generally accepted accounting practice. Investors expect the financial statements of  
 22 public companies to be prepared in accordance with GAAP and SEC Regulation S-X, which  
 23 states that financial statements filed with the SEC that are not prepared in conformity with  
 24 GAAP are presumed to be misleading and inaccurate, notwithstanding any accompanying  
 25 disclosures.  
 26

1           100. GAAP requires that financial statements be based on materially true and accurate  
 2 information and that financial statements present an accurate overview of the financial situation  
 3 of a company. Where necessary to ensure that the financial statements provide a materially  
 4 accurate picture of a company, the financial statements must be accompanied by explanatory  
 5 notes. Financial statements that convey materially false and misleading information are  
 6 inherently in violation of GAAP.  
 7

8           101. Because HQSM's auditors were unable to verify any of HQSM's customers, its  
 9 cash balances in bank accounts, the legitimacy of its invoices or its spending on television  
 10 advertisements, and because the Company's financial statements were prepared using materially  
 11 inaccurate information, HQSM's financial statements during this period were not prepared in  
 12 compliance with GAAP and HQSM and the Individual Defendants' assertions to the contrary  
 13 were materially false or misleading.  
 14

#### 15 **B. May 2009 Quarterly Disclosures**

16           102. On May 11, 2009, after the close of trading, HQSM issued a press release which  
 17 included the Company's financial statements for the first quarter of 2009, which ended on March  
 18 31, 2009. The press release also described the Company's performance during that period in  
 19 very positive terms:  
 20

21           For the quarter ended March 31, 2009, sales increased by 18% to  
 22 \$10.8 million, compared to \$9.2 million for the first quarter of  
 23 2008. The Aquaculture Product segment accounted for \$7.3  
 24 million in sales, up 12% from \$6.5 million reported for the same  
 period last year. Sales from the Health and Bio-product segment  
 were \$3.5 million, up 32% from \$2.6 million for the first quarter of  
 2008.

25           The gross profit for the first quarter of 2009 increased by 22% to  
 26 \$4.8 million, compared to gross profit of \$3.9 million for the same  
 period of 2008. The overall gross profit ratio increased to 44%,



1 compared to 42% for the three month period ended in March 31,  
2 2008.

3 “I am very pleased by our performance during the first quarter....”  
4 said Norbert Sporns, CEO of HQ Sustainable Maritime Industries,  
5 Inc.

6 103. The financial statements and the other statements in this press release were  
7 materially false or misleading in that, as would later be disclosed, the Company’s customers,  
8 invoices, cash balances and spending on television advertisements were all unverifiable and, as a  
9 result, its financial statements were materially inaccurate and not prepared in conformity with  
10 GAAP.

11 104. Also on May 11, 2009, at approximately 4:00 p.m. Eastern Time, the Company  
12 filed its quarterly report on Form 10-Q with the SEC for the first quarter of 2009. This report  
13 was signed by Defendants Sporns and Dallaire in their capacities as CEO and Chief Accounting  
14 Officer, respectively. This filing included the same financial results as included in the May 11,  
15 2009 press release, and was materially false and misleading for the same reasons.

16 105. Also included in this Form 10-Q were certifications of Defendants Sporns and  
17 Dallaire that attested to the truthfulness of the disclosures in the Form 10-Q, as well as to the  
18 accuracy and effectiveness of HQSM’s systems of accounting internal control. Sporns signed a  
19 “Section 302” certification that reads as follows:  
20

21 I ... certify that:

22 1. I have reviewed this quarterly report on Form 10-Q of  
23 HQ Sustainable Maritime Industries, Inc.;

24 2. Based on my knowledge, this report does not contain any  
25 untrue statement of a material fact or omit to state a material fact  
26 necessary to make the statements made, in light of the  
circumstances under which such statements were made, not  
misleading with respect to the period covered by this report;



3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The Registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Issuer, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the Issuer's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the Issuer's internal control over financial reporting that occurred during the Registrant's fiscal quarter ending March 31, 2009 that has materially affected, or is reasonably likely to materially affect, the Issuer's internal control over financial reporting; and

5. The Registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditor and the audit

committee of the Registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

106. Defendant Dallaire signed an essentially identical certification, which was also attached to the May 11, 2009 Form 10-Q.

107. Defendant Sporns also signed a separate "Section 906" certification which read as follows:

1. The [accompanying 10-Q] Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

108. Defendant Dallaire signed an essentially identical certification, which was also attached to the May 11, 2009 Form 10-Q.

109. Together, these certifications are hereinafter referred to as the "Sarbanes-Oxley Certifications," and, using materially identical language, were made by Defendants Sporns and Dallaire with respect to each quarterly and annual report filed with the SEC throughout the Class Period.

110. These Sarbanes-Oxley Certifications were materially false and misleading because, as both Defendants Sporns and Dallaire knew, the financial statements contained in

1 these reports were materially inaccurate and not in conformity with GAAP because HQSM's  
 2 internal controls systems were materially flawed and not properly designed to ensure accurate  
 3 financial reporting.

4 **C. June 2009 Offering Documents**

5 111. On June 15, 2009, HQSM filed with the SEC a Prospectus Supplement (dated  
 6 June 11, 2009) pursuant to which HQSM made an offering of its common stock. Defendant  
 7 Roth Capital was the underwriter for this offering. The Prospectus Supplement was issued  
 8 pursuant to a Shelf Registration Statement that became effective on November 13, 2008. The  
 9 June 11, 2009 Prospectus Supplement incorporated by reference previous SEC filings, including  
 10 HQSM's Quarterly Report on Form 10-Q for the fiscal quarter ended March 31, 2009 (as filed  
 11 on May 11, 2009).

12 112. The financial statements included in the Prospectus Supplement were materially  
 13 false or misleading in that, as would later be disclosed, the Company's customers, invoices, cash  
 14 balances and spending on television advertisements were all unverifiable and, as a result, its  
 15 financial statements were materially inaccurate and not prepared in conformity with GAAP.

16 **D. August 2009 Quarterly Disclosures**

17 113. On August 10, 2009, HQSM issued a press release which included the Company's  
 18 financial statements for the second quarter of 2009, which ended on June 30, 2009. The press  
 19 release also described the Company's performance during that period in very positive terms:

20 For the quarter ended June 30, 2009, sales increased by 10 per cent  
 21 to \$16 million, compared to \$14.5 million for the second quarter of  
 22 2008. The Aquaculture Product segment accounted for \$10.5  
 23 million in sales, up 9 per cent from \$9.6 million reported for the  
 24 same period last year.

1 Gross profit for the second quarter of 2009 increased by 37 per  
2 cent to \$6.8 million, compared to gross profit of \$5 million for the  
3 same period of 2008.

4 “The second quarter once again saw strong top line growth across  
5 our business segments, and though our net income was adversely  
6 affected by new accounting rules, we believe that this revenue  
7 growth demonstrates the significant leverage that our business  
8 model continues to hold. Highlights for the second quarter also  
9 included very favorable increases in our gross profit margins.  
10 Fueling this leverage and our continued vertical integration was the  
11 recent completion of our feed mill.

12 This addition renders our feed the most efficient feed available in  
13 China to Tilapia farmers, reducing feed cost for farmers while  
14 guaranteeing for consumers quality at a very high level,” said  
15 Norbert Sporns, CEO of HQ Sustainable Maritime Industries, Inc.

16 114. The financial statements and the other statements in this press release were  
17 materially false or misleading in that, as would later be disclosed, the Company’s customers,  
18 invoices, cash balances and spending on television advertisements were all unverifiable and, as a  
19 result, its financial statements were materially inaccurate and not prepared in conformity with  
20 GAAP.

21 115. Also on August 10, 2009, HQSM filed its quarterly report for the second quarter  
22 of 2009 on Form 10-Q with the SEC. This Form 10-Q was signed by Defendants Sporns and  
23 Dallaire and included the same financial information as the August 10, 2009 press release, and  
24 was materially false or misleading for the same reasons.

25 116. Further, this Form 10-Q contained Sarbanes-Oxley Certifications signed by  
26 Defendants Sporns and Dallaire that were materially identical to the first quarter 2009 Form 10-  
Q Sarbanes-Oxley Certifications and which were materially false or misleading because, as both  
Defendants Sporns and Dallaire knew, the financial statements contained in these reports were

1 materially inaccurate and not in conformity with GAAP because HQSM's internal controls  
2 systems were materially flawed and not properly designed to ensure accurate financial reporting.

3 **E. November 2009 Quarterly Disclosures**

4 117. On November 9, 2009, HQSM issued a press release which included the  
5 Company's financial statements for the third quarter of 2009, which ended on September 30,  
6 2009. The press release also described the Company's performance, highlighting a reported  
7 increase in profits:  
8

9 For the quarter ended September 30, 2009, sales decreased by  
10 1.4% to \$22.2 million, compared to \$22.4 million for the third  
11 quarter of 2008.

12 \*\*\*

13 Gross profit for the third quarter of 2009 increased by 5% to \$10  
14 million, compared to gross profit of \$9.5 million for the same  
15 period of 2008. Operating income for the third quarter decreased  
16 to \$4.9 million, from \$6.5 million in September 2008. The  
17 decrease experienced in the quarter was mainly the result of the  
18 provision for potential losses in the Company's receivables in its  
19 health and bio-product segment which had not materialized to date,  
20 as well as an increase in advertising and marketing expenses within  
21 the same segment.

22 \*\*\*

23 "Our Company continues to see significant demand for its biomass  
24 products.... During the quarter, increased demand for our Marine  
25 Bio and Healthcare products resulted in much improved sales, and  
26 helped to mitigate the impact of the reduction in the selling price of  
tilapia in our aquatic products segment that we have seen this year.  
Increased vertical integration is also beginning to pay dividends, as  
we saw decreased raw material costs with respect to our fish and  
other indirect expenses during the quarter. This has resulted in a  
significant improvement in our profitability so far in 2009, and we  
hope to see this trend continued in future quarters," said Norbert  
Sporns, CEO of HQ Sustainable Maritime Industries, Inc.

118. The financial statements and other statements in the press release were materially  
false or misleading in that, as would later be disclosed, the Company's customers, invoices, cash

1 balances and spending on television advertisements were all unverifiable and, as a result, its  
 2 financial statements were materially inaccurate and not prepared in conformity with GAAP.

3 119. Also on November 9, 2009, HQSM filed its quarterly report for the third quarter  
 4 of 2009 on Form 10-Q with the SEC. This Form 10-Q was signed by Defendants Sporns and  
 5 Dallaire and included the same financial information as the November 9, 2009 press release, and  
 6 was materially false and misleading for the same reasons.  
 7

8 120. Further, this Form 10-Q contained Sarbanes-Oxley Certifications signed by  
 9 Defendants Sporns and Dallaire that were materially identical to the first quarter 2009 Form 10-  
 10 Q Sarbanes-Oxley Certifications and which were materially false or misleading because, as both  
 11 Defendants Sporns and Dallaire knew, the financial statements contained in these reports were  
 12 materially inaccurate and not in conformity with GAAP because HQSM's internal controls  
 13 systems were materially flawed and not properly designed to ensure accurate financial reporting.  
 14

#### 15 **F. March 2010 Annual Disclosures**

16 121. On March 15, 2010, HQSM issued a press release which included the Company's  
 17 financial statements for the year ending December 31, 2009. The press release also described the  
 18 Company's performance during that period in very positive terms:

19 "The Company successfully expanded its sales of high quality,  
 20 health and bio-products made from Tilapia by-products, in  
 21 response to a landmark shift in China food safety legislation passed  
 22 in March of 2009, which caused the closure of several of China's  
 23 health and food product manufacturing facilities. This  
 24 unprecedented opportunity for our Company in China has resulted  
 25 in a short term increase in receivables and higher marketing  
 26 expenses in our health and bio-product segment," said Norbert  
 Sporns, HQ Sustainable Maritime's President and Chief Executive  
 Officer.

“In 2010, we believe our efforts to reposition our Company behind higher margin product categories combined with increased operating efficiencies from our vertically integrated operations will enable us to realise an exceptional period of strong sales, margin expansion, and long-term profitable growth.”

\*\*\*

For the full year of 2009, net sales increased 6.7 per cent to \$72.3 million compared to \$67.7 million in the same period last year. The 2009 increase in net sales compared to 2008 is primarily the result of an increase in volume and average sales price originating from new products in the health and bio-product segment.

\*\*\*

Gross profit for the full year of 2009 increased 11.3 per cent to \$30.2 million, compared to \$27.1 million in the full year of 2008. The Company’s gross profit margin increased 170 basis points to 41.8 per cent in the full year of 2009 versus 40.1 per cent in the same period last year. The increase in gross profit margin is primarily due to margin expansion in both the aquaculture and bio-product segments.

122. The financial statements and the other statements in this press release were materially false or misleading in that, as would later be disclosed, the Company the Company’s customers, invoices, cash balances and spending on television advertisements were all unverifiable and, as a result, its financial statements were materially inaccurate and not prepared in conformity with GAAP.

123. Also on March 15, 2010, HQSM filed its annual report for the year ended December 31, 2009 on Form 10-K with the SEC. This Form 10-K was signed by Defendants Sporns, Dallaire and Wang Li and included the same financial information as the March 15, 2010 press release, and was materially false or misleading for the same reasons.

124. Further, this Form 10-K contained Sarbanes-Oxley Certifications signed by Defendants Sporns and Dallaire that were materially identical to the first quarter 2009 Form 10-Q Sarbanes-Oxley Certifications and which were materially false and misleading because, as



Defendants Sporns Dallaire and Wang Li knew, the financial statements contained in these reports were materially inaccurate and not in conformity with GAAP because HQSM's internal controls systems were materially flawed and not properly designed to ensure accurate financial reporting.

**G. May 2010 Quarterly Disclosures**

125. On May 10, 2010, HQSM issued a press release which included the Company's financial statements for the first quarter of 2010, which ended on March 31, 2010. The press release also described the Company's performance during that period in very positive terms:

For the first quarter of 2010, sales increased 33% to \$14.4 million, compared to \$10.8 million for the first quarter of the prior year. The increase in sales was primarily the result of strength across each segment including aquaculture products, health and bio-products, as well as the new feed products added in late 2009.

\*\*\*

Net income for the first quarter of 2010 was \$1.5 million ... compared to net income of \$1.1 million ... in the first quarter of 2009. Net income during the first quarter of 2010 was positively impacted by the net recovery in doubtful accounts of approximately \$0.7 million and a decrease in marketing and advertising expenses by approximately \$0.4 million from the health and bio-product segment.

"We are pleased to report a strong improvement in our sales and profitability. In the first quarter, we successfully recovered more than 80% of our doubtful accounts. The provisions for doubtful accounts were made in prior quarters' as a result of a planned, strategic investment in our health and bio-product segment, in order to capture greater market share," said Norbert Sporns, HQ Sustainable Maritime's President and Chief Executive Officer. "We continue to focus on being leaders in the value added use of Tilapia fillet and Tilapia by-products. We are building strong international partnerships across each of our product segments through the credibility and efficacy of our products and brands. These partnerships give us great confidence in our business model and our long-term growth opportunities."



1           126. These financial statements and the statements in the related press release were  
 2 materially false or misleading in that, as would later be disclosed, the Company's customers,  
 3 invoices, cash balances and spending on television advertisements were all unverifiable and, as a  
 4 result, its financial statements were materially inaccurate and not prepared in conformity with  
 5 GAAP.

6  
 7           127. Also on May 10, 2010, HQSM filed its quarterly report for the first quarter of  
 8 2010 on Form 10-Q with the SEC. This Form 10-Q was signed by Defendants Sporns and  
 9 Dallaire and included the same financial information as the May 10, 2010 press release, and was  
 10 materially false and misleading for the same reasons.

11           128. Further, this Form 10-Q contained Sarbanes-Oxley Certifications signed by  
 12 Defendants Sporns and Dallaire that were materially identical to the first quarter 2009 Form 10-  
 13 Q Sarbanes-Oxley Certifications and which were materially false or misleading because, as both  
 14 Defendants Sporns and Dallaire knew, the financial statements contained in these reports were  
 15 materially inaccurate and not in conformity with GAAP because HQSM's internal controls  
 16 systems were materially flawed and not properly designed to ensure accurate financial reporting.

#### 17 **H. August 2010 Quarterly Disclosures**

18  
 19           129. On August 9, 2010, HQSM issued a press release which included the Company's  
 20 financial statements for the second quarter of quarter of 2010, which ended on June 30, 2010.  
 21 The press release also described the Company's performance during that period in very positive  
 22 terms:

23  
 24                   For the second quarter of 2010, sales increased 29% to \$20.7  
 25                   million, compared to \$16 million for the second quarter of the prior  
 26                   year. The increase in sales was primarily the result of strength  
                   from the new feed products added in late 2009.

\*\*\*

1 “We are pleased to report strong revenue growth for the second  
2 quarter. Operationally our results improved sequentially and we  
3 are optimistic about our future growth in each of our three primary  
4 product segments,” said Norbert Sporns, HQ Sustainable  
5 Maritime’s President and Chief Executive Officer. “We are laying  
6 the foundation to deliver long-term value to our shareholders. We  
7 continue to focus on execution, including increased sales of our  
8 diversified products, increased margin expansion, and vertical  
9 integration in the production of our all-natural Tilapia aquaculture  
10 bio-mass which will further reduce the costs of production and  
11 increase long-term profitable growth and cash flow generation.”

12 130. The financial statements and the other statements in this press release were  
13 materially false or misleading in that, as would later be disclosed, the Company’s customers,  
14 invoices, cash balances and spending on television advertisements were all unverifiable and, as a  
15 result, its financial statements were materially inaccurate and not prepared in conformity with  
16 GAAP.

17 131. Also on August 9, 2010, HQSM filed its quarterly report for the second quarter of  
18 2010 on Form 10-Q with the SEC. This Form 10-Q was signed by Defendants Sporns and  
19 Dallaire and included the same financial information as the August 9, 2010 press release, and  
20 was materially false or misleading for the same reasons.

21 132. Further, this Form 10-Q contained Sarbanes-Oxley Certifications signed by  
22 Defendants Sporns and Dallaire that were materially identical to the first quarter 2009 Form 10-  
23 Q Sarbanes-Oxley Certifications and which were materially false or misleading for the same  
24 reasons because, as both Defendants Sporns and Dallaire knew, the financial statements  
25 contained in these reports were materially inaccurate and not in conformity with GAAP because  
26 HQSM’s internal controls systems were materially flawed and not properly designed to ensure  
accurate financial reporting.

**I. August 2010 Offering Documents**

133. On August 10, 2010, HQSM filed with the SEC a Prospectus Supplement pursuant to which HQSM made an offering of its common stock and warrants to purchase its common stock. Defendant Ladenburg Thalmann was the underwriter for this offering. The Prospectus Supplement was issued pursuant to a Shelf Registration Statement signed by Defendants Sporns, Wang Li and Dallaire, dated December 2, 2009, and a January 5, 2010 amendment to that Registration Statement, which was also signed by Defendants Sporns, Wang Li and Dallaire. The August 10, 2009 Prospectus Supplement incorporated the following previous SEC filings, among others:

- HQSM's Form 10-K for the fiscal year ended December 31, 2009 (as filed on March 15, 2010);
- HQSM's Quarterly Report on Form 10-Q for the fiscal quarter ended March 31, 2010 (as filed on May 10, 2010);
- HQSM's Quarterly Report on Form 10-Q for the fiscal quarter ended June 30, 2010 (as filed on August 9, 2010).

134. The financial statements and other statements in the Prospectus Supplement, including those incorporated by reference, were materially false or misleading in that, as would later be disclosed, the Company's customers, invoices, cash balances and spending on television advertisements were all unverifiable and, as a result, its financial statements were materially inaccurate and not prepared in conformity with GAAP.

**J. November 2010 Quarterly Disclosures**

135. On November 9, 2010, HQSM issued a press release which included the Company's financial statements for the third quarter of 2010, which ended on September 30, 2010. The press release also described the Company's performance during that period in very positive terms:

For the third quarter of 2010, sales increased 27% to \$28.2 million, compared to \$22.2 million for the third quarter of the prior year. The increase in sales was primarily the result of strength from the new feed products added in late 2009.

\*\*\*

Net income for the third quarter of 2010 increased by 70% or \$2.8 million to \$6.9 million.... Although the overall gross profit was less in the third quarter of 2010, the bad debt recovery had the most significant positive impact on the current quarterly results.

"We are extremely pleased with our third quarter financial performance. Our management team continues to execute on our operational and strategic initiatives for growth," said Norbert Sporns, HQ Sustainable Maritime's President and Chief Executive Officer. "We believe we have laid the groundwork for future financial and operational successes through our vertically integrated approach to all-natural Tilapia aquaculture bio-mass product development and distribution. We are very optimistic about our outlook for the remainder of 2010 and more importantly fiscal 2011 as we focus on long-term profitable growth and strong cash flow generation."

136. These financial statements and the statements in the related press release were materially false or misleading in that, as would later be disclosed, the Company's customers, invoices, cash balances and spending on television advertisements were all unverifiable and, as a result, its financial statements were materially inaccurate and not prepared in conformity with GAAP.

137. Also on November 9, 2010, HQSM filed its quarterly report for the third quarter of 2010 on Form 10-Q with the SEC. This Form 10-Q was signed by Defendants Sporns and Dallaire and included the same financial information as the November 9, 2010 press release, and was materially false or misleading for the same reasons.

138. Further, this Form 10-Q contained Sarbanes-Oxley Certifications signed by Defendants Sporns and Dallaire that were materially identical to the first quarter 2009 Form 10-Q Sarbanes-Oxley Certifications and which were materially false and misleading because, as both Defendants Sporns and Dallaire knew, the financial statements contained in these reports were materially inaccurate and not in conformity with GAAP because HQSM's internal controls systems were materially flawed and not properly designed to ensure accurate financial reporting.

#### **K. Statements Regarding Superior Compliance Procedures**

139. On a November 9, 2010, conference call with investors and securities analysts, Defendant Sporns emphasized that the Company's compliance practices were superior to those at other similarly situated companies:

HQS[M] corporate governance practices have been maintained at high levels from the outset.... *Our auditors travel wherever is required to audit our records on a first-hand basis.* Our directors, including independent directors, are leaders in their respective industries and bring valuable independent oversight to our decisions. Western-educated management focused on execution and independent oversight, combined with an unqualified SOX 404 [Sarbanes-Oxley Act Section 404] compliance record. This distinguishes our Company from many newly-listed Asian companies, challenged by the rigors of being publicly traded.

140. These statements were materially false or misleading because Defendants did have an "unqualified" Sarbanes-Oxley Act compliance record and HQSM's "corporate governance practices" had not been "maintained at high levels." To the contrary, as would

subsequently be disclosed, the Company's customers, invoices, and cash balances were all unverifiable and, as a result, its financial statements were materially inaccurate and not prepared in conformity with GAAP or with U.S. law.

## VIII. OFFERINGS DURING THE CLASS PERIOD

141. Taking advantage of the credibility offered by its NYSE Amex Stock Exchange listing and its purportedly healthy financial position and bright potential for future growth, in 2009 and 2010 HQSM raised \$23.5 million by selling investors additional shares (and warrants to purchase shares) in two separate public offerings.

### A. The 2009 Offering

142. In June 2009, HQSM sold 1,408,750 shares of its common stock in a public offering (including an over-allotment purchase by the underwriter of 183,750 shares), raising a total of approximately \$11.9 million in gross proceeds. The public offering price per share was \$8.50. Defendant Roth Capital underwrote this Offering.

143. This Offering was made pursuant to a Supplemental Prospectus dated June 11, 2009 and filed June 15, 2009. This Supplemental Prospectus supplemented a Prospectus and Registration Statement which became effective on November 13, 2008.

### B. The 2010 Offering

144. In August 2010, HQSM sold 3,202,999 "units" in a public offering, raising gross proceeds of approximately \$11.6 million. Each unit consisted of one share of HQSM common stock and one half of a warrant to purchase a share of HQSM common stock at a fixed price, pursuant to certain terms and conditions. The public offering price was \$3.6125 per unit.

145. This offering was made pursuant to a Supplemental Prospectus filed and dated August 10, 2010. This Supplemental Prospectus supplemented a Prospectus and Registration

1 statement which became effective on January 26, 2010. Defendant Ladenburg Thalmann  
2 underwrote this Offering.

### 3 **C. No Allegation of Fraud Against Underwriters**

4 146. As alleged in this Complaint, the offering documents for the 2009 and 2010  
5 Offerings contained materially false or misleading statements. This Complaint does not allege  
6 that the underwriters of these offerings knew that these statements were materially false or  
7 misleading, engaged in any fraud directed at the Class Members or otherwise acted with scienter.  
8

## 9 **IX. JURISDICTION AND VENUE**

10 147. The claims asserted herein arise under and pursuant to Sections 10(b) and 20(a) of  
11 the Exchange Act and Rule 10b-5 promulgated thereunder by the SEC, and Sections 11, 12 and  
12 15 of the Securities Act.

13 148. This Court has jurisdiction over the subject matter of this action pursuant to 28  
14 U.S.C. § 1331, Section 27 of the Exchange Act and Section 22 of the Securities Act.  
15

16 149. Venue is proper in this District pursuant to 28 U.S.C. § 1391(b), Section 27 of the  
17 Exchange Act and Section 22 of the Securities Act. Many of the acts alleged herein, including  
18 the preparation and dissemination of materially false and misleading information, occurred in  
19 substantial part in this District.

20 150. In connection with the acts alleged in this Complaint, Defendants, directly or  
21 indirectly, used the means and instrumentalities of interstate commerce, including, but not  
22 limited to, the mails, interstate telephone and Internet communications, and the facilities of the  
23 national securities markets.  
24  
25  
26

**X. CLASS ACTION ALLEGATIONS**

151. Plaintiff brings this action as a class action pursuant to Federal Rule of Civil Procedure 23(a) and (b)(3) on behalf of a class consisting of: (1) all those who purchased or otherwise acquired the common stock or warrants to purchase the common stock of HQSM issued pursuant or traceable to the June 2009 and August 2010 secondary offerings and were damaged thereby; and (2) all those who purchased or otherwise acquired the common stock of HQSM from May 12, 2009 through and including April 1, 2011, inclusive, and who were damaged thereby. Excluded from the Class are 1) any person who is a Defendant or who is or has been an officer or director of HQSM at any time; or 2) immediate family members of any such person; the legal representative, heir, successor or assign of any such person; or any entity in which any such person has or had a controlling interest.

152. The members of the Class are so numerous that joinder of all members is impracticable. Throughout the Class Period, HQSM common stock was actively traded on the NYSE Amex Stock Exchange. While the exact number of Class Members is unknown to Plaintiff at this time and can only be ascertained through appropriate discovery, Plaintiff has reasonable grounds to believe that there are thousands of members in the proposed Class. Beneficial owners of HQSM common stock and warrants may be identified from records maintained by HQSM, its transfer agent or by other financial institutions and may be notified of the pendency of this action by mail or electronic means, as is customarily done in securities class actions.

153. Plaintiff's claims are typical of the claims of the members of the Class as all members of the Class are similarly affected by Defendants' wrongful conduct in violation of federal law complained of herein.



1           154. Plaintiff will fairly and adequately protect the interests of the members of the  
2 Class and has retained counsel competent and experienced in class action and securities  
3 litigation.

4           155. Common questions of law and fact exist as to all members of the Class and  
5 predominate over any questions solely affecting individual members of the Class. Among the  
6 questions of law and fact common to the Class are:  
7

- 8           • whether the federal securities laws were violated by Defendants' acts  
9 as alleged herein;
- 10          • whether statements made by Defendants to the investing public during  
11 the Class Period misrepresented material facts about the finances,  
12 business and operations of HQSM;
- 13          • whether the price of HQSM common stock was artificially inflated  
14 during the Class Period; and
- 15          • to what extent the members of the Class have sustained damages and  
16 the proper measure of such damages.

17          156. A class action is superior to all other available methods for the fair and efficient  
18 adjudication of this controversy since joinder of all members is impracticable. Furthermore, as  
19 the damages suffered by many individual Class Members will be relatively small, the expense  
20 and burden of individual litigation make it impossible, as a practical matter, for many members  
21 of the Class to individually redress the wrongs done to them. There will be no difficulty in the  
22 management of this action as a class action.  
23  
24  
25  
26

## XI. LOSS CAUSATION

157. During the Class Period, as detailed herein, HQSM and the Individual Defendants engaged in a scheme to deceive the market and a course of conduct that artificially inflated the prices of HQSM common stock and operated as a fraud or deceit on Class Period purchasers of HQSM common stock by failing to disclose and misrepresenting the adverse facts detailed herein. When their misrepresentations and fraudulent conduct were disclosed and became apparent to the market, the price that purchasers were willing to pay for HQSM common stock fell precipitously as the prior artificial inflation came out of the stock's price. Moreover, as a direct and foreseeable result of their fraud, trading in HQSM stock was halted, making the stock virtually worthless and nearly impossible to sell. Consequently, Plaintiff and the other Class Members suffered economic loss as a result of their conduct.

158. By failing to disclose to investors the adverse facts detailed herein, HQSM and the Individual Defendants presented a misleading picture of HQSM's business and prospects. Their false and misleading statements had the intended effect and caused HQSM common stock to trade at artificially inflated levels throughout the Class Period, reaching as high as \$9.92 per share on May 26, 2009.

159. The decline in the price of HQSM shares, and the suspension in trading of these shares, was a direct result of the nature and extent of HQSM and the Individual Defendants' fraud and of their related inability to timely file required financial statements, fill required seats on its Board, or retain an auditor, as was revealed to regulators, investors and the market. The timing and magnitude of the price decline in HQSM common stock negates any inference that the loss suffered by Plaintiff and the other Class Members was caused by changed market conditions, macroeconomic or industry factors or Company-specific facts unrelated to HQSM

1 and the Individual Defendants' fraudulent conduct. The economic loss suffered by Plaintiff and  
 2 the other Class Members was a direct result of HQSM and the Individual Defendants' fraudulent  
 3 scheme to artificially inflate the prices of HQSM common stock and the subsequent significant  
 4 decline in the value of HQSM common stock when HQSM and the Individual Defendants' prior  
 5 misrepresentations and other fraudulent conduct were revealed and when regulators suspended  
 6 trading in the stock as a result of the fraud.  
 7

## 8 **XII. PRESUMPTION OF RELIANCE**

9 160. At all relevant times, the market for HQSM common stock was an efficient  
 10 market for the following reasons, among others:

- 11 • HQSM common stock met the requirements for listing, and was listed  
 12 and actively traded on the NYSE Amex Stock Exchange, a highly  
 13 efficient market;
- 14 • as a regulated issuer, HQSM filed periodic public reports with the  
 15 SEC;
- 16 • HQSM regularly communicated with public investors via established  
 17 market communication mechanisms, including regular disseminations  
 18 of press releases on the national circuits of major wire services and  
 19 other wide-ranging public disclosures, such as communications with  
 20 the financial press and other similar reporting services; and
- 21 • HQSM was followed by securities analysts who wrote reports which  
 22 were distributed to investors.

23 161. As a result of the foregoing, the market for HQSM common stock promptly  
 24 digested current information regarding HQSM from all publicly available sources and reflected  
 25 such information in the prices of the stock. Under these circumstances, all purchasers of HQSM  
 26

1 common stock during the Class Period suffered similar injury through their purchase of HQSM  
 2 common stock at artificially inflated prices and a presumption of reliance applies.

### 3 **XIII. NO SAFE HARBOR**

4 162. The statutory safe harbor provided for forward-looking statements under certain  
 5 circumstances does not apply to any of the allegedly false statements pleaded in this Complaint.  
 6 Many of the specific statements pleaded herein were not identified as “forward-looking  
 7 statements” when made. To the extent there were any forward-looking statements, there were no  
 8 meaningful cautionary statements identifying important factors that could cause actual results to  
 9 differ materially from those in the purportedly forward-looking statements. Alternatively, to the  
 10 extent that the statutory safe harbor does apply to any forward-looking statements pleaded  
 11 herein, HQSM and the Individual Defendants are liable for those false forward-looking  
 12 statements because, at the time each of those forward-looking statements were made, the  
 13 particular speaker knew that the particular forward-looking statement was false, or the forward-  
 14 looking statement was authorized or approved by an executive officer or agent of a Defendant  
 15 who knew that those statements were false when made.  
 16

### 18 **XIV. STATUTE OF LIMITATIONS**

19 163. Claims under the Exchange Act must be made within “the earlier of ... 2 years  
 20 after the discovery of the facts constituting the violation; or ... 5 years after such violation,” in  
 21 accordance with 28 U.S.C. 1658(b). Section 13 of the Securities Act provides that Claims under  
 22 that Act must be “brought within one year after the discovery of the untrue statement or the  
 23 omission, or after such discovery should have been made by the exercise of reasonable  
 24 diligence” and, with respect to public offerings, within three years after the security at issue was  
 25  
 26

1 offered to the public. As set forth above, each claim set out in this Complaint was timely made  
2 within the relevant time period.

3 **XV. JURY TRIAL DEMANDED**

4 164. Plaintiff hereby demands a trial by jury.

5 **XVI. CAUSES OF ACTION**

6 **COUNT I**

7 **Violation of Section 10(b) of the Exchange Act and Rule 10b-5**  
8 **Promulgated Thereunder**  
9 **Against HQSM and the Individual Defendants**

10 165. Plaintiff repeats and realleges each and every allegation contained in this  
11 Complaint as if fully set forth herein.

12 166. This Claim is made against HQSM and the Individual Defendants.

13 167. This Claim is brought pursuant Section 10(b) of the Exchange Act and Rule 10b-5  
14 promulgated thereunder.

15 168. During the Class Period, these Defendants disseminated or approved the  
16 materially false and misleading statements specified above, which they knew, or were extremely  
17 reckless in not knowing, were misleading in that they contained misrepresentations and failed to  
18 disclose material facts necessary in order to make the statements made, in light of the  
19 circumstances under which they were made, not misleading.

20 169. These Defendants: (a) employed devices, schemes, and artifices to defraud; (b)  
21 made untrue statements of material fact and/or omitted to state material facts necessary to make  
22 the statements not misleading; and (c) engaged in acts, practices, and a course of business which  
23 operated as a fraud and deceit upon the purchasers of the Company's common stock and  
24 warrants to purchase the Company's common stock during the Class Period.  
25  
26



1 had the power and authority to cause HQSM to engage in the wrongful conduct complained of  
2 herein.

3 178. At the time they obtained their shares, Plaintiff and members of the Class did so  
4 without knowledge of the facts concerning the materially false misstatements or omissions  
5 alleged herein.  
6

7 179. By reason of the foregoing, the Individual Defendants are jointly and severally  
8 liable pursuant to Section 20(a) of the Exchange Act.  
9

10 **COUNT III**  
**Violation of Section 11 of the Securities Act**  
**Against All Defendants**  
11

12 180. Plaintiff repeats and realleges each and every allegation contained in this  
13 Complaint as if fully set forth herein only to the extent, however, that such allegations do not  
14 allege fraud, scienter or the intent of the Defendants to defraud Plaintiff or members of the Class.

15 181. This Claim is brought against all Defendants except that this claim is not made  
16 against the Individual Defendants with respect to the 2009 Offering.

17 182. This Claim is brought pursuant to Section 11 of the Securities Act and is  
18 predicated upon Defendants' strict liability for material misstatements and omissions in the  
19 Registration Statements, Prospectuses and Prospectus Supplements (including any amendments  
20 to these documents and all documents incorporated by reference into these documents)  
21 (collectively the "Offering Documents") pursuant to which the 2009 and 2010 Offerings were  
22 made.  
23

24 183. This Claim is not based on and does not sound in fraud. Any allegations of fraud  
25 or fraudulent conduct and/or motive are specifically excluded from this Claim. For purposes of  
26 this Claim, Plaintiff does not allege that Defendants acted with scienter or fraudulent intent. For

1 purposes of this Claim, Plaintiff expressly excludes and disclaims any allegation that could be  
2 construed as alleging fraud or intentional or reckless misconduct, as this Count is based solely on  
3 claims of strict liability under the Securities Act.

4 184. The Offering Documents were materially inaccurate and misleading, contained  
5 untrue statements of material facts, omitted to state other facts necessary to make the statements  
6 not misleading, and omitted to state material facts required to be stated therein.

7 185. As provided for in Section 11 of the Securities Act, the Defendants named in this  
8 claim are responsible for these false or misleading statements and are strictly liable to Plaintiff  
9 and Class Members for these statements. No Defendant made a reasonable and diligent  
10 investigation of the statements contained in the Offering Documents to ensure that such  
11 statements were true and correct and that there was no omission of material facts required to be  
12 stated in order to make the statements contained therein not misleading.

13 186. Plaintiff and Class Members suffered significant losses as a result of Defendants'  
14 materially false and misleading statements and omissions of material fact in the Offering  
15 Documents. The value of their shares has declined substantially, subsequent to, and due to, the  
16 violations of the Defendants named in this claim. Plaintiff and the Class would not have  
17 purchased HQSM common stock at the prices they paid, or at all, if they had been aware that the  
18 market prices had been artificially and falsely inflated by false or misleading statements.

19 187. At the time they obtained their shares, Plaintiff and members of the Class did so  
20 without knowledge of the facts concerning the misstatements or omissions alleged herein.

21 188. By reason of the foregoing, each of the Defendants named in this claim are jointly  
22 and severally liable for violation of Section 11 of the Securities Act.



**COUNT IV**  
**Violation of Section 12(a)(2) of the Securities Act**  
**Against HQSM and the Underwriter Defendants**

189. Plaintiff repeats and realleges each and every allegation contained in this Complaint as if fully set forth herein only to the extent, however, that such allegations do not allege fraud, scienter or the intent of the Defendants to defraud Plaintiff or members of the Class.

190. This Claim is brought against the Underwriter Defendants and HQSM.

191. This Claim is brought pursuant to Section 12(a)(2) of the Securities Act and is predicated upon these Defendants' strict liability for material misstatements and omissions in the Offering Documents.

192. This Count is not based on and does not sound in fraud. Any allegations of fraud or fraudulent conduct and/or motive are specifically excluded from this Count. For purposes of asserting this claim under the Securities Act, Plaintiff does not allege that Defendants acted with scienter or fraudulent intent. Plaintiff expressly excludes and disclaims any allegation that could be construed as alleging fraud or intentional or reckless misconduct, as this Count is based solely on claims of strict liability under the Securities Act.

193. HQSM and the Underwriter Defendants promoted and sold shares pursuant to the Offering Documents, which contained untrue statements of material facts, omitted to state other facts necessary to make the statements made not misleading, and concealed and failed to disclose material facts.

194. As provided for in Section 12(a)(2) of the Securities Act, Defendants named in this claim are responsible for these false and misleading statements and are strictly liable to Plaintiff and Class Members for these statements. None of these Defendants made a reasonable and diligent investigation of the statements contained in the Offering Documents to ensure that

1 such statements were true and correct and that there was no omission of material facts required to  
2 be stated in order to make the statements contained therein not misleading.

3 195. Plaintiff and Class Members suffered significant losses as a result of these  
4 Defendants' materially false and misleading statements and omissions of material fact in the  
5 Offering Documents. The value of their shares has declined substantially, subsequent to, and  
6 due to, the violations of the Defendants named in this claim. Plaintiff and the Class would not  
7 have purchased HQSM common stock at the prices they paid, or at all, if they had been aware  
8 that the market prices had been artificially and falsely inflated by false or misleading statements.  
9

10 196. At the time they obtained their shares, Plaintiff and members of the Class did so  
11 without knowledge of the facts concerning the misstatements or omissions alleged herein.  
12

13 197. By reason of the foregoing, each of the Defendants named in this claim are jointly  
14 and severally liable for violation of Section 12(a)(2) of the Securities Act.

15 **COUNT V**  
16 **Violation of Section 15 of the Securities Act**  
17 **Against the Individual Defendants**

18 198. Plaintiff repeats and realleges each and every allegation contained in this  
19 Complaint as if fully set forth herein only to the extent, however, that such allegations do not  
20 allege fraud, scienter or the intent of the Defendants to defraud Plaintiff or members of the Class.

21 199. This count is asserted against the Individual Defendants and is based upon Section  
22 15 of the Securities Act.

23 200. This Claim is not based on and does not sound in fraud. Any allegations of fraud  
24 or fraudulent conduct and/or motive are specifically excluded from this Claim. For purposes of  
25 asserting this Claim under the Securities Act, Plaintiff does not allege that these Defendants  
26 acted with scienter or fraudulent intent. For purposes of this Claim, Plaintiff expressly excludes

1 and disclaims any allegation that could be construed as alleging fraud or intentional or reckless  
2 misconduct, as this Count is based solely on claims of strict liability under the Securities Act.

3       201. The Individual Defendants acted as controlling persons of HQSM within the  
4 meaning of Section 15 of the Securities Act., as alleged herein. By reason of their positions as  
5 officers or directors of HQSM, and their ownership of HQSM stock, the Individual Defendants  
6 had the power and authority to cause HQSM to engage in the wrongful conduct complained of  
7 herein.  
8

9       202. The Individual Defendants at all relevant times participated in the operation and  
10 management of HQSM, and conducted and participated, directly and indirectly, in the conduct of  
11 HQSM's business affairs. As officers and directors of a publicly-owned company, the Individual  
12 Defendants had a duty to disseminate accurate and truthful information with respect to HQSM's  
13 financial condition and results of operations. Because of their positions of control and authority  
14 as officers and directors of HQSM, the Individual Defendants were able to, and did, control the  
15 contents of the Offering Documents, which contained materially false and misleading statements.  
16 The Individual Defendants' control, ownership and positions made them privy to and provided  
17 them with knowledge of the material facts concealed from Plaintiff and members of the Class.  
18

19       203. Plaintiff and Class Members suffered significant losses as a result of these  
20 Defendants' materially false and misleading statements and omissions of material fact in the  
21 Offering Documents. The value of their shares has declined substantially, subsequent to, and  
22 due to, the violations of the Defendants named in this claim. Plaintiff and the Class would not  
23 have purchased HQSM common stock at the prices they paid, or at all, if they had been aware  
24 that the market prices had been artificially and falsely inflated by false or misleading statements.  
25  
26

204. At the time they obtained their shares, Plaintiff and members of the Class did so without knowledge of the facts concerning the misstatements or omissions alleged herein.

205. By reason of the foregoing, each of the Individual Defendants is jointly and severally liable pursuant to Section 15 of the Securities Act.

## XVII. PRAYER FOR RELIEF

**WHEREFORE**, Plaintiff prays for relief and judgment, as follows:

- Determining that this action is a proper class action and certifying Plaintiff as a Class representative under Rule 23 of the Federal Rules of Civil Procedure and Plaintiff's counsel as counsel for the Class;
- Awarding compensatory damages in favor of Plaintiff and the other Class Members against all Defendants, jointly and severally, for all damages sustained as a result of Defendants' wrongdoing, in an amount to be proven at trial, including interest thereon;
- Awarding Plaintiff and the Class their reasonable costs and expenses incurred in this action, including counsel fees and expert fees; and
- Such other and further relief as the Court may deem just and proper.

Dated: November 22, 2011

Respectfully submitted,

KELLER ROHRBACK L.L.P.

/s/ Elizabeth A. Leland

Lynn Lincoln Sarko, WSBA # 16569

Juli E. Farris, WSBA # 17593

Elizabeth A. Leland, WSBA # 23433

1201 Third Avenue, Suite 3200

Seattle, WA 98101-3052

Telephone: (206) 623-1900

Facsimile: (206) 623-3384

*Liaison Counsel for the Proposed Class*

COHEN MILSTEIN SELLERS & TOLL PLLC

Steven J. Toll (admitted pro hac vice)  
Julie Goldsmith Reiser, WSBA #27485  
Matthew B. Kaplan (admitted pro hac vice)  
1100 New York Avenue, NW  
Suite 500 West  
Washington, D.C. 20005  
Telephone: (202) 408-4600  
Facsimile: (202) 408-4699

*Lead Counsel for the Proposed Class*

**SCHEDULE OF EXHIBITS**

- Exhibit 1: April 6, 2011 resignation letter from Andrew Intrater to Norbert Sporns
- Exhibit 2: June 13, 2011 letter from Schwartz Levitsky Feldman LLP explaining Schwartz Levitsky Feldman LLP's resignation
- Exhibit 3: July 12, 2011 Determination and Notification of Removal from Listing and/or Registration Under Section 12(b) of the Securities Exchange Act of 1934 filed by the NYSE Amex Stock Exchange

**CERTIFICATE OF SERVICE**

I hereby certify that on November 22, 2011, I electronically filed the foregoing paper with the Clerk of the Court using the ECF system which will send notification of such filing to the following ECF participants:

Steve W. Berman steve@hbsslaw.com, heatherw@hbsslaw.com, robert@hbsslaw.com

Lynn Lincoln Sarko lsarko@kellerrohrback.com, cengle@kellerrohrback.com

Kenneth Lee Karlberg ken@karlberglaw.com

Elizabeth Ann Leland bleland@kellerrohrback.com, dwilcher@kellerrohrback.com

William R Spurr bill@williamrspurr.com

Karl Phillip Barth karlb@hbsslaw.com, dawn@hbsslaw.com, shelby@lmbllp.com, shelbys@hbsslaw.com

Juli E. Farris jfarris@KellerRohrback.com, ltardiff@KellerRohrback.com

Brian Weinstein brian@weinsteincouture.com, briandw@comcast.net

Dan Drachler ddrachler@zsz.com

Erin Maura Riley eriley@kellerrohrback.com, chopkins@kellerrohrback.com

Jeremy E Roller jroller@yarmuth.com, smeyer@yarmuth.com

Benjamin J Stone bstone@cozen.com, mstone@cozen.com

Steven J Toll stoll@cohenmilstein.com, efilings@cohenmilstein.com

Robert W Hayes rhayes@cozen.com, sgerhard@cozen.com

Andrea Delgadillo Ostrovsky aostrovsky@yarmuth.com, sstephens@yarmuth.com

Julie Goldsmith Reiser jreiser@cohenmilstein.com

Rachel Robbins rrobbins@cozen.com, ecosden@cozen.com

Peter M. Ryan pryan@cozen.com, kduffy@cozen.com

1 Thomas J. McCormack tmccormack@chadbourne.com

2 Marc D Ashley mashley@chadbourne.com

3 Marcelo Blackburn mblackburn@chadbourne.com

4 Mary K. Blasy mblasy@scott-scott.com, efile@scott-scott.com

5 Stephen L. Brodsky sbrodsky@zsz.com

6  
7  
8 /s/ Elizabeth A. Leland

9 Elizabeth A. Leland



# Exhibit 1

EX-99.1 2 dex991.htm ANDREW INTRATER'S RESIGNATION LETTER

Exhibit 99.1

Andrew Intrater  
Independent Non-Executive Director  
Chairman, Audit Committee  
HQ Sustainable Maritime Industries  
April 6, 2011

Norbert Sporns  
Director, Chief Executive Officer, President  
HQ Sustainable Maritime Industries, Inc.  
Melbourne Towers  
1511 Third Avenue  
Seattle, WA 98101

Re: Resignation

Dear Norbert,

I am writing today to tender my resignation as an Independent Non-Executive Director and Chairman of the Audit Committee of HQ Sustainable Maritime Industries, Inc. I am sending a copy of this letter to the board of directors, including the independent directors, out of respect for their roles. I have also sent a copy to Armando Valeri, head of the audit team at Schwartz Levitsky Feldman. The last few weeks have been demanding, but the events of the last several days have caused me to lose faith in the management of the company and the path it is charting. As a result, I feel have no choice but to make this difficult decision.

As you are aware, over the last few weeks issues have been raised during the audit process focusing on difficulties in verifying information relating to company accounts and customer positions. During that time, the audit committee has asked repeatedly that management cooperate with the audit process and provide the requested information and verifications on terms that were acceptable to both the auditors and company management. Those efforts were met with delay and resistance. While some steps were taken to address the situation, they were insufficient to resolve the issues. Just to be clear, I will discuss some of these details below.

On Tuesday (March 29), following discussions with you and other directors and in my capacity as Audit Committee Chairman, I engaged Latham & Watkins to conduct an independent inquiry into the concerns that developed during the audit process as to the possible breach of procedures relating to the verification or confirmation of company accounts and customer positions and the extent to which that possible breach extended beyond a handful of incidents. All of this was under the pressure of the filing deadline, when time was of the essence. That deadline was missed, however, and the trading of the company's stock was suspended as of April 1, 2011.

At the time that I initiated the independent inquiry, you pledged your cooperation. Latham & Watkins tendered a list of requests to the company through lawyers at Troutman Sanders, which served as outside counsel for the firm, and they subsequently requested payment of a retainer to begin work. This was followed on Thursday by a meeting of the board of directors in which the members of the management team who serve on the board, including you,

Lillian Li and Harry Hua, initially declined to vote affirmatively on two basic but key resolutions, one to retain Troutman Sanders as counsel to the company with an enlarged mandate to assist the internal inquiry and the second pledging the company's cooperation in the internal inquiry. When I and some of the other independent directors asked for the reasons for the management team's troubling decision to refuse to vote for these two important and essential resolutions, the reasons given - namely that a resolution mandating cooperation was "insulting" and that Troutman Sanders had only been serving as securities counsel- were not compelling. Unfortunately, it took me and some of the other independent directors to convince you and the management team to vote for these resolutions.

That same Thursday board of directors meeting was followed almost immediately by additional requests from Latham directed to the company via Troutman Sanders, as well as requests from me directly to management including, among other things, payment of the retainer for Latham, payment of a retainer for Troutman Sanders (which was essential for the inquiry to progress as expeditiously as possible), payment of newly issued invoices by the company's independent auditors, and a request for the company to immediately provide answers to several questions, together with supporting documents. All of these items could have (and should have) been done in a few hours of work. Instead of responding promptly to these requests and assisting in the conduct of the internal inquiry at a point when every day counted, you instead became unavailable to me and some others on the board. It has now been five days since I last heard from you, even though you have, during the same period, interacted with selected members of the board of directors. All of the requests directed to the company have gone unanswered and no retainer fees have been paid. As a result of these delays, the internal inquiry has yet to begin.

On Monday, management for the company instructed Troutman Sanders not to file any notice of claim with the company's insurance carriers under the company's directors' and officers' liability policies, contrary to Troutman's advice. This decision together with other factors, prompted Troutman Sanders, which as noted above has served as company counsel for some time, to withdraw. This will now mean a significant delay in the independent inquiry as new counsel steps into the picture. Management also has not complied with any of the requests made by me or counsel conducting the independent inquiry - including the most rudimentary demands, such as for an organizational chart - nor has it paid the necessary retainers for Latham & Watkins or Troutman Sanders. Moreover, during this entire period, I have heard nothing from you or other members of the management team, except for our CFO, Jean Pierre Dallaire.

I understand that yesterday you met with the auditors in Toronto in a meeting in which little or no progress was made in addressing the significant issues that remain open in the audit process. Moreover, I still have not heard from you, even though you have been in contact with other members of the management team, other board members, and the auditors. Yesterday evening, I renewed my requests for the payment of the appropriate retainers and the production of important information and documents that are essential preliminary steps to launching the independent inquiry. I also added a request to see a draft of the 8K filing which must be made tomorrow. I asked that those items be complied with by 1 PM today. As of that time, aside from the efforts of Jean Pierre to collect documents under his control regarding activities in the United States, none of my requests had been complied with.

This series of events, beginning gradually during the difficulties in the audit process and then increasing over the last week, the uncooperative conduct of the management team at the board of directors meeting, and now the current failure to communicate with me at a point when every second counts, coupled with a pattern of decisions by management that are difficult for me to understand, have left the company without its long-standing outside counsel at a crucial moment, have failed to advance the audit process and have failed even to initiate, let alone move forward, the independent inquiry, leads me to the conclusion that I can no longer be effective in my efforts to help the company move forward. My interest in seeing this process through to its completion remains unwavering, but the continued resistance of management to these necessary steps has made it impossible to advance this effort. Accordingly, I am compelled by conscience to resign from the board of directors and the audit committee, effective immediately.

Sincerely,

/s/ Andrew Intrater  
Andrew Intrater

cc: Board of Directors  
HQ Sustainable Maritime Industries, Inc.  
  
Armando Valeri  
Schwartz Levitsky Feldman

# Exhibit 2

EX-16.1 2 dex161.htm LETTER FROM SCHWARTZ LEVITSKY FELDMAN LLP.

**Schwartz Levitsky Feldman llp**  
CHARTERED ACCOUNTANTS  
LICENSED PUBLIC ACCOUNTANTS  
TORONTO • MONTREAL



June 13, 2011

Securities and Exchange Commission  
Washington, D.C. 20549

Re: HQ Sustainable Maritime Industries, Inc.

Dear Ladies and Gentleman:

We were previously engaged as independent auditors for HQ Sustainable Maritime Industries, Inc. (the "Company") for the fiscal year ending December 31, 2010. On May 26, 2011, we resigned from that position. We have read the Company's statements included under Items 3.01, 4.01 and 7.01 of its Form 8-K dated June 2, 2011, and we agree with such statements, except for the following under Items 3.01 and 4.01:

I. We are not in a position to agree or disagree with:

- a. the Company's statements concerning its communications with the NYSE Amex LLC (the "Exchange") concerning the Company's plan of compliance to address the Company's listing deficiencies;
- b. the Company's statement that it is in the process of commencing an immediate search for a new independent accountant; and
- c. the Company's statement that it intends to authorize Schwartz Levitsky Feldman LLP ("SLF") to respond fully to the inquiries of the successor accounting firm.

II. We do not agree with:

- a. the Company's statement that SLF advised Mr. Fred Bild, a member of the Committee's Audit Committee, on May 25, 2011, that SLF was resigning because of its inability to proceed with the audit of the Company's consolidated financial statements for the fiscal year ended December 31, 2010 ("FY2010") due to the lack of support from the Company's management;

1167 Caledonia Road  
Toronto, Ontario M6A 2X1  
Tel: 416 785 5353  
Fax: 416 785 5663



- i. In fact, during the teleconference with Mr. Bild on May 25, 2011, SLF cited the following culmination of factors as its rationale for concluding that SLF could no longer rely on the representations of the Company's management and, therefore, SLF was resigning immediately from its position as the independent auditor of the Company.
- ii. During the course of the FY2010 audit, SLF encountered difficulties in confirming the cash balances in the Company's bank accounts and verifying the existence of customers in the People's Republic of China ("PRC"). To address this, SLF exercised its best judgment to extend its audit procedures in these two areas, but the Company's management resisted SLF's efforts. As a result, SLF was unable to satisfactorily complete the full confirmation process on the cash balances in the Company's bank accounts and the verification procedures on the existence of customers. Therefore, SLF was unable to complete its work in order for the Company to file its annual report on time, resulting in the decision of the Exchange to suspend the trading of HQ stock. Subsequently, the Exchange and the Company engaged in an ongoing dialogue to design an acceptable plan of compliance to permit the Exchange to lift the trading suspension.
- iii. Concurrently, SLF kept the Chairman of the Audit Committee fully apprised of the situation concerning these problems with the FY2010 audit process. As a result, the Chairman of the Audit Committee engaged the law firm of Latham & Watkins LLP ("Latham") to perform an independent review into the issues that arose during the course of the audit process. It was the understanding of SLF that the Audit Committee and then the full Board of Directors unanimously approved this independent review on March 31, 2011. In light of the expectation of the independent review approved by the Audit Committee and Board of Directors, SLF suspended its audit process to await the results of this independent review and/or assist the independent review, as may be needed or requested by Latham.
- iv. On April 6, 2011, the Chairman of the Audit Committee resigned, citing his concerns about the Company's management. After the resignation of the Chairman of the Audit Committee, the Company's management became increasingly non-responsive, uncooperative and non-communicative with SLF. In fact, there had been little direct communication between the Company's management and SLF from early April 2011 through SLF's resignation on May 26, 2011.
- v. The Company had been unwilling to provide SLF with information on a timely basis concerning the Company's proposed plan of compliance to permit the Exchange to lift the trading suspension. In fact, the Company made a submission to the Exchange on May 2, 2011, which SLF was unaware of and did not have an opportunity to review in advance.



- vi. On May 25, 2011, SLF received for the first time a copy of the Company's May 2 letter to the Exchange (however, SLF was not provided with the attachments to such letter, which included the minutes of the meeting of the Company's Board of Directors on March 31, 2011). In that May 2 letter, the Company's management (through the Company's outside counsel) claimed that the former Chairman of the Audit Committee had initiated the independent review by Latham without receiving the approval of the Audit Committee or the Board of Directors. This was the first time that SLF became aware of such a claim by the Company's management. In fact, this claim is inconsistent with SLF's contemporaneous understanding, as well as communications with current and former members of the Audit Committee. On May 25, 2011, Mr. Bild, a member of the Company's Audit Committee, confirmed to SLF that the Audit Committee and later the Board of Directors had, in fact, authorized the independent review on March 31, 2011. Also, on May 25, 2011, Mr. Bild advised SLF that the final minutes of the March 31 Board meeting (which SLF has not seen to date) previously had been drafted by Company's management so as not to accurately reflect such approval (when, in fact, according to Mr. Bild and others, the Audit Committee and later the Board of Directors had approved the independent review on March 31).
- vii. Further, as discussed below, during the course of the FY2010 audit process and then at the time that the Company was working on its plan of compliance for the Exchange, the Company raised a purported issue concerning SLF's licensing to perform audit services in the PRC. SLF tried to work in good faith with the Company's management to resolve this issue, but had been frustrated and obstructed by the Company's delay, non-responsiveness and lack of cooperation on this subject.
- viii. Additionally, the Company's management had been delinquent in payment of the outstanding audit fees to SLF, even though such fees had been properly invoiced and approved for payment by the Audit Committee.
- ix. In sum, all these factors cited above, among others, together led SLF to conclude that it was no longer able to rely on the Company's management's representations and led to SLF's decision to resign as the Company's auditor immediately on May 26, 2011.





- b. the Company's contention that during the course of SLF's work on the FY2010 audit, SLF was unable to complete the FY2010 audit because the Company learned that SLF was not licensed to provide auditing services for the Company and its subsidiaries in the PRC. In fact, the purported licensing issue did not impede SLF's ability to conduct the FY2010 audit. Rather, the Company raised this purported issue for the first time late in the FY2010 audit process only when SLF sought to conduct the planned audit procedure to visit the Company's banks in the PRC to verify the existence of the cash balances in the Company's bank accounts. As a result of raising this purported issue, the Company prevented SLF from satisfactorily completing the full confirmation process of the cash balances in the Company's bank accounts in the PRC. It is notable that the Company had never before raised the purported licensing issue in the PRC. Further, none of the banks or customers in the PRC from which SLF was seeking direct confirmation of bank account and accounts receivables balances, respectively, raised this purported licensing issue; rather, it was raised only by the Company;
- c. the Company's statements that (i) it believes that SLF is not now permitted to obtain a Temporary Practice Permit for an Offshore Accounting Firm in the PRC, and (ii) if the Company's assessment is correct, the written support that SLF requested that the Company (and its subsidiaries) provided could have subjected the Company to administrative sanctions in the event that the PRC authorities determined that SLF engaged in unpermitted auditing business activities in Hainan Province. On March 21, 2011, the Department of Finance in the PRC issued the Interim Provisions on Overseas Accounting Firms Engaging in Temporary Auditing Activities in Mainland China ("2011 Interim Provisions"), which came into effect on the same date and replaced the prior statutory scheme in the PRC. As a result of the 2011 Interim Provisions which came into effect on March 21, 2011, SLF made the determination to obtain a provisional practicing permit to conduct its audit of HQ's subsidiaries in the PRC. In order to obtain the provisional practicing permit, SLF is required to submit an application in the PRC which includes, among other items, the consents of the client and the local subsidiaries of the client for SLF to perform such audit services in the PRC. The Company refused to provide any such consents and claimed that SLF allegedly is barred from obtaining such a temporary permit under the 2011 Interim Provisions implemented on March 21, 2011. To support this, the Company claimed that it had a new legal opinion from its Chinese counsel to such effect, but then refused to provide SLF with a copy of this legal opinion (even though the Company previously had provided both SLF and the Exchange with copies of other legal opinions from the Company's Chinese counsel). In sum, SLF tried to work in good faith with the Company's management to resolve this issue, but had been frustrated and obstructed by the Company's delay, non-responsiveness and lack of cooperation on this subject; and



- d. the Company's statement that SLF initially agreed to the use of certain "chain of custody" procedures in the confirmation process so as to obviate the need for any direct contact between SLF and the Company's customers and banks in the PRC and that, subsequently and without explanation, SLF elected not to utilize this alternative and reverted to its demand to utilize the more stringent confirmation procedures. In fact, SLF exercised its judgment as an independent auditor in extending its FY2010 audit procedures and never modified its requirement that it contact the Company's customers and banks directly so as to obtain the necessary confirmations of the Company's accounts receivable and bank account balances, respectively.

Yours very truly,

SCHWARTZ LEVITSKY FELDMAN LLP

A handwritten signature in cursive script that reads "Schwartz Levitsky Feldman LLP".

cc: Norbert Sporns, Chief Executive Officer  
Jean-Pierre Dallaire, Chief Financial Officer  
Fred Bild, Audit Committee member  
Daniel Too, Audit Committee member

# Exhibit 3

EX-99.25 2 hqsform2507122011.htm

**NYSE AMEX LLC**

DETERMINATION AND NOTIFICATION OF REMOVAL FROM LISTING  
AND/OR REGISTRATION UNDER SECTION 12(b) OF THE  
SECURITIES EXCHANGE ACT OF 1934  
Attachment to Form 25

July 12, 2011

NYSE Amex LLC (the "Exchange"), pursuant to Section 12(d) of the Securities Exchange Act of 1934 and Rule 12d2-2(b) promulgated thereunder by the Securities and Exchange Commission (the "SEC" or the "Commission"), has determined to strike from listing and registration on the Exchange, the following:

**HQ Sustainable Maritime Industries Inc.**

Common Stock, \$0.001 Par Value

Commission File Number – 001-33473

1. The standards of the Exchange provide, among other things, that consideration may be given to the removal of a security when: (i) the financial condition and/or operating results of the issuer appear to be unsatisfactory; (ii) the issuer has failed to comply with its listing agreements with the Exchange; or (iii) any other event shall occur or any condition shall exist which makes further dealings on the Exchange unwarranted.

In applying these standards, the Exchange gives consideration to delisting the securities of a company that is not in compliance with or is subject to:

- (a) Section 132(e) of the NYSE Amex LLC Company Guide (the "Company Guide") which provides that the Exchange may request any additional information or documentation, public or non-public, deemed necessary to make a determination regarding a security's continued listing, including but not limited to, any material provided to or received from the SEC or other appropriate regulatory authority. A listed company may be delisted if it fails to provide such information within a reasonable period of time or if any communication (including communications made in connection with an initial listing application to the Exchange contains a material misrepresentation or omits material information necessary to make the communication to the Exchange not misleading;
- (b) Sections 134 and 1101 of the Company Guide which requires listed issuers to comply with applicable SEC requirements with respect to the filing of reports and other documents through the SEC's Electronic Data Gathering Analysis and Retrieval ("EDGAR") system;
- (c) Section 802(a) of the Company Guide which states that at least a majority of the directors on the board of directors of each listed company must be independent directors, unless the issuer is a controlled company, a Smaller Reporting Company or otherwise exempt under Section 801 of the Company Guide;
- (d) Section 803(B)(2)(a) of the Company Guide which states that each issuer must have, and certify that it has and will continue to have, an audit committee of at least three members;
- (e) Section 803(B)(4) of the Company Guide which states that the audit committee of each issuer must have the specific audit committee responsibilities, authority and

procedures necessary to comply with Rule 10A-3(b)(2), (3), (4) and (5) under the Securities Exchange Act of 1934 (subject to the exemptions provided in Rule 10A-3(c)), concerning responsibilities relating to: (a) registered public accounting firms, (b) complaints relating to accounting, internal accounting controls or auditing matters, (c) authority to engage advisors, and (d) funding as determined by the audit committee;

- (f) Section 1003(d) of the Company Guide which states that the securities of an issuer failing to comply with its listing or other agreements with the Exchange and/or SEC requirements in any material respect (*e.g.*, failure to distribute annual reports when due, failure to report interim earnings, failure to observe Exchange policies regarding timely disclosure of important corporate developments, failure to solicit proxies, issuance of additional shares of a listed class without prior listing thereof, failure to obtain shareholder approval of corporate action where required by Exchange policies, failure to provide requested information within a reasonable period of time or providing information that contains a material misrepresentation or omits material information necessary to make the communication to the Exchange not misleading, etc.) are subject to suspension from dealings and, unless prompt corrective action is taken, removal from listing; and
- (g) Section 1003(f)(iii) of the Company Guide which provides that the Exchange will normally consider suspending dealings in, or removing from the list, a security if the issuer or its management shall engage in operations which, in the opinion of the Exchange, are contrary to the public interest.

2. The Common Stock (the “Common Stock”) of HQ Sustainable Maritime Industries Inc. (the “Company”) does not qualify for continued listing for the following reason:

- (a) The Company failed to file its Form 10-K for the year ended December 31, 2010 and Form 10-Q for the period ended March 31, 2011 with the SEC.
- (b) The Company is subject to delisting pursuant to Section 132(e) of the Company Guide, which provides that a listed company may be delisted “if any communication...to the Exchange contains a material misrepresentation.” The Company informed the Staff in a letter dated May 2, 2011 that the former chairman of the Company’s audit committee had initiated an independent review of the Company’s audit process by Latham & Watkins without authorization by the audit committee or the board of directors. Based upon a review of information provided by the Company and the Company’s former independent auditor, Schwartz Levitsky Feldman LLP (“SLF”), Latham & Watkins was engaged by the audit committee to conduct an independent review of the Company’s audit situation and that the independent review was unanimously approved by the Company’s board.
- (c) The Company is noncompliant with Section 803B(4) of the Company Guide which requires that the audit committee of each issuer must have the specific audit committee responsibilities, authority and procedures necessary to comply with Rule 10A-3(b)(4) and (5) under the Securities Exchange Act of 1934 (subject to the exemptions provided in Rule 10A-3(c)), concerning responsibilities relating to authority to engage advisors and funding for compensation to be paid to such advisors as determined by the audit committee. Specifically, Company management refused to make the retainer payment required in connection with the engagement of Latham & Watkins which was approved by the Company’s audit committee.
- (d) The Company is subject to delisting pursuant to Section 1003(f)(iii) of the

Company Guide in that the Company or its management has engaged in operations, which, in the opinion of Staff, are contrary to the public interest. The Company appears to have consistently acted to obstruct SLF in conducting an audit and, in doing so, acted in a manner that is inconsistent with the public interest in having listed companies make timely filings of required financial information that has been audited in accordance with generally accepted auditing standards.

3. In reviewing the eligibility of the Company's Common Stock for continued listing, the Exchange has complied with its standards and procedures as follows:

- (a) On April 1, 2011, the Company was notified by the Exchange that it was not in compliance with Sections 134 and 1101 of the Company Guide due to its failure to file its Form 10-K for the year ended December 31, 2010. The Company was also advised that its failure to timely file this report was a material violation of its listing agreement with the Exchange and therefore, pursuant to Section 1003(d) of the Company Guide, the Exchange is authorized to suspend and, unless prompt corrective action is taken, remove the Company's securities from the Exchange. In accordance with Section 1009 of the Company Guide, the Company was given the opportunity to submit a plan of compliance advising the Exchange of actions that it had taken or would take to bring the Company into compliance with Sections 134 and 1101 of the Company Guide by June 30, 2011.
- (b) On April 11, 2011, the Exchange further advised that as a result of the resignation of Mr. Andrew Intrater as an independent non-executive director and chairman of the audit committee effective April 6, 2011 the Company was not in compliance with Sections 802(a) and 803(B)(2)(a) of the Company Guide in that it no longer had a majority of independent directors on its board or the requisite three members on its audit committee.
- (c) On April 18, 2011, the Company submitted a plan of compliance to the Exchange (the "Plan"). On May 27, 2011, the Exchange notified the Company of an additional instance of non-compliance with Sections 134 and 1101 of the Company Guide in that it failed to file its Form 10-Q for the period ended March 31, 2011. The Company was given the opportunity to supplement the Plan (the "Revised Plan") as to how it intended to file its Form 10-K for the year ended December 31, 2010 by June 30, 2011 and Form 10-Q for the period ended March 31, 2011 by July 15, 2011.
- (d) The Company submitted the Revised Plan on June 3, 2011.
- (e) On June 24, 2011, the Exchange notified the Company that it did not make a reasonable demonstration in the Plan and Revised Plan of its ability to regain compliance with Sections 134 and 1101 of the Company Guide and that the Exchange had determined to initiate delisting proceedings against the Company (the "Staff Determination"). The Exchange's letter dated June 24, 2011 also notified the Company of additional deficiencies with respect to Sections 132(e), 803(B)(4) and 1003(f)(iii) of the Company Guide.
- (f) Pursuant to Sections 1203 and 1009(d) of the Company Guide, the Company was given a limited right to request a hearing before a Listing Qualifications Panel (the "Panel") within seven days of the Staff Determination, or by July 1, 2011. The Company did not appeal the Staff Determination within the requisite time period or thereafter and has not otherwise regained compliance with the continued listing standards.

Accordingly, the Exchange, having complied with all of its procedures, is authorized to file this application in accordance with Section 12 of the Securities Exchange Act of 1934 and the rules promulgated thereunder.

4. In the opinion of the Exchange, all of the material facts relating to the reasons for this application are contained herein.

5. The Exchange official whose signature is set forth below is duly authorized to file this application.

6. In accordance with the provisions of Rule 12d2-2, the Exchange has issued public notice of its final determination to remove the Company's Common Stock from listing and/or registration by issuing a press release and posting notice on [www.nyse.com](http://www.nyse.com). Further, a copy of this application has been forwarded to Mr. Norbert Sporns, Chief Executive Officer of HQ Sustainable Maritime Industries Inc.

Janice O'Neill  
Senior Vice President  
Corporate Compliance  
NYSE Amex LLC