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Skadden

Hong Kong Regulatory Update

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This update provides an overview of key regulatory developments in the second quarter relevant to companies listed, or planning to list, on The Stock Exchange of Hong Kong Limited (**HKEx**) and their advisers. It covers amendments to the Rules Governing the Listing of Securities on HKEx (**Listing Rules**) as well as announcements, guidance and enforcement-related news from HKEx and the Securities and Futures Commission (**SFC**). Other recent market developments may also be included. We do not intend to cover all updates that may be relevant, but we welcome feedback, so please contact us if you would like to see analysis of other topics in the future.

HKEx Launches HKD-RMB Dual Counter Trading

HKEx has launched its new "Dual Counter Model," which enables companies with an existing listing on HKEx (trading in Hong Kong dollars) to add a second counter trading and settled in Renminbi (RMB). Trading in the new RMB dual counters began on 19 June 2023. The initiative gives companies access to the large pool of offshore RMB funds in Hong Kong, and gives investors with RMB funds in Hong Kong more channels to invest. HKEx says the Dual Counter Model will also "pave the way" for Mainland investors to trade RMB-denominated securities through southbound Stock Connect at a later stage.

The model allows issuers to retain their existing stock code (or "counter") for Hong Kong dollar trading, and add a new RMB-designated stock code. The counters are fully fungible, and can be interchanged one for the other. Thus it is possible to buy shares in one counter, and then sell them in the other. Supply and demand determine the price of the RMB counter, with no price pegging between the two counters. Instead, the model employs a market maker system, with approved market makers required to provide liquidity and minimize price discrepancies between the counters. The RMB counters are eligible for short selling on the same basis as the corresponding Hong Kong dollar counters, so if a company is designated for short selling, both the Hong Kong and RMB counters may be sold short.

The dual counters function only for trading and settlement purposes. They do not facilitate any change to the share capital of the company: Each company haves only one class of shares and one single register of members, with shareholders retaining a single holding and one share certificate (or CCASS account, as the case may be). There are no changes to Listing Rules regarding calculation of public float, size limits for issuances or repurchases of securities or share schemes, and calculation of market capitalization, all of which HKEx will continue to calculate with reference to the total issued shares and, where relevant, using the Hong Kong dollar trading price.

At the date of writing, 24 companies have joined the program and have RMB counters trading. Among those are China tech leaders, including JD.com, Baidu, Xiaomi, Meituan, Tencent and Alibaba; state-owned companies CNOOC and China Mobile; and Hong Kong-based companies, including Hang Seng Bank and Sun Hung Kai Properties.

HKEx is not charging companies any additional listing fees to launch RMB counters.

HKEx Consults on Enhancing Climate Disclosures

HKEx has issued a consultation paper proposing to enhance listed companies' climate-related disclosure. HKEx will require all issuers to make climate-related disclosures in their Environmental, Social and Governance (**ESG**) reports, and to introduce new climate-related disclosures aligned with the International Sustainability Standards Board (**ISSB**) Climate Standard. The ISSB Climate Standard builds on the principles of the recommendations of the Financial Stability Board's Task Force on Climate-Related Disclosure (**TCFD**), and sets out detailed climate disclosures.

The new rules will adopt a mandatory disclosure requirement, instead of the current "comply or complain" approach, to apply to financial years commencing on or after 1 January 2024. Because certain disclosure requirements (*e.g.*, scope 3 emissions and current and anticipated financial effects) may require preparation for companies to be in a position to comply, interim provisions for these requirements will apply for the first two reporting years following 1 January 2024. Issuers are expected to be in full compliance with all the new climate-related disclosures in reporting for financial years commencing on or after 1 January 2026 (*i.e.*, the first ESG reports fully compliant with the new rules will be produced in 2027).

The new climate-related disclosure requirements fall under the following four pillars:

Governance	Issuers must disclose the governance process, controls and procedures used to monitor and manage climate-related risks and opportunities.
Strategy	**a. Reporting climate-related risks and opportunities:** Issuers must disclose climate-related risks and opportunities and their impact on the issuer's business operations, business model and strategy.
	b. Reporting on transition plans: Issuers must disclose the responses to climate-related risks and identified opportunities, including (i) the changes made to their business models, strategies, adaptation and mitigation efforts; and (ii) climate-related targets for transition plans, and greenhouse gas (**GHG**) emission targets required under local legislation.
	c. Reporting on climate resilience: Issuers must disclose the resilience of their strategies (including their business models) and operations to climate-related changes, developments or uncertainties, assessing these conditions using a method of climate-related scenario analysis that is commensurate with the issuer's circumstances.
	d. Reporting financial effects of climate-related risks and opportunities: Issuers must disclose the current (quantitative where material) and anticipated (qualitative) financial effects of climate-related risks and opportunities on the issuer's financial position, financial performance and cash flow. - During the interim period, issuers may use qualitative disclosures to report the current financial effect.
Risk Management	Issuers must disclose the process used to identify, assess and manage climate-related risks and opportunities.
Metrics and Targets	**a. Reporting GHG emissions:** Issuers must disclose scope 1, scope 2 and scope 3 emissions. - During the interim period, only limited disclosure is required for scope 3 emissions.
	b. Reporting other cross-industry metrics: Issuers must disclose the amount and percentage of assets or business activities that are (i) vulnerable to transition/physical risks; or (ii) aligned with climate-related opportunities, and the amount of capital expenditure deployed toward climate-related risks and opportunities.

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	c. Reporting on the internal carbon price: Issuers must disclose the internal carbon price and explain how they apply it in decision-making.
	d. Reporting remuneration: Issuers must disclose how they factor climate-related considerations into remuneration policy.
	e. Reporting industry-based metrics: Issuers should consider industry-based disclosure requirements prescribed under international ESG reporting frameworks and make disclosures as the issuer sees fit.

HKEx Issues Conclusions on Recent Consultations

HKEx recently issued its conclusions on two market consultations:

- The conclusions to the "Proposals To Expand the Paperless Listing Regime and Other Rule Amendments" (covered in our January 2023 update), issued in June and effective on 31 December 2023.
- The conclusions to the "Rule Amendments Following Mainland China Regulation Updates and Other Proposed Rule Amendments Relating to PRC Issuers" (covered in our April 2023 update), issued in July and effective on 1 August 2023.

Both sets of conclusions adopted all of the proposals, subject to minor modifications.

In the latter consultation, the removal of the requirement for PRC-specific risk factors has received some media attention. HKEx states as its rationale in both the consultation and conclusions that "new applicants should assess and highlight material matters and specific risk factors that are relevant to their particular circumstances." Thus the removal of this requirement does not necessarily imply that issuers may entirely omit PRC-related risk factors from listing documents if those factors are nevertheless relevant and material to an issuer.

HKEx Highlights Issues for Listed Companies

In June 2023, HKEx issued its latest semiannual Listed Issuer Regulation Newsletter, in which HKEx highlights recent issues that have arisen in practice and provides compliance recommendations to listed companies. The highlights address:

- **Compliance with new rules on share schemes.** HKEx identified a number of common issues related to share schemes under the new Chapter 17 of the Listing Rules:
  - The circumstances for award grants with a shorter vesting period of 12 months were too generic and did not meet the requirements — examples acceptable to HKEx include grants of "make-whole" awards to new joiners to replace the awards forfeited, grants to a participant whose employment is terminated due to death or disability or occurrence of any out of control event, and grants with performance-based vesting conditions in lieu of time-based vesting criteria.
  - The descriptions for performance targets were also too generic and failed to set out the criteria for assessing whether the performance targets would be met.
- **Auditing, financial reporting and related internal control matters.**
  - **Change in auditors:** An announcement of a change of auditors should explain why the change could expedite the audit process or resolve audit issues identified by the outgoing auditor. The company should comply with the guidance previously issued by HKEx (as reported in our January 2023 regulatory update). In addition, audit committees should monitor the timing of auditors' fee discussions to mitigate the possibility of late auditors' resignation.
  - **Modified audit opinions and delays in publication of results:** Companies and their audit committees should monitor the audit progress to understand the nature and root cause of any outstanding matters, and to facilitate agreement between the management and the auditors on a plan to resolve issues. Companies should build and maintain a strong compliance culture and mentality, devote sufficient resources to their financial reporting functions and strengthen their internal control systems.
- **Disclosure of business valuations in transactions.** In a notifiable transaction where the valuation of a target company is a primary factor in forming the basis for the consideration or other material terms, the acquiring company must disclose of the valuation. Issuers should disclose the valuation models used (*e.g.*, the discounted cash flows method or the market comparables approach) and explain why they were selected, in particular why the methods were appropriate for the transactions or the target companies. In addition, issuers should disclose (i) the assumptions and valuation inputs in detail, and (ii) the fairness and reasonableness of the assumptions and/or inputs if they are significantly different from the historical information of the target company/industry or the parameters of comparable companies.

SFC Proposes Amendments to the Takeovers Code

The SFC has proposed a number of amendments to the Codes on Takeovers and Mergers and Share Buy-Backs (**Takeovers Code**) in a recent consultation paper.

While many of the amendments are clarifying or technical in nature, some of the more notable proposals include the following:

- **Concert parties:** The SFC proposes to broaden the definition of "acting in concert" so that "close relatives" — which currently refers only to a person's spouse, *de facto* spouse, children, parents and siblings — to also include a person's grandparents, grandchildren, siblings' spouses, siblings' children, parents-in-law and spouse's siblings as persons presumed to be acting in concert.
- **Voting rights:** The SFC proposes to expand the definition of "voting rights" to include voting rights exercisable at a general meeting of a company, whether or not attributable to the share capital of the company, and voting rights that are subject to any restrictions to their exercise by agreement, by operation of law or pursuant to a court order. This will expand the scope of voting rights included in calculating whether a person has acquired 30% voting rights in a company, which percentage triggers an obligation to make a mandatory general offer.
- **Irrevocable commitments:** The SFC proposes that, before an issuer approaches shareholders to obtain irrevocable commitments prior to launching an offer, the issuer must consult with the SFC only where the offeror intends to approach shareholders not holding a material interest (defined as 5% or more) in the offeree company. An offeror would be permitted to approach a maximum of six shareholders (including those with and without a material interest).
- **Chain principle:** In assessing whether a subsidiary is "significant" to its parent company when determining whether the chain principle applies to render an acquisition of the parent company to be deemed an acquisition of the subsidiary for the purposes of the Takeovers Code, the SFC proposes to consider market capitalization in addition to assets and profits (where a relative value of 60% is considered "significant" for this purpose). Where a party argues that calculations based on the latest financial year produce an anomalous result, the SFC will "look back" to at least the three most recent financial periods.
- **"Put up or shut up" orders:** The SFC proposes to codify the existing practice into a rule giving the SFC express power to issue a "put up or shut up" order that requires a potential offeror to announce its firm intention to make an offer within a time limit, or to announce that it will no longer proceed with an offer. The SFC would consider the following factors: (i) the current duration of the offer period; (ii) reasons for the offeror's delay in issuing an announcement of firm intention; (iii) the proposed offer timetable (if any); (iv) any adverse effects that the offer period has had on the offeree company; and (v) the conduct of the parties to the offer.
- **Disclosure of offer price in talks announcement:** To balance the competing interests in both (i) the flexibility for an offeror to reduce its offer price after an offer price has been disclosed and (ii) the need to minimize potential abuse by offerors attempting to use disclosures of an indicative offer price to condition the market, the SFC proposes to codify the current practice that prohibits offerors from disclosing an indicative offer price until an announcement of firm intention is made, unless under exceptional circumstances (for example, where there is a need to clarify an incorrect market rumor or incorrect statement in the media that may be creating a false market, or where there are overseas regulatory requirements to disclose an offer price prior to the firm intention announcement). When an issuer makes such disclosure, the indicative offer price will be a price floor for any offer that materializes.
- **Deduction of dividends from offer price:** The SFC proposes to codify the current practice that no deduction of dividends from an offer price is allowed unless an offeror specifically reserves its rights in an announcement.
- **Paperless initiatives:** The SFC proposes to permit companies to dispatch documents by electronic means (subject to applicable law, constitutional documents and the Listing Rules) and to separately dispatch English or Chinese versions. Also the SFC would no longer require companies to publish announcements in newspapers.

Enforcement Matters

HKEx Publishes Private Reprimands Against Directors

HKEx recently published the key contents of private reprimands it has issued to directors for various Listing Rules breaches. The reprimands cover the following key areas:

- Failure to take reasonable steps to monitor the affairs of a subsidiary or to ensure the subsidiary complies with internal procedures for transacting business. The failure to proactively follow up on the subsidiary's business after the management accounts revealed significant lending activity by the subsidiary ultimately led to a failure to announce and seek shareholders' approval for loan transactions.
- Failure to comply with procedural requirements, including the failure to promptly announce transactions and/or seek shareholders' approval, as a result of (i) inadequate and ineffective internal controls and risk management systems to support the identification, reporting and/or execution of notifiable transactions; (ii) failure to proactively raise enquiries about a transaction referred to in a document circulated to the board.
- Failure of members of the nomination and remuneration committees, to (i) carry out due diligence on board candidates, properly evaluate candidates and scrutinize the requisite skills and characteristics for the role; (ii) properly consider board candidates' proposed remuneration.
- Failure to provide accurate information to the HKEx during investigations.

All parties involved in the cited cases agreed to settle the disciplinary action in order to save costs, time and other resources. HKEx took into account affirmative steps and remedial measures that the directors had taken, such as discussing issues with the auditors, initiating independent investigations and conducting independent internal control reviews. These rulings serve to remind all directors of Hong Kong-listed companies that they must proactively perform their directors' duties and cause the companies they advise to comply with the Listing Rules requirements.

HKEx Reminds Nonexecutive Directors About Internal Controls

A recent HKEx disciplinary case highlights that all company directors, whether executives or nonexecutives, are collectively and individually responsible for overseeing the company's corporate governance matters.

The case involved two former executive directors of S&S Intervalue China Limited, who entered a series of unauthorized transactions under which the company provided financial assistance to third parties without justifiable commercial reason. The transactions resulted in substantial losses close to RMB 200 million. The directors responsible for these transactions did not conduct any due diligence, and did not inform the board about the transactions. In addition, material deficiencies in S&S's internal controls emerged, including that: (i) S&S's subsidiary adopted a sole-directorship system leading to a concentration of power; (ii) S&S did not have an effective system for management appointments or to define the limits of management power; (iii) S&S's disclosure system was ineffective due to inadequacies in reporting lines, compliance culture and director/staff training; (iv) S&S's employed an ineffective financial reporting function that failed to monitor financing activities; and (v) S&S had no policy or practice to prepare and circulate monthly updates to the board. These deficiencies remained unaddressed.

HKEx censured the former executive directors and the company's independent nonexecutive directors (including the members of the audit committee) for breach of directors' duties and failures of oversight and internal controls. HKEx imposed a statement of director unsuitability on all the company's executive directors, declaring that they are not suitable to act as directors or senior management of the company or any of its subsidiaries.

The case highlights that, even where nonexecutive directors are not involved in day-to-day operations, these directors are expected to proactively seek sufficient information to properly discharge their directors' duties. Directors should conduct regular reviews of the company's internal controls and follow up on any potential internal controls weaknesses that are identified.

Risks for Directors in Business Expansion

Entry into or expansion of a new business line is often a source of risk requiring heightened scrutiny by boards. HKEx emphasizes this board duty in a recent disciplinary action.

Arta TechFin Corporation Limited significantly expanded its money lending business and granted a total of HK$2.28 billion in unsecured loans to borrowers, the majority of which were based in the PRC. All the loans defaulted, leading to impairment losses of over HK$1.9 billion. The expansion of the money lending business had not been properly considered and, despite the sizeable amounts of the loans, the directors failed to ensure that proper due diligence and credit assessments had been conducted, failed to adequately monitor the loans after they had been made and/or failed to act as a gatekeeper for the company's funds.

HKEx censured the relevant executive directors responsible for or involved in the money lending business for mismanagement of company business, and imposed a director unsuitability statement against one of them for his further noncooperation with HKEx's investigation.

HKEx noted that, in such circumstances, directors must fulfill their fiduciary duties and apply a reasonable level of skill, care and diligence. HKEx expects directors to critically assess the commercial rationale for the business and to play an active role in safeguarding the assets of the issuer. In money lending, directors must take proper steps to assess and manage the exposure to the issuer, including due diligence, a thorough analysis of the lending risks and ongoing oversight of the loan portfolio. Directors, who have the primary responsibility for these matters, must keep comprehensive records of all these steps.

SFC Freezes Assets of Suspected Insider Dealers

The SFC has obtained an injunction to freeze the assets of a suspected insider dealer who has left Hong Kong.

An individual allegedly shared with her friend inside information obtained through her employment at an investment bank. In 2020, 2.844 million shares of I.T Limited were bought and immediately sold after a proposed privatization was announced. As a result, the parties gained HK$4 million profits in three months.

The suspected parties have both left Hong Kong and taken steps to remove their assets from Hong Kong. In light of the risk of dissipation, the SFC obtained an injunction to prevent the parties from further transferring their assets out of Hong Kong in order to enable any future orders made by the court and/or the Market Misconduct Tribunal to be fulfilled if the parties are found liable for insider dealing.

HKEx Takes Disciplinary Action Against Keyne and Its Directors for Incomplete Disclosure and Internal Control Deficiencies

Directors, and in particular a board's audit committee, have responsibility for a company's internal control environment and must proactively address deficiencies or warning signs that arise. HKEx highlighted this responsibility in a recent case.

In 2018 and 2019, a wholly owned subsidiary of Keyne Limited entered into two pledge agreements: The subsidiary pledged two properties to support an entity wholly owned by Keyne's controlling shareholder and his mother (who is an executive director of Keyne) to secure that entity's RMB500 million payment obligation. In return, Keyne's controlling shareholder advanced an interest-free RMB200 million loan to Keyne. All these transactions constituted major and connected transactions subject to announcement, circulation and independent shareholders' approval. However, the company did not observe these procedural requirements, and the pledges and the loan were not disclosed in Keyne's 2018 and 2019 annual reports. Keyne made an announcement about the pledges in April 2020 (a delay of up to two years after the execution of the relevant pledge agreements). However, the announcement was incomplete as it failed to disclose (i) the precise nature of the arrangements; (ii) that under the arrangements, in the event the controlling shareholder failed to honour its commitments, there would be no recourse against the controlling shareholder since the pledge was made to secure the obligations of the controlling shareholder entity only.

HKEx found that Keyne lacked sufficient internal controls and risk management systems to ensure its compliance with the Listing Rules. HKEx censured the director responsible for the transaction for failing to inform the board and therefore depriving Keyne of due consideration of potential issues and risks associated with them. HKEx also censured directors on the audit committee for failing to sufficiently address internal controls deficiencies when they were identified.

Director's Conflict of Interest Leads to HKEx Criticism

Listed company directors must remain mindful of their broad-ranging obligations to avoid or transparently manage even an indirect risk of conflict. They should make open and early disclosure of anything that might be considered a conflict, even if the possibility of an actual conflict is likely remote.

An example of a failure to appropriately manage a conflict arose in a recent case involving property developer Agile Group Holdings Limited. In this case, Mr. Chan Cheuk Yin and his family members held more than 66% of the equity interest in Agile. These individuals had undertaken noncompetition obligations in favour of Agile, pursuant to which they agreed not to engage or take interests in businesses that compete with Agile. In March 2014, the Agile board redesignated Mr. Chan as a nonexecutive director (rather than an executive director) and entered into a supplemental deed to release his family members from their obligations under the noncompetition undertakings, given that he was no longer an executive director of Agile.

Mr. Chan continued to hold an advisory role with Agile and to have access to Agile's confidential information. Also, since late 2013, Mr. Chan had been funding his son's business, which constituted a competitor of Agile, but Mr. Chan did not inform the board about this. Additionally, he acted as a director and signatory of two companies within his son's business group, which companies Mr. Chan later acquired in October 2018. Mr. Chan was named one of the discretionary beneficiaries under a family trust holding his son's business, but he did not disclose to the Agile board his interest in the family trust and his acquired business. In December 2019, his son's business was listed on HKEx, and the prospectus revealed that Mr. Chan had provided the initial funding for the business.

HKEx censured Mr. Chan for failing to disclose his interests in his son's competing business so that the Agile board could make an informed assessment of the supplemental deed and Mr. Chan's conflicting interest.

Furthermore, the HKEx considered the supplemental deed to be a connected transaction because it conferred benefits on the Chan family and their associates permitting them to engage in competing businesses, which they could not otherwise have done under the original noncompetition undertaking, regardless of whether any of them held a role as executive director. As a result, the company breached the Listing Rules by failing to comply with the requirements for connected transactions.

HKEx Censures Former Directors of China Clean Energy

A board seeking to resist the removal of its members by receivers and managers has resulted in a wide-ranging disciplinary decision by HKEx.

In 2021, receivers and managers of over 50% of the shares of the China Clean Energy Technology Group Limited sought to replace most of the members of the board of directors by requesting the board to convene an extraordinary general meeting (EGM), but the board refused to do so. As a result, the receivers initiated and convened the EGM and obtained the relevant resolution. China Clean Energy (led by Mr. Chen Jun, the former executive director and chairman, and other former directors at the time) refused to accept the EGM result, which the Cayman Court later declared had been validly obtained, making the removal of directors therefore effective.

Despite HKEx's repeated requests, China Clean Energy did not announce the requisition to convene the EGM, publish the related circular or provide HKEx with requested information as to whether the objection against the requisition was compliant with the company's articles and Cayman laws. HKEx found that Mr. Chen deliberately withheld announcing the requisition and publishing the circular, which deprived shareholders and the investing public of timely and material information. HKEx found that he placed his own interests ahead of the company and shareholders' interests, and breached his director's duties. HKEx censured and imposed a statement of director unsuitability against the former company directors for failing to ensure Mr. Chen sought professional advice and failing to cooperate with HKEx's investigation. In response to the serious nature of the breaches, HKEx also imposed a statement of prejudice to investors' interest against Mr. Chen.

Acquisition Valuations Bring Risks

A recent HKEx disciplinary action emphasized directors' duty to exercise skill, care and diligence, including conducting sufficient due diligence, when considering a proposed acquisition. The acquisition process will often warrant a professional valuation, and directors must ensure the valuation is obtained and used appropriately. Each director must also exercise his/her own independent judgement when assessing a proposed transaction. Unquestioning reliance on valuation reports or the assessment of others may constitute a breach of duty.

In September 2018, Blockchain Group Company acquired ginseng assets for approximately $2.1 billion — constituting a substantial acquisition, which was not announced or disclosed. In support of the acquisition, the director responsible for the acquisition obtained a valuation report dated 25 August 2018, prepared using the income approach, without information on the age and harvesting periods of the ginseng assets. By 31 December 2018, subsequent valuation based on the market price of ginseng of similar age, weight and grade assessed the assets at only half of the pre-acquisition assessed value.

HKEx found that the director responsible for the acquisition failed to exercise skill, care and diligence in ensuring sufficient due diligence was conducted and that material information about the ginseng assets was obtained and/or made available to the valuer. He also failed to apply independent judgement and to take follow-up actions to address the lack of material information available for the valuation. In addition, in considering the acquisition of the ginseng assets, HKEx determined that the other directors breached their directors' duty by (i) failing to ensure that the acquisition served the interests of the company and its shareholders; (ii) failing to ensure that the acquisition was disclosed (HKEx noted that a reasonable director would have been aware that the acquisition would constitute a notifiable transaction); and (iii) by delaying the related financial reporting and not cooperating with HKEx's investigation. HKEx therefore censured and imposed a statement of prejudice to investors' interests statement against the directors.

Listed Debt Disclosure Breaches Lead to Disciplinary Action

A recent case related to failures of a listed debt issuer to make appropriate information disclosures highlights that issuers of both debt and equity must promptly announce information necessary to avoid creating a false market. Otherwise, the debt issuer must apply for a trading halt or suspension.

In 2017, Tianjin Real Estate Group Co. Ltd. listed its US$100 million bonds on HKEx, with a date of maturity on 29 September 2020. Pursuant to the debt's terms and conditions, a cross-default would occur if there was any actual or potential default by the issuer on any of its other obligations. On 15 September 2020, Tianjin Real Estate defaulted on two onshore bonds in the PRC, resulting in market speculation about the company's financial difficulties. Subsequently, HKEx initiated an investigation into whether a cross-default had occurred and whether other information was required to be disclosed under the Listing Rules. However, Tianjin Real Estate did not substantively respond to HKEx's enquiries. On 25 September 2020, the company's listed debt ceased trading due to its maturity. The company issued an announcement about a proposed extension of the repayment deadline and regarding the trading suspension on 29 September 2020, which was no longer relevant since trading had already ceased.

HKEx found that Tianjin Real Estate had known about its inability to repay the debt since July 2020, but did not timely announce such information to the market. The company also failed to disclose its default on the two onshore bonds in the PRC, which would have triggered a cross-default. This information should have been announced to avoid a false market. Tianjin Real Estate also failed to appoint new authorized representatives to communicate with HKEx after the company's previous authorized representatives could not act as the principal channel of communication due to an ongoing regulatory investigation.

HKEx used the case as an opportunity to remind issuers to maintain an open line of communication with the exchange and to ensure that authorised representatives can fulfil their communication duties effectively.

SFC Seeks Disqualification of Directors for Alleged Fraudulent Activities

The SFC has commenced legal proceedings in the Court of First Instance for orders to disqualify the seven former directors and the former chief financial controller of China Candy Holdings Limited. The action follows SFC's investigation into alleged fraudulent activities that inflated the company's financial results.

The SFC found that China Candy's 2016 interim report and 2016 annual report contained false and misleading information about the company's financial positions. Specifically, by creating falsified bank and accounting records, the company overstated its cash and bank balances by 87% and 97% as of 30 June 2016 and 31 December 2016, respectively.

The SFC alleges that three respondents, having orchestrated the fraudulent scheme, were the instigators and perpetrators of the fraud, or at least knowingly permitted, acquiesced or turned a blind eye to it. The SFC determined that the other five respondents were negligent and/or in breach of their directors' duties for failing to apply an adequate degree of skill, care and diligence in reporting and for failing to act in the best interests of the company.

Under section 214 of the Securities and Futures Ordinance (SFO), if a person is found to be wholly or partly responsible for a company's affair having been conducted in a manner involving fraud or other misconduct, the court may make orders to disqualify such person from being a director or being involved in the management of any corporation for up to 15 years.

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SFC Obtains Director Disqualification Orders Against Former Directors for Secret Profits

The SFC has obtained disqualification orders against two directors of a listed company in circumstances where the chairman concealed his interest in a transaction and thereby obtained a secret profit.

The case relates to an acquisition by Luxey International (Holdings) Limited of Ratio Knitting Factory Limited. The Court of First Instance found that Joseph Lau Chi Yuen, the chairman and executive director of Luxey, breached his director's duties by utilising a nominee company to first acquire Ratio for $50.1 million before Ratio was then resold to Luxey for $390 million. Mr. Lau concealed his profit and material interest in these transactions, thus breaching his director's duties.

The SFC obtained disqualification orders in the Court of First Instance against Mr. Lau and Chung Man Wai, Luxey's former CEO and executive director. The court determined that the two former directors conducted Luxey's business in a manner (i) involving defalcation, fraud, misfeasance or other misconduct; (ii) resulting in a failure to provide Luxey's shareholders with all the information about Luxey's business or affairs that they might reasonably expect; and (iii) unfairly prejudicial to Luxey's shareholders.

Mr. Chung breached his director's duties by failing to conduct sufficient inquiries about Mr. Lau and the relationships of Mr. Lau's nominees, or preventing Luxey from acquiring Ratio for an inflated consideration.

The court also found that both directors were responsible for the false statements in Luxey's announcement and circular regarding the acquisition by falsely disclosing that (i) the vendor was an independent third party; (ii) the consideration was determined by arm's length negotiations; and (iii) the terms of the acquisitions were on normal commercial terms, fair and reasonable and in the interests of Luxey and its shareholders as a whole.

This case demonstrates the importance for directors to avoid situations that create conflicts of interest or secret profits. Directors have a duty to inquire proactively into suspicious factors and relationships between the parties of transactions, and to make sure full and accurate disclosures of transactions are available for shareholders to exercise informed judgment.

Failure To Obtain Regulatory Approval Before Triggering a Mandatory General Offer Obligation Prompts SFC Criticism

A potential offeror should ensure that all requisite regulatory approvals are obtained before making any acquisition of voting rights that would give rise to an obligation to make a general offer under the Takeovers Code, as a recent SFC case illustrates.

On 5 July 2022, Mr. Cheung Chi Shing acquired shares in Styland Holdings Limited, as a result of which the combined shareholding of Mr. Cheung and his concert parties increased from 27.52% to 31.84%. As a result, Mr. Cheung was obliged to make a mandatory general offer for Styland pursuant to the Takeovers Code.

Four subsidiaries of Styland are corporations licensed to carry out regulated activities under the SFO. If the mandatory offer became unconditional, Mr. Cheung and his concert parties would become new substantial shareholders of these licensed corporations under the SFO, which would require the SFC's approval prior to triggering the obligation to make the offers. This approval was not obtained. As a result, Mr. Cheung was in breach of the Takeovers Code.

The SFC publicly criticized Mr. Cheung for his failure to obtain the necessary regulatory approval before triggering the mandatory general offer obligation.

SFC Commences MMT Proceedings Against Former Bank Employee for Insider Dealing

The SFC has commenced Market Misconduct Tribunal proceedings against a former employee of China CITIC Bank International Limited for alleged insider dealing in shares of Bloomage BioTechnology Corporation Limited. Mr. Wu Kam Shing worked with a team of China CITIC Bank staff to execute a loan transaction to finance an offer to privatise Bloomage. Aware of the proposed privatisation offer, Mr. Wu purchased Bloomage shares via his and his wife's securities accounts and earned a profit of approximately HK$3 million by selling the shares after publication of the privatisation announcement. The SFC has thus alleged that Mr. Wu engaged or may have engaged in insider dealing.

Directors Disqualified for Allowing Company To Be Dominated by Chairman

The SFC has obtained disqualification orders in the Court of First Instance against a former executive director and two former independent nonexecutive directors of National Agricultural Holdings Limited after they admitted that they breached their directors' duties by allowing the company's affairs to be dominated by its former chairman and senior officers for those officers' personal advantage.

The SFC's investigation revealed that (i) the controlling shareholder acquired shares in the company but failed to pay the relevant consideration when the shares were issued; (ii) HK$384 was transferred to a company to establish an investment fund for National Agri but was in fact used for purposes unrelated to the company, with part of the sum transferred to the controlling shareholder; (iii) a sum of RMB1.85 billion, comprised of refunds arising from lapsed transactions that was deposited into the company's accounts, was shortly transferred out of company accounts through a series of dubious transactions for unknown purposes; and (iv) the former chairman transferred HK$50 million from the company to a company connected to him without justifiable reason, and concealed the transaction.

The court held that the former directors neglected to identify or rectify the misconduct by the former chairman and others. The court determined that the directors also failed to raise concerns, queries or seek necessary information in relation to the questionable transactions. The former independent nonexecutive directors were also fund to have breached their duties by failing to exercise independent judgement and supervision.