

**SEHK enforcement action against Huazhong In-Vehicle Company Limited and its directors  
(October, 2015)**

**I. Summary**

**The Listing Committee of The Stock Exchange of Hong Kong Limited (the "Committee")** censures:

- (1) Huazhong In-Vehicle Holdings Company Limited (the "Company") for failing, under the Listing Rules, to:
  - (a) comply with the reporting, announcement, independent shareholders' approval requirements in respect of certain connected transactions relating to "financial assistance";
  - (b) consult and seek advice from its compliance adviser on a timely basis when those connected transactions were contemplated; and
  - (c) ensure that the information on the connected transactions contained in an announcement on the connected transactions issued in 2013 (the "Announcement") and its 2012 and 2013 Annual Reports was accurate and complete, and not misleading or deceptive;

**further censures or criticizes (in light of varying degree of culpability)**

- (2) Its former chairman and controlling shareholder of the Company; executive directors and non-executive directors for breaching:
  - (a) their director's duties under Rule 3.08 (in varying degree) of the Listing Rules; and
  - (b) their obligations under their respective Director's Declaration and Undertaking (Appendix 5B).

**II. Facts**

- The Company was listed in 2012. As required for newly-listed companies, it retained a compliance adviser (Guotai Junan Capital Limited ("Guotai"))
- Financial assistance (the "Financial Assistance") was provided by the Company and its subsidiaries (the "Group"), being certain advances (the "Advances") and a deposit pledge (the "Deposit Pledge") to its former Chairman ("Former Chair") and his associates (i.e. "connected persons" of the Company)

- The Financial Assistance was procured by the Former Chair, without the knowledge and involvement of the other directors, by instructing the Group's finance manager to execute the transactions. The Company and the Former Chair asserted that the finance manager was responsible for obtaining authorization from the chief financial officer (the "CFO") who was in turn responsible for determining whether board approvals were required, and if so, seeking such approvals
- There were no written agreements for the provision of any of the Advances
- The Company did not consult its compliance adviser when each of the Financial Assistance was contemplated
- There were contemporaneous documents produced by Guotai that it alerted the Company and the Former Chair to possible Listing Rule breaches in respect of some of the Advances around September 2012. However, the Company alleged, without supporting evidence, that the Financial Assistance was only discovered by its auditors in 2013 in the course of preparing the 2012 annual results and the 2013 interim results respectively
- At the March 13 board meeting, the 2012 Annual Report was approved by certain executive and non-executive directors
- The Company submitted that the CFO informed the attending directors about the possible Listing Rule implications at the meeting. Those directors instructed the CFO to investigate and report back, and if there were any Listing Rule breaches, to seek advice for remedial actions. However, this submission was not reflected in the minutes of the board meeting. These directors submitted that they mistakenly believed that the disclosure in the 2012 Annual Report was sufficient for Rule compliance
- Some of the Advances were disclosed in the 2012 Annual Report, described as *"connected transactions exempt from the independent shareholders' approval requirement"* (the "Exemption Statement")
- At the board meeting held in August 2013, certain directors approved and ratified the Financial Assistance and approved an announcement (the "Announcement"). The Announcement contained a statement that the Advances (unsecured, interest-free and repayable on demand) were provided on normal commercial terms (the "NCT Statement") and therefore the exemption under Rule 14A.66(2) applied (i.e. repeated the Exemption Statement).
- As stated in the Announcement, the Company relied on the following reasons in support of its assertion that the Advances were provided on normal commercial terms:
  - (a) The former Chair had made valuable contributions to the Group. The Company made the advances to him primarily for him to repay a personal loan he borrowed from an independent third party for the purpose of listing;

- (b) His associates had offered favourable rental terms or free services/ advice to the Group prior to listing.
- The Company stated in the announcement that as the Deposit pledge was released on 30 August 2013, it would not proceed to obtain independent shareholder approval

### III. Exchange Listing Rule requirements and breaches

#### (1) Breaches by the Company

- (a) Reporting, announcement, and independent shareholder requirements regarding the financial assistance -- the Advances and the Deposit Pledge were subject to Rule 14A.63, i.e. Rule 14A.45 (reporting requirement), Rule 14A.47 (announcement requirement), Rules 14A.48, 14A.49 and 14A.52 (independent shareholders' approval requirements). These transactions did not meet the exemption conditions for the independent shareholders' approval requirements

Exemption conditions for independent shareholder approval requirements

- the Advances (given that the percentage ratios were less than 5 per cent) could be exempted pursuant to Rule 14A.66(2) if they were provided on normal commercial terms, even though they were not provided in the ordinary and usual course of business.
- "*Normal commercial terms*" is defined in Rule 14A.10(8) as "*terms which a party could obtain if the transaction were on an arm's length basis or on terms no less favourable to the listed issuer than terms available to or from independent third parties*".

- (b) Rule 14A.04 requires an issuer to enter into a written agreement for each connected transaction.
- (c) Rule 2.13 requires an issuer to ensure that the information contained in any announcement or corporate communication required pursuant to the Exchange Listing Rules is accurate and complete in all material respects and not be misleading or deceptive.
- (d) Rule 3A.23 requires an issuer to consult with and, if necessary, seek advice from its compliance adviser on a timely basis, during the period from the date of its listing to the date of publication of the issuer's first full financial year's results, where a connected transaction is contemplated.

## **(2) Internal controls**

It was noted that the connected transactions and the related Rule breaches were not prevented or detected by the Company's internal controls, but were identified by Guotai and the Company's auditors.

The Listing Committee therefore concluded that Company did not have adequate and effective internal controls at the relevant time to ensure the Company's compliance with Chapter 14A of the Listing Rules.

## **(3) Breaches by the directors**

While the precise disciplinary action against individual directors vary in accordance with fact-specific circumstances, it is noteworthy that:

### **(a) Breach of Rule 3.08**

- (i) The Former Chair was disciplined for breaching Rule 3.08 (a) to (f)
- (ii) In general, the other directors were disciplined for failing to comply with Rule 3.08 (f)

#### What Rule 3.08 requires

the board of directors are to be collectively responsible for its management and operations. Under Rule 3.08, the directors are expected, both collectively and individually, to fulfil fiduciary duties and duties of skill, care and diligence to a standard at least commensurate with the standard established by Hong Kong law, meaning that every director must, in the performance of his duties as a director:

- (a) act honestly in good faith in the interests of the company as a whole;
- (b) act for proper purpose;
- (c) be answerable to the issuer for the application or misapplication of its assets;
- (d) avoid actual and potential conflicts of interest and duty;
- (e) disclose fully and fairly his interests in contracts with the issuer; and
- (f) apply such degree of skill, care and diligence as may reasonably be expected of a person of his knowledge and experience and holding his office within the issuer.

(b) Breach of directors' undertakings

In general terms (varying in degree of culpability), the directors were found to have breached their undertakings:

- (i) for failing to comply to the best of his ability with the Listing Rules by virtue of his breach of Rule 3.08 (note: various subsections, in light of varying degree of culpability)
- (ii) for failing to use their best endeavours to procure the Company's Listing Rule compliance (note: varying in light of factual situation) in respect of the NCT Statement and the Exemption Statement contained in the various corporate documents, and failure to ensure the Company had adequate and effective internal controls in place to identify the connected transactions for Rule compliance.