

December 2018 Legal and Regulatory Update

Top stories

Two cases on information to shareholders

(i) Disclosure of inside information (“positive profit alert”)

SFC commenced proceedings in the Market Misconduct Tribunal (“MMT”) against CMBC Capital Holdings Limited and 6 former (executive and independent non-executive) directors, for failing to disclose inside information as soon as reasonably practicable. (Click: [press release](#); [MMT notice](#))

Key issue is **material improvement in financial performance** should have been apparent from **internal management accounts**.

What you should know/watch out for:

- **Nature:** delay in disclosure — material improvement in performance
- **Monthly management accounts** relevant: improvement should have been apparent by the fifth month of the interim period
- Being **specific information** regarding the company; **price sensitive** and **not generally known to the public** at the material time
- Chronology:
 - Background:
 - (i) interim results (6 months to Sept 13): loss of \$12m
 - (ii) full year 13: profit of \$417m
 - **(13 Oct 14):** those directors received **consolidated management accounts for the first five months**, reflecting significant improvement in performance (profit: \$838m)
 - **(7 Nov 14):** finally **issued profit alert**
- Those directors, being **officers**, are alleged to be **in breach** for reckless or negligent conduct causing alleged breach by company
- (Click: our [Nov 18 legal update](#) on a similar (but “profit warning”) case)

(ii) **HKEX censured Shenji Group Kunming Machine Tool Company Limited and former chairman**, for failing to ensure **information** contained in an **announcement** was **accurate and complete** in all material respects and **not misleading**. (Rule 2.13(2) (Click: [Press release](#))).

The company made an **announcement** that its **substantial shareholder** had entered into an **agreement to sell its entire 25% interest** to a third party. Stated **completion conditions** include approval by state-owned assets commission of PRC State Council.

A **3-month deadline in completion** contained in the agreement was not announced.

Such approval was not obtained by the deadline, and agreement terminated.

Company **defended** that it was **not a party** to the negotiations. Draft **announcement** was prepared based on **information and previous drafts of agreement provided by the parties** (not containing the completion deadline). Announcement was made under a **tight timetable**.

What you should know:

- The deadline is a **material term**
- Significant movements in trading volume, after company made first announcement, then progress and termination announcements
- **Rejected above defences**
 - Final agreement provided to former chairman (“only 6 pages long”)
 - Could have ensured careful review, for announcement preparation

Former chairman

- **Breach of directors’ duties (Rule 3.08 (f))**
 - Duties of **skills, care, and diligence** to a standard at least commensurate with HK law
 - i.e. **reasonably expected** of a person of **his knowledge and experience**, holding **his office**
 - Was on the board for 8.5 years (ED and chair for over 4 years)
- **Breach of Directors’ Undertaking** include:
 - **Own compliance** with Listing Rules to **best ability**
 - **Best endeavours** to procure **Company’s compliance**

What you should watch out for:

- The **high standard** expected in **ensuring accuracy of announcements**; and **directors’ duties**
- **Directors duties** being an enforcement focus

Also in this issue

Regulators

(i) Updated HKEX FAQs:

[\(A\) Review of Corporate Governance Code and related Listing Rules \(series 17\)](#)

[\(B\) Notifiable and Connected Transaction Rules relating to Lease Transactions \(following new HKFRS/IFRS 16 “Leases”\) \(series 45\)](#)

Useful FAQs on 2 key areas: Corporate Governance Code; “Notifiable/ Connected Transactions”!

Regarding leases, **HKFRS/IFRS 16 (“Leases”)** is effective for **accounting periods beginning on and after Jan 2019**, introducing changes in the accounting treatment of “leases”. This is **more than an accounting matter**, affecting other areas including compliance!

(Click our [Sept 18 legal update](#), on FAQs previously issued on “Leases”).

What you should know/watch out for:

Corporate Governance Code

- Noteworthy FAQs include **audit committee members (“appropriate professional accounting and financial management expertise”)** (FAQ 10B-F)
 - E.g. a candidate’s only experience being audit committee of an issuer for many years; NOT prima facie adequate (FAQ10E)

Leases

- Treatment under **“Notifiable Transactions”** rules, where a lease has (i) a fixed lease payment; (ii) variable amounts based on sales (FAQ 46A)
- Treatment under **“Connected Transactions”** rules; how to set annual caps for continuing transactions (FAQ 47)

(ii) **HKEX introduced [e-training](#) for directors**. The first course covers six topics relating to corporate governance, complementing the revised Corporate Governance Code (effective 1 Jan 19). (Click: [Press release](#))

(iii) SFC's latest [Takeovers Bulletin](#) covers a new **Practice Note (display of “material contracts”)**; and a case illustrating why an **offer price structure** would be regarded as “oppressive” to shareholders.

What you should know/watch out for:

New Practice Note 22 (Display of material contracts)

- Guidance on the interpretation of “**material contracts**” under the Takeovers Code
- As a starting point, contracts of “discloseable transactions” would normally constitute “material contracts”; but this is not exhaustive

Offer price structure oppressive to shareholders?

- (**General Principle 5** of the Code): “shareholders should be given sufficient information, advice and time to reach an **informed decision** on an offer”
- The Code has provisions for timing of despatch of relevant documents; consideration by shareholders
- Current case: shareholders would receive a higher price only if the offer became or was declared unconditional by a stipulated date
- **Oppressive**; in effect pressuring shareholders to accept the offer at an earlier time, than allowed under the Code
- In some cases, may result in shareholders having to decide accepting the offer (for the higher price), before having the chance to review key information

Legislation

The Companies (Amendment) (No.2) 2018 Ordinance, introducing amendments to the 2014 new Companies Ordinance: (i) implementation issues (ii) clarification/remove inconsistencies, will (apart from 2 sections) come into effect on 1 February 2019.

Notable amendments include **expanding the scope for “simplified (financial) reporting”** by **corporate groups**, e.g. those **with non-HK incorporated subsidiaries**. Some **administrative procedures have been streamlined** (e.g. disclosure of names of directors of subsidiary undertakings).

(Click: Companies Registry publications: (i) [circular](#), referencing a thematic section on its website, and a dedicated hotline; (ii) [summary of changes](#)).

Published by Practising Governance Limited

January 2019