

May 2017 Legal and Regulatory Update

Top stories

SFC: Directors' duties in acquisitions/disposals

SFC published a **Guidance Note on directors' duties in the context of valuations in corporate transactions**.

SFC is concerned that prices paid in some acquisitions/disposals of assets and businesses may not be fair and reasonable. Issuers have not obtained valuation, or placed excessive reliance on valuation reports.

It is an important document. Firstly, there is useful guidance on key issues the board should note regarding valuations. Similar principles also apply for engaging other advisors in these transactions (e.g. financial advisors). Importantly, SFC will consider if the Guide has been adhered to, in assessing a breach of directors' duties. (Click here: [press release](#), [full report](#))

At the same time, SFC also issued a **Statement on liability of valuers** for false or misleading information ([Click here](#)) and a **Circular to financial advisors regarding valuations** ([Click here](#)).

What you should know:

SFC's specific guidance includes:

- **“Proper investigation and due diligence”** (para 12):
 - (i) **Nature of asset/ business of target**
 - (ii) **Carefully consider all relevant information**
 - (iii) **Take reasonable steps to verify accuracy and reasonableness** of material information
 - e.g. assess **financial forecasts and assumptions**, given target's financial status, performance, prospects, peer comparison
 - (iv) **Engage valuers if appropriate**
 - (v) **Seek further information** from vendors
- **Closer attention needed:** examples (para 13):
 - (i) **Limited track record** — target business is new, loss-making/little profit, minimal/negative net assets
 - (ii) **Aggressive assumptions** used in forecasts
 - (iii) **Questionable sales:** are projections based on non-binding or newly signed contracts?

- **Engaging an independent valuer** (para 15)
 - (i) Should do so particularly if:
 - director have **no relevant experience/expertise**
 - target business is new**
 - information provided needs **professional advice/scrutiny**
 - relative **size** and **significance** of the transaction
 - risks, complexity, nature** of transaction
 - any **director** has actual or potential **conflict of interest**
 - (ii) **Qualifications of valuer** (para 16) — independence, no conflicts of interest, suitably qualified, relevant expertise, adequate resources
 - (iii) **Provide all relevant information** likely to affect the valuation (para 17)
 - (iv) **Appropriate mandate** (para 18) — to ensure valuation be useful and relevant
- **Engaging other advisors** (para 19):
 - (i) **Financial advisors** also engaged, as required in some situations under Listing Rules
 - (ii) **Scope of review and mandate** — must satisfy SFC's [Corporate Finance Advisor Code of Conduct](#)
 - (iii) Noteworthy — to ensure financial advisors perform additional steps before relying on work done by other experts (para 5.3 (a) and (b) of the Code)
- **Reliance** must be **reasonable** (para 20):
 - (i) Critical attitude
 - (ii) Analyze valuation report
 - (iii) Enquiring with valuer; get satisfied with assumptions or methodology
 - (iv) Consider degree of director involvement (given risks, size, significance, etc.)

What you should watch out for/do:

- **Board process in approving transactions** — should seriously consider engaging a valuer
- Prepare appropriate **scope of mandate** — don't overlook the "formalities"
- **Same principles** apply for **engaging financial advisors in acquisitions/disposals**
- **Directors' duties** in approving transactions — more rigour expected
- **Internal controls** — embed the Guide's principles in **your company's policies and procedures**. It is relevant for SFC enforcement actions
- We also noted regulators' heightened scrutiny in issuers' disclosure of acquisitions generally — accurate; include all relevant information
- **Our further observations: valuation is an important, but not the sole consideration** of the board in approving transactions. Other factors like risks, strategic fit, alternative investment options are also relevant for **directors' duties**

Regulators

(i) SFC's "Enforcement Reporter" on liabilities of directors and senior executives of listed companies (Click here for [press release](#), [full report](#))

What you should know/watch out for:

- Director/senior management duties is a SFC enforcement focus, in combating corporate misfeasance
- **Reminder on directors' duties:**
 - (i) act in **good faith and in the best interests of the company, shareholders** as a whole
 - (ii) exercise **due and reasonable care, skill and diligence**
 - (iii) exercise **independent judgment**
 - (iv) exercise powers for **proper purposes**
 - (v) avoid **actual or potential conflicts of interest**
 - (vi) refrain from making **undisclosed profits**
- Key priorities for SFC enforcement actions
 - (i) fraud
 - (ii) misleading financial statements
 - (iii) serious conflict of interests
- Gave examples of recent SFC cases, and a summary of SFC powers (these cases already covered in our previous updates)

(ii) (Effective 3 July) Mandatory electronic filing of disclosure of interests notifications

From **3 July 2017**, disclosure of interests by directors/chief executives, and substantial shareholders **must be done electronically**. HKEX ([Click here](#)) and SFC ([Click here](#)) announced logistics arrangements, as regards a new online platform, new prescribed forms and codes. These are subject to a **3-month transitional period**.

There are no other changes in the disclosure obligations under the Securities and Futures Ordinance ("SFO").

(For background: Click our [March update](#))

What you should know/do:

- HKEX's new **Disclosure of Interests Online ("DION") System** — issuers to complete new registration arrangements
- All filings via DION system, **without having to notify the issuers separately**. On receipt of a filing, **HKEX notifies issuers** to access information on the system
- SFC's **new notification forms** and related **codes**
- Issuer reporting of share ownership investigations (**s. 329 SFO**) — **new form** to come
- **Training materials** to be posted on HKEX website in **June**
- **3-month transitional period** — may submit new forms using the DION system. **Or** may use the old forms and submit by fax, hand, post or email to HKEX and to the listed issuer concerned
- **Authorized financial institutions** — watch out for **HKMA's new arrangements** for filing disclosure notifications received by you

Legislation

The Employment (Amendment) Bill 2017 was gazetted.

What you should know:

It proposes to amend the Employment Ordinance to provide that where an employee is unreasonably and unlawfully dismissed (ie by breaching specified provisions of the Ordinance), the court or Labour Tribunal may make a reinstatement or re-engagement without the consent of the employer.

If the employer refuses to comply, it has to pay an **additional sum** (on top of other awards) of three times the employee's monthly wages (up to a maximum of \$72k).