

May 2020 Legal and Regulatory Update

Top stories

HKEX censures Kong Sun Holding Limited, named former executive directors, non-executive and independent directors. ([Press release](#))

The case involves **loans and advances** (around RMB 1.6b) made by the (*not directors*) COO and financial controller (“FC”), **without the board’s knowledge**. These were non-interest bearing, unsecured, with no fixed date of repayment. The company had negative cash-flow then, thus exposed to significant financial risks.

Firstly, the company failed to comply with **procedural requirements of “notifiable transactions”** (being “disclosable transaction”; “advances to an entity”; “major transaction” respectively).

Secondly, the directors failed to perform their **fiduciary duties**. (*Rule 3.08(f); Directors’ Undertaking*)

These are HKEX’s current enforcement themes.

HKEX stresses directors’ duties and “individual accountability”. (Background: HKEX’s Enforcement Newsletter, read our [Aug 19 legal update](#); recent cases: [Apr 20 legal update](#))

Facts:

From 2014 to March 2016, the COO and FC made the first series of unauthorized loans.

In March 2016, external auditors informed the board of the unauthorized loans/advances and Listing Rule requirements. They eventually resigned in light of unresolved audit issues.

Despite the board’s instructions to cease making further loans/advances, the COO and FC continued to make further loans/advances during March-May 2016.

It was only in Dec 2016 that the company made disclosure of the loans.

What you should know/watch out for:

Breaches of directors’ duties

- **Internal control**

No written procedures for:

- Approval/disclosure of contracts
- Reporting and recording of contracts/loans
- Management/use/storage of company chops/seals

- Remittance of large amounts via internet banking; inappropriate authority limits
- **“Delegation”?**
 - Not absolve directors from responsibilities or applying the required levels of skill, care and diligence
 - Not only at formal meetings
 - Must apply suitably greater level of scrutiny and follow up on anything untoward
- Failed to ensure adequate **Listing Rules staff training**
- Failed to use best endeavours to procure the **company’s Listing Rule compliance**
- **Auditor** resignation for unresolved audit issues
 - No sufficient/effective steps to respond
- *(After informed of unauthorized loans)*
 - No effective steps to **stop further loans**
 - Simply asking culprits to stop not good enough
 - Given severity of prior breaches
 - Should have taken pro-active actions

Also in this issue

Regulators

SFC obtained disqualification orders (s. 214, Securities and Futures Ordinance) in the Court of First Instance against 3 former directors of EganaGoldpfeil (Holdings) Ltd for their roles in **the company’s misapplication of funds**. They were disqualified from being a director or taking part in the management of any corporation in Hong Kong, without leave of the Court, for a period of **6-9 years**. ([Press release](#))

(Background: [SFC’s Statement on the Conduct and Duties of Directors when Considering Corporate Acquisitions or Disposals](#) ; read our [July 19 legal update](#))

These directors approved transactions and signed cheques giving rise to the company’s doubtful receivables amounting to about \$2.55 billion, including payments to debtors which were in fact controlled by a director. The underlying transactions were not genuine commercial transactions.

They failed to carry out **proper inquiries** and perform **appropriate due diligence** before the company entered into the transactions.

The SFC also sought compensation orders against the former directors under s. 214.

The court accepted that a compensation order can, in an appropriate case, be made irrespective of whether a respondent has received any financial benefits. It declined to grant the compensation order, and considered it should remain with the liquidators to assess whether it would be beneficial to bring proceedings in the name of the company against any party.

Published by Practising Governance Limited

June 2020