

Sept/Oct 2022 Legal and Regulatory Update

Top stories

HKEX: (NEW) Guide on Cooperation and updated Sanctions Statement

HKEX published (1) new [Guidance Note on Cooperation](#) (“Cooperation Guide”), (2) revised [Enforcement Sanctions Statement](#) (“Updated Sanctions Statement”). Its [Enforcement Policy Statement](#) has also been updated to include links to these documents. ([Press release](#))

The **Cooperation Guide** clarifies HKEX’s expectations on co-operation. It specifically highlights the importance of **timely engagement with HKEX**. There are **useful examples** of what may constitute **good cooperation**. In appropriate cases, this may be recognised by a reduction of sanctions or the inclusion in a statement regarding cooperation in HKEX’s disciplinary statements.

On the other hand, it also provides examples on **uncooperative conduct**. E.g. provision of **inaccurate, incomplete or misleading information**; **late** submissions. A failure to cooperate when there is a duty to do so is **itself** considered a **serious breach**. It can also constitute an **“aggravating factor”** to be considered when determining the appropriate sanction.

The **Updated Sanctions Statement** sets out general principles and factors to be considered in determining sanctions. There are **“active”** as well as **“passive” misconduct**. **Passive** misconduct would include a **failure to take sufficient steps to discharge a duty** (*e.g. internal control deficiencies*) for which directors are responsible, even if these failings do not directly lead to any other Listing Rule breaches.

It also provides further guidance on HKEX’s expectations re: issuer’s **internal controls**, and the **extent to which a director may rely on others** (*e.g., management, advisors*) in the **discharge of duties**.

What you should know:

(1) Cooperation Guide

Examples of cooperation (P.2)

- **Providing true and complete information and documents**
- **Proactive approach: prioritise/devote resources to investigate and respond to enquiries**
 - E.g. investigation is being conducted and/or input sought from professional third parties
 - Auditors, forensic investigators, legal or financial advisers

– Should be done promptly to ensure the party can submit a timely response to HKEX

- **Early admission of breaches**
- **Initiating settlement / accepting sanctions**

Examples of “uncooperative” conduct (P.3)

- **Failure to respond**
- **Provision of inaccurate, incomplete or misleading information**
- **Unnecessarily prolonging HKEX’s investigation**
- **Failure to attend an interview or disciplinary hearing**

- **Provision of late submissions/ evidence**

As regards legal professional privilege (P.5)

- **fully respects** the parties’ right to this
- **Voluntary waiver** (*over one or more documents, even on a limited basis*) will be taken into consideration in assessing the **degree of cooperation**

(2) Updated Sanctions Statement

Examples of factors determining sanctions (P.2)

- **Compliance history**
- Whether misconduct was **systemic**/indicative of a pattern of non-compliance
- Evidence of a **culture** conducive to Listing Rule compliance/ good corporate governance
- **Cooperation**
- **Whether “reliance on others” reasonable** (*e.g. management, advisors*)
 - Give **adequate oversight**
 - Apply **professional scepticism**
 - Exercise **independent judgment**
- **Whether control environment has been regularly reviewed, maintained and updated**
- **Proper channels for raising concerns re: risk or Rule compliance; escalation**

What you should do:

- **Note HKEX’s expectations on “cooperation”**
- **Update your board, including as regards their duties and “passive misconduct”**
- **Update relevant teams** of your company
- **Reinforces** the principle that **internal controls deficiencies itself** may lead to **disciplinary action**

Also in this issue

Regulators

(i) SFC has obtained an order in the Court of First Instance against the chairman and executive director of Sound Global Ltd., to purchase shares held by other shareholders at a price to be determined by the Court. ([Press release](#))

The order was the **first of its kind made under section 214 of the Securities and Futures Ordinance**. The press release stated that it reflects SFC’s **“determination to deploy its full range of regulatory tools** to tackle market misconduct and uphold market integrity.”

(Background: s 214(2)(e) provides that the Court may “make any other order it considers appropriate, whether for regulating the conduct of the business or affairs of the corporation in future, or for the purchase of the shares of any members of the corporation by other members of the corporation...”)

The defendant was found to have orchestrated a scheme to inflate the company’s bank balances as at 2012 and 2013 year ends *(by over 80% of its net assets as reported in the relevant annual reports)*, and fabricated relevant bank statements and balance confirmations.

(ii) The Accounting and Financial Reporting Council (“AFRC”; formerly as FRC and renamed from Oct 22) issued its 2022 Annual Investigation and Compliance Report.

([Press release](#), [Full report](#))

AFRC identified the **most common areas of irregularities in (1) financial reporting, (2) auditing**. It also states **its expectations** on auditors and **listed companies**.

It **urges** listed company **boards, management and audit committees** to take note of the key findings and observations in respect of **financial reporting non-compliances**. **Audit committees** should also take note of those relating to **auditing irregularities**.

Legislation

(iii) The Competition Commission (the “Commission”) commenced proceedings in the Competition Tribunal against The Tien Chu (Hong Kong) Company Limited for “resale price maintenance” in supplying MSG powder to its two main local distributors. ([Press release](#))

It is the first “resale price maintenance” (“RPM”) case in the Tribunal. RPM (*under the First Conduct Rule*) occurs, when a supplier establishes a **fixed or minimum resale price** to be observed by its distributors (including retailers) when they resell the product. RPM prevents them from competing with each other by offering lower prices, hence resulting in harm to competition in many cases.

The Commission alleged that until around Sept 2017, Tien Chu continued to give effect to and/or engage in RPM arrangements by establishing **minimum resale prices** for MSG powder to be charged by its **two main local distributors**. It did so by issuing notices, reminders and warnings to the distributors. It also took steps to secure compliance, which included the use of disincentives, threats and/or penalties.

What you should watch out for/do:

- “**First Conduct Rule**” means — parties acting together with an **agreement**, and/or engaging in a **concerted practice**, whose **object or effect** is “**to prevent, restrict or distort**” competition in HK
- The Commission can bring **RPM cases** (as 1 of the 4 “serious anti-competitive conduct”) to the **Tribunal** directly and **without first issuing a warning notice**.

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