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CHAPTER 4

PUBLIC ISSUES AND LISTED COMPANIES

Regulatory Structure

As is noted in Chapter 1, companies whose shares are listed on the Stock Exchange of Hong Kong, regardless of where they are incorporated, are also regulated by the Securities and Futures Commission,¹ which administers the Securities and Futures Ordinance (Cap.571),² as well as the Exchange and the Exchange Listing Rules. These requirements are much more detailed and onerous than the specific requirements applicable to listed companies found in the Companies Ordinance (Cap.32).³

4.001

The SFO is a composite body of legislation regulating (*inter alia*):

4.002

- entities permitted to operate stock exchanges and clearing houses;⁴
- persons engaged in the business of dealing and advising in securities and investment products;⁵
- offers of investments;⁶
- market misconduct;⁷ and
- disclosure of interests in listed companies.⁸

¹ The SFC was formed in 1989 as a new statutory supervisory body at the recommendation of the Securities Review Committee following the market crash of October 1987. Responsibility for administering the Securities Ordinance (Cap.333) and related legislation had previously been in the hands of government departments whose repeated pleas for additional resources to cope with rapidly developing markets had too often been delayed or rejected, leaving them unable properly to operate as market watchdogs: SRC Report, paras.1.6 & 1.7.

² Laws of Hong Kong.

³ The Companies Ordinance requirements with which listed companies are principally concerned are the prospectus provisions in Parts II & XII; these are administered in conjunction with the SFC and Stock Exchange.

⁴ Part III, SFO.

⁵ Parts V to XI, SFO (Licensing & Registration, Capital, Accounting & Auditing Requirements, Business Conduct, Supervision & Investigation, Disciplinary, Supervisory Intervention, Appeals); the SFC's investigative powers include at s.179 provisions specifically aimed at instances where the business of a listed company has been conducted with intent to defraud its creditors, for any fraudulent or unlawful purpose or in a manner oppressive to its members, as well as instances where persons engaged in its listing or later management have engaged in fraud.

⁶ Part IV, SFO.

⁷ Part XIII, SFO (Civil) & Part XIV, SFO (Criminal).

⁸ Part XV, SFO.

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4.003 The SFCs regulatory work is undertaken principally by five divisions: corporate finance, supervision of markets, licensing of intermediaries, supervision of intermediaries and enforcement.⁹ The SFC supervises and regulates:

- dealing in securities, futures contracts and leveraged foreign exchange trading;
- advising on securities, futures contracts and corporate finance;
- providing automated trading services, securities margin financing and asset management;
- investment products offered to the public;
- the Stock Exchange, share registrars and the Investor Compensation Company; and
- market participants.

4.004 Hong Kong Exchanges and Clearing is itself a listed company and operates Hong Kong's authorized stock market, derivatives and futures exchanges as well as authorized securities, options and futures clearing houses. The Exchange's functions are organized under Primary Market (listing policy, enforcement and operations, compliance and monitoring), Secondary Market (clearing, risk management and market surveillance) and Support Services (legal, finance, administration, human resources) functions. Pursuant to a series of Memoranda of Understanding dating back to 25 November 1991, the SFC has reserved to itself the regulation of takeovers and mergers of companies whose shares are listed in Hong Kong, the approval of amendments to the rules made by any designated stock exchange and clearing house, along with general listing policy decisions.¹⁰

4.005 However, the SFC has otherwise delegated to the Exchange the regulation of listing-related matters and front-line regulation of issuers. These duties are principally undertaken by way of requiring compliance with the Exchange Listing Rules but extend in addition to administration under delegated authority of the SFCs legal

⁹ Oversight of the SFC rests principally in the Process Review Panel which reviews and advises the SFC upon the adequacy of the SFCs internal procedures and operational guidelines governing the action taken and operational decisions made by the SFC and its staff in the performance of its regulatory functions, including the receipt and handling of complaints, licensing and inspection of intermediaries and disciplinary action; membership of the SFCs Advisory Committee and various regulatory committees (principally the Takeovers and Mergers Panel) draws from professional advisers and market practitioners; while the composition of its regulatory committees ensures that disciplinary action in takeovers matters and also regarding share registrars benefits from market participant perspectives, the major thrust of the SFCs disciplinary work – licensed entities and registered persons – does not.

¹⁰ Recent developments in securities regulation have been nothing short of dramatic: prior to 1986 Hong Kong had four exchanges (founded in 1891, 1969, 1971 and 1972); and even the most demanding rulebook was at around 64 pages shorter than most of today's mobile phone handbooks; the 1973 market crash led to the appointment of a Commissioner for Securities but the 1987 market crash revealed, among other shortcomings, that his office was underfunded; the Securities Review Committee's report of 1989 led to the formation of the SFC, much greater statutory powers and a wholesale improvement in the governance and rules of the Exchange.

"WARNING

The contents of this document have not been reviewed by any regulatory authority in Hong Kong. You are advised to exercise caution in relation to the offer. If you are in any doubt about the contents of this document, you should obtain independent professional advice."

- offers to not more than 50 persons in any event;
- small scale offers, being offers to raise not more than \$5 million;
- offers in respect of which the minimum subscription by any person is \$500,000 or more;
- bonus or scrip dividend offers;
- offers restricted to a company's present and former directors, employees, officers and consultants;
- offers by charitable or educational institutions;
- offers by members or applicants for membership of clubs where the invitees have a common interest and the proceeds are to be applied towards the clubs' affairs;
- an offers comprising the exchange of shares or debentures in the same company which does not result in the increase in the company's share capital or aggregate principal amount outstanding under the debentures, as the case may be.

The following kinds of offers specified in the 17th Schedule are not required to comply with the required by the 18th Schedule health warning:

- offers to professional investors;²²
- offers in connection with invitations to participate in underwriting an offer, placing or rights issue, etc;
- an offer in connection with a takeover, merger or share repurchase, provided such complies with the Codes on Takeovers and Mergers and Share Repurchases;
- offers in connection with SFC-authorized collective investment schemes whose advertising has been authorized by the SFC.

4.008 The definition includes, however, documents by which a company allots or agrees to allot any shares or debentures with a view to those shares or debentures being offered for sale.²³

²² As defined in Part I of Schedule 1 to the Securities and Futures Ordinance.

²³ Section 41, Companies Ordinance.

A prospectus must be in either the English or Chinese language, but in either case contain a translation, state matters specified in Part I of the 3rd Schedule, set out the reports specified in Part II of the 3rd Schedule and contain the following statement as required by the 18th Schedule:

4.009

"IMPORTANT

If you are in any doubt about the contents of this prospectus, you should obtain independent professional advice."

The principal matters specified in Part I of the 3rd Schedule address the company's business and the relative importance of different parts of the business; share capital and a means by which investors may form a valid and justifiable opinion as to the company's financial condition and profitability; details of founders and shares owned by them; the amount to be raised in the offer, the purposes to which it will be put and what amount will be retained for working capital purposes; recent history of share capital issued and options granted; properties and details of any directors' or promoters' interests in the company's acquisition of properties or in other transaction.²⁴ The required reports comprise reports by (a) the company's auditors covering the previous three years' history of the company and its subsidiaries, (b) reporting accountants covering the most recent three-year history of any business²⁵ the acquisition of which is to be funded from the proceeds of the intended issue, and (c) valuers covering the company's properties valued at \$3 million or more.

Prospectuses required of s.38 are not needed in cases of share or debenture issues²⁶ offered to existing shareholders or debenture holders nor to offers where the shares or debentures are in all respects the same as previously-issued shares or debentures²⁷ nor to specific cases where SFC exemption has been obtained.²⁸

4.010

Any prospectus bearing a statement by an expert²⁹ shall not be issued unless the expert has given and not withdrawn his consent to the inclusion of his statement and the prospectus discloses such fact.³⁰ If an expert's statement includes untrue statements then the expert may be civilly liable³¹ but will not be criminally liable merely for untrue statements in a prospectus merely on account of having authorized the inclusion of his statement.³²

4.011

²⁴ The extent of the detail required of the 3rd Schedule is less demanding than that required by the Exchange Listing Rules but is of statutory authority and consequently, of greater significance in the event of material non-disclosure.

²⁵ Whether acquired in the form of an asset & liability purchase or in the form of shares in a company.

²⁶ The provision does not extend to warrants or options to purchase the company's shares or debentures, but SFC exemption may be obtained and the requirements of s.38 otherwise avoided.

²⁷ Section 38(5), Companies Ordinance.

²⁸ Sections 38A(1) & 38A(2), Companies Ordinance; such exemptions in the case of non-listed entities mostly concern structured financial products such as mortgage-backed securities, equity linked notes and similar.

²⁹ "Expert" is defined for the purposes of s.38C as including any person whose profession gives authority to a statement made by him, such as engineer, valuer or accountant.

³⁰ Section 38C, Companies Ordinance.

³¹ Section 40(1), Companies Ordinance.

³² Section 40A(2), Companies Ordinance.

- 4.012 Civil liability attaches to (a) every director,³³ (b) promoter, and (c) every person who has authorized the issue of a prospectus for financial loss or damage sustained by subscribers³⁴ in respect of any untrue statement in the prospectus where they have relied on that statement.³⁵ However, liability will not attach to a director who has withdrawn his consent to a prospectus prior to issue or to any person where the prospectus was issued without his knowledge or consent and he gave notice of the fact upon becoming aware that he had been named or after issue of the prospectus but before shares were allotted he becomes aware of any untrue statement in it he gave notice of gave notice of withdrawing his consent. Civil liability for untrue statements will not attach where such statements are made on the authority of an expert or public official document or statement and the maker of the statement had reasonable grounds to believe it was in fact true.³⁶
- 4.013 Civil liability for untrue statements will not attach to an expert whose consent is required of s.38C where he has either withdrawn his consent prior to issue of the prospectus or having become aware of the untrue statement between issue of the prospectus and allotment of shares, gave notice of withdrawing his consent or was competent to make the statement in question, had reasonable grounds for making it and believed it to be true.³⁷
- 4.014 Section 342E extends the civil liability (and relief from liability) in s.40 to prospectuses issued by non-Hong Kong and other foreign companies pursuant to Part XII.
- 4.015 Criminal liability for untrue statements attaches to any person who has authorized³⁸ the issue of a prospectus containing such untrue statements unless he proves either (a) that the statement was immaterial or (b) he had reasonable grounds to believe; and did believe up to the time of issue, that the statement in question was true.³⁹
- 4.016 No prospectus may be issued by or on behalf of a company unless it (a) complies with the requirements of the Ordinance, (b) has been authorized for registration with the Registrar of Companies, and (c) has in fact been so registered. Although s.38D(3) states that application for authorisation to register a prospectus, accompanied by experts' consents and copies of material contracts and reports covered in the prospectus, must be addressed to the SFC the Securities and Futures (Transfer of

³³ Including any person who was a director at the time of issue and every person who has authorized himself to be named as director or agreed to become a director.

³⁴ The class of potential litigants is extended by provisions in the 22nd Schedule to the Ordinance to include in addition (a) persons who acquire the company's shares through an agent, and (b) persons who acquire the company's shares pursuant to arrangements between the issuer or vendor of the shares and intermediaries appointed for the purposes of the offer. Moreover, the fact that a person has since sold his shares and is no longer a member or has merely exercised a right to subscribe and has not yet become a member will not bar his claim: s.40B, Companies Ordinance.

³⁵ Section 40(1), Companies Ordinance.

³⁶ Section 40(2), Companies Ordinance.

³⁷ Section 40(3), Companies Ordinance.

³⁸ As is noted above, this does not include experts who have consented to the inclusion of statements.

³⁹ Section 40A, Companies Ordinance.

Functions – Stock Exchange Company) Order operates to delegate to the Stock Exchange the task of vetting of prospectuses relating to listings.⁴⁰

Once a prospectus has been issued and registered and states that a minimum subscription must be raised in order to proceed, no allotment of shares or debentures shall be made unless that minimum is raised.⁴¹ This provision is, however, almost entirely academic since issuers invariably engage financial institutions as underwriters to ensure a full demand for the securities on offer. But no allotment may be made in any event until at least three days after the issue of the prospectus or such longer period as may be provided by the prospectus, but in no event beyond 30 days after the date of issue.⁴²

The impact of seeking a listing of shares or debentures imposes a further deadline: where a prospectus states that application will be made for listing the shares or securities, if permission to list has not been obtained before the third day after issue of the prospectus (or where initial application was rejected, within three weeks⁴³ from the closing of the subscription lists) then any subsequent allotment will be void⁴⁴ and the company will be required to repay application monies received, together with interest, if this is not done within eight days.⁴⁵

The prospectus requirements of Hong Kong incorporated companies are applicable to foreign companies, regardless of whether they have established a place of business in Hong Kong and regardless of whether they have registered that place of business pursuant to Part XI of the Ordinance.⁴⁶ Given the additional feature of foreign incorporation, however, a prospectus issued by a foreign company must address in addition particulars concerning the foreign company's (a) constitution or similar instrument, (b) applicable law by which the foreign company was formed, (c) the date on and country in which the foreign company was formed, (d) whether the foreign company has in fact registered a place of business pursuant to Part XI of the Ordinance, and (e) a Hong Kong address where such documents may be inspected. The prospectus registered by a foreign company must comply with the 3rd Schedule requirements as if the company were a Hong Kong company and criminal liability attaches to its directors and responsible persons for breach unless they can show ignorance of the requirement, honest mistake or the matter is otherwise immaterial.

⁴⁰ The task of vetting prospectuses in relation to offers which do not involve listing, such as structured financial products, remains in the hands of the SFC. The impact of the dual filing regime means that the SFC retains its powers to invoke sanctions for misleading statements in prospectuses vetted by the Exchange in the case of intended listings: s.384 of the SFO creates the offence of providing misleading information to the Stock Exchange in compliance with a "relevant provision", which includes in particular Parts II & XII of the Companies Ordinance concerning prospectuses.

⁴¹ Section 42, Companies Ordinance; allotments contravening this section are deemed voidable at the instance of the allottee: s.44, Companies Ordinance.

⁴² Sections 44A(1) & 44A(2), Companies Ordinance.

⁴³ The period may be extended but in no event beyond six weeks.

⁴⁴ Section 44B(1), Companies Ordinance: contrast the position with minimum subscriptions addressed by s.42.

⁴⁵ Section 44B(2), Companies Ordinance.

⁴⁶ Section 342(1), Companies Ordinance.

- 4.020** Compliance with the full rigour of the prospectus requirements may be reduced in the case of foreign companies upon application to the SFC⁴⁷ but registration requirements are otherwise similar to those applicable to Hong Kong companies.
- 4.021** As is the case with Hong Kong companies, civil liability (and relief therefrom) attaches to directors, promoters and others whose consents are given in the prospectus for any untrue statements contained⁴⁸ but only as regards the prospectuses of such foreign companies which are issued, circulated or distributed in Hong Kong.
- 4.022** Also as is the case with Hong Kong companies, criminal liability for untrue statements attaches to any person who has authorized⁴⁹ the issue of a prospectus containing such untrue statements unless he proves either (a) that the statement was immaterial or (b) he had reasonable grounds to believe, and did believe up to the time of issue, that the statement in question was true.⁵⁰ In the case of foreign companies, criminal liability extends to persons who authorize the circulation or distribution of an offending prospectus and is not confined, as the case with Hong Kong companies, to persons who authorized its issue. Also, as is the case with Hong Kong companies, an expert will not be liable criminally only by having given his consent to the inclusion of a statement purporting to be made by him as expert.⁵¹

Securities and Futures Ordinance

Regulation of Offers

- 4.023** While the Companies Ordinance prescribed creates criminal and civil liability for what is (and is not) contained in a prospectus, the SFO creates a criminal offence of issuing or possessing for the purposes of issue any advertisement, invitation or document which, to the person's knowledge contains an invitation to the public to acquire, dispose of or subscribe for securities or to underwrite their acquisition or disposal, unless the advertisement, invitation or document in question complies with the prospectus requirements of the Companies Ordinance.⁵² Specific exemptions apply to persons legitimately involved in the preparation of prospectus documents prior to their authorization such as licensed intermediaries, printers and media and similar broadcasters.
- 4.024** A further criminal offence is created where a person fraudulently or recklessly induces others to enter into an agreement to acquire, dispose of or subscribe for securities or to underwrite their acquisition or disposal.⁵³ And where there has been fraudulent, reckless – or even negligent – inducement to others to enter into such

⁴⁷ Section 342A, Companies Ordinance.

⁴⁸ Section 342E, Companies Ordinance, extending the impact of s.40.

⁴⁹ As is noted above, this does not include experts who have consented to the inclusion of statements.

⁵⁰ Section 342F(1), Companies Ordinance.

⁵¹ Section 342F(2), Companies Ordinance.

⁵² Section 103(1), SFO; penalties extend to a fine of \$500,000 and three years in prison.

⁵³ Section 107, SFO.

agreement, the person responsible for inducing the agreement may face civil liability.⁵⁴

Investigations

The SFC has wide powers to require the production of records and compel officers and staff of listed companies as well as its auditors and other persons⁵⁵ to provide explanations or statements and verify the same if it appears to the SFC that there are circumstances suggesting:⁵⁶

4.025

- those concerned in the process of its listing have engaged in fraud or other misfeasance;
- those concerned in its later management have engaged in fraud, misfeasance or other misconduct towards its members;
- the business of the company has been carried on with intent to defraud creditors, for a fraudulent or unlawful purpose, in a manner oppressive to its members;
- the company was in fact formed to pursue fraudulent or unlawful purposes;
- its members have not been given all information reasonably expected; or
- matters on which the SFC is providing assistance internationally relate to the company.

The SFC's powers are couched with the precursor that requiring the production of records, explanation and statements must be founded upon a reasonable belief that the person to whom the requirement is addressed is able to render relevant assistance and anyone required to attend at the SFC's offices to provide explanations failing to do so may be prosecuted. A person is not excused from compliance with the obligation to provide explanations only on the ground that to do so may incriminate him.⁵⁷

4.026

Market Misconduct

Parts XIII and XIV of the SFO address civil and criminal liability⁵⁸ for misconduct in relation to a listed company's securities. Market misconduct is defined as:

4.027

- insider dealing (dealing or counseling or procuring the dealing in a listed company's securities with the benefit of price-sensitive information not generally known to the market);

⁵⁴ Section 108, SFO: this provision does not require there to have been any prior prosecution or conviction in respect of the inducement, and in contrast with the equivalent criminal liability provided for at s.107, a person need only prove negligent misrepresentation in order to secure compensation.

⁵⁵ While this would obviously include the company's bankers and brokers regarding the company's business records, it would not extend to matters covered by legal professional privilege.

⁵⁶ Section 179, SFO.

⁵⁷ Sections 179(13), 179(16).

⁵⁸ There are provisions designed to avoid double jeopardy: once civil proceedings have been commenced in the MMT then the matters complained of cannot thereafter be pursued in the criminal courts (s.307, SFO) and vice versa (s.283, SFO).

- false trading (intentionally or recklessly creating a false or misleading appearance of active trading in, or with respect to the market for, the listed company's securities);
- price rigging (entering into transactions of sale or purchase of a listed company's securities not involving the change of beneficial ownership but having the effect of interfering with their market price, or entering into a fictitious or artificial transaction with the intention, or being reckless as to whether, it will have the effect of interfering with their market price);
- disclosure of information concerning prohibited transactions (disclosing information, even truthful information, the effect of which is likely to interfere with the market price of a listed company's shares because the information concerns a transaction which is itself a form of market misconduct);
- disclosure of false or misleading information inducing transactions (disclosing information either false or misleading as to a material fact or rendered false or misleading through the omission of a material fact by a person who knows or is reckless as to whether it is false or misleading, which information is likely to induce others to deal in securities or futures contracts); or
- stock market manipulation (the carrying out of two or more transactions likely to increase, reduce or maintain the price of a listed company's securities with the intention of inducing another to deal in those securities or the securities of a related company).

4.028 Where market misconduct has been found in either civil proceedings before the Market Misconduct Tribunal or criminal proceedings in the criminal courts, investors suffering loss may pursue statutory rights of action against those responsible for the misconduct.⁵⁹

4.029 As was the case with insider dealing proceedings before the Insider Dealing Tribunal, listed company officers have featured as being found culpable of market misconduct in the Market Misconduct Tribunal's initial reports.⁶⁰

4.030 Although the elements of market misconduct wrongdoing are the same regardless of whether allegations are pursued through the Market Misconduct Tribunal or the criminal courts, there are significant differences in procedure and penalty. Whereas the criminal courts are bound by established principles as to admissibility of evidence and the rule against self-incrimination, the MMT is entitled to admit such evidence as it sees fit, even if that evidence would not be admissible in civil or criminal proceedings in a court of law,⁶¹ and is empowered to require those attending to give evidence before it to answer questions put to them.⁶² Whereas the criminal

⁵⁹ Section 281, SFO (civil) and s.305, SFO (criminal).

⁶⁰ Reports of the MMT concerning dealings in Sunny Global Holdings Ltd and Mobicon Group Ltd.

⁶¹ Section 253(1)(a), SFO; this includes compelled responses to SFC inquiries.

⁶² Section 253(4), SFO.

courts may impose substantial fines and terms of imprisonment, the MMT's powers are inherently protective, not penal. Nevertheless, the MMT may order:

- that those found culpable of market misconduct shall "cease and desist" from market misconduct in the future;⁶³
- shall for up to five years not deal in securities;⁶⁴
- shall for up to five years not hold office as director, liquidator, receiver or manager of a listed company or other specified corporation;⁶⁵
- shall pay to the Government any profits made or losses avoided as a result of the misconduct;⁶⁶
- shall pay to the Government and SFC their costs reasonably incurred in the proceedings;⁶⁷ and
- that any professional body of which the culpable person is a member be recommended to take disciplinary action against him.⁶⁸

Disclosure of Directors, Chief Executives and Shareholders' Substantial Interests

Part XV of the SFO contains detailed and complex provisions⁶⁹ requiring directors, chief executives and substantial shareholders of listed companies to disclose their interests in those companies. Although the rationale for these provisions was originally built upon disclosure provisions in Part VI of the 1985 UK Companies Act and intended to assist listed companies keep track of beneficial interests in their share registers⁷⁰ the equivalent Hong Kong provisions quickly became used as an important means of assisting regulators in market surveillance.⁷¹

4.031

The broad thrust of the Part XV provisions is straightforward: directors and chief executives are required to disclose to (a) the listed company and (b) the Exchange any interest they have in the listed company's voting shares. Persons who are not directors or chief executives are required to disclose to the listed company and the Exchange substantial interests (five per cent or more) in the company's voting shares. In all cases, disclosure is required within three days of the event triggering disclosure. Listed companies are required to maintain registers of disclosed interests.

4.032

⁶³ Section 257(1)(c), SFO: there is no time limit on this order.

⁶⁴ Section 257(1)(b), SFO.

⁶⁵ Section 257(1)(a), SFO.

⁶⁶ Section 257(1)(d), SFO.

⁶⁷ Section 257(1)(e) & (f), SFO.

⁶⁸ Section 257(1)(g), SFO.

⁶⁹ So complex that the SFCs own "Outline of Part XV" guidance note had to be extensively revised only months after being originally released and prosecutions, albeit relatively frequent, are in most cases met with only modest fines (and in one case an absolute discharge) unless there is evidence of willful failure to disclose.

⁷⁰ Substantial shareholders were required to disclose to listed companies their acquisitions and disposals and company secretaries routinely required nominee shareholders to respond to so-called "s.212 notices" and disclose to the listed company – and no one else – whom they regarded as beneficially interested in shares registered in their names.

⁷¹ The volume of and duplication inherent in, information disclosed often renders it unintelligible to all but those prepared to spend significant time analysing it.

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