

online version

## HKEX Disciplinary Actions September to November 2024

The Hong Kong Stock Exchange (**HKEX**) published the results of eight disciplinary actions against listed issuers and/or their directors between September and November 2024. The cases involved, among others, issuers granting loans or making investments without conducting proper due diligence, risk assessment and on-going monitoring, failure to avoid or properly manage directors' conflicts of interest, and directors' failure to exercise independent judgement in determining whether transactions were in the issuer's best interest. Three cases involved directors' failure to cooperate in HKEX investigations – an obligation which continues after a person ceases to be a director and after the issuer's delisting. The cases are summarised below.

### 1. HKEX Disciplinary Action against Sunshine 100 China Holdings Ltd and Eight Directors

#### **HKEX issuers' obligations: notifiable and connected transactions and financial reporting**

The case involved Sunshine 100 China Holdings Ltd (**Sunshine 100**) and the conduct of Mr. Yi Xiaodi (**Mr. Xiaodi**), its executive director and chairman, Mr. Fan Xiaochong (**Mr. Xiaochong**), its executive director and vice chairman, two non-executive directors, three independent non-executive directors and one former independent non-executive director (together, the **Relevant Directors**).

Between 2020 and 2021, Sunshine 100 granted three loans amounting to RMB1.05 billion in total to borrowers with financial difficulties who were themselves the creditors of the debts of other ultimate borrowers. Those debts were secured primarily by a property in Beijing. Despite their awareness of the significant credit risks presented by the loans, the Relevant Directors envisioned that if the borrowers and ultimate borrowers defaulted, the company would be able to acquire the Beijing property at a substantial price discount as a distressed asset in a judicial auction (**Fire Sale Opportunity**).

Despite knowing that the poor financial creditworthiness of the borrowers and ultimate borrowers presented significant risks, the Relevant Directors failed to conduct adequate due diligence before making the loans, did not obtain legal advice, and lacked a strategy to recover the amount owed if the Fire Sale Opportunity was not successful.

In November 2022, Sunshine 100 made a further loan to one of the borrowers, which, when aggregated with the earlier loans, constituted a major transaction under Chapter 14 of the HKEX Listing Rules with a total outstanding amount of RMB1.11 billion. However, Sunshine 100 failed to comply with the announcement, circular and shareholders' approval requirements.

Mr. Xiaodi and Mr. Xiaochong were responsible for procuring due diligence and executing the transactions.

The borrowers failed to repay the loans, resulting in Sunshine 100 making Expected Credit Loss provisions that increased annually, reaching a total of RMB 619.9 million in 2023, more than half of the loans' principal amount. By April 2024, the Relevant Directors had not devised a strategy for recovering the outstanding loans or acquiring the Beijing property, despite two borrowers successfully obtaining judgments in PRC courts on accounts receivables arising from the ultimate borrowers' debts.

Sunshine 100 had additionally provided financial assistance on two other occasions in 2022. One transaction was a discloseable transaction under Chapter 14 of the HKEX Listing Rules, and the other was a major transaction under Chapter 14 and a connected transaction under Chapter 14A of the

HKEX Listing Rules. The company failed to comply with the announcement, circular and shareholders' approval requirements.

Sunshine 100 also failed to publish certain interim and annual results and reports as required under Chapter 13 of the HKEX Listing Rules in 2022 and 2023 due to its failure to keep proper records of the loans.

Sunshine 100 conceded that there were deficiencies in its internal controls which contributed to the company's breaches of the requirements of Chapters 13, 14 and 14A of the HKEX Listing Rules described above.

### **Breaches of the HKEX Listing Rules**

Sunshine 100 was found to have breached:

- HKEX Listing Rules 13.46(2)(a), 13.48, 13.49(1) and 13.49(6) in failing to publish its annual and interim results and despatch its annual and interim reports within the prescribed time limits; and
- HKEX Listing Rules 14.34, 14.38A, 14.40 and 14A.35 in failing to comply with the announcement, circular and/or shareholders' approval requirements applicable to the loans and its provision of financial assistance on two occasions in 2022.

The Relevant Directors were found to have breached:

- HKEX Listing Rule 3.08 in failing to exercise due skill, care and diligence in relation to the grant and enforcement of the loans; and
- HKEX Listing Rule 3.08 and their obligations as now set out in HKEX Listing Rule 3.09B(2) to use their best endeavours to procure the company's compliance with the HKEX Listing Rules.

### **Sanctions imposed by HKEX Listing Committee under Chapter 2A of the HKEX Listing Rules**

The HKEX Listing Committee criticised Sunshine 100 and censured Mr. Xiaodi and Mr. Xiaochong. It also criticised the six other directors involved and directed them, as well as Mr. Xiaodi and Mr. Xiaochong, to attend directors' training.

The Statement of Disciplinary Action is available *here*.

## **2. HKEX Disciplinary Action against a Director of Tenfu (Cayman) Holdings Company Limited**

### **HKEX listed issuer: director's conflict of duty**

In December 2023, Tenfu (Cayman) Holdings Company Limited (**Tenfu**) authorised a non-executive director, Mr. Tseng Ming-Sung (**Mr. Tseng**), to purchase its shares on its behalf under the company's share repurchase scheme. At the same time, Mr. Tseng agreed with two substantial shareholders of Tenfu that he would also buy Tenfu shares on their behalf. Mr. Tseng then made a number of purchases of Tenfu shares on behalf of the company and the two substantial shareholders.

Mr. Tseng's dual roles involved a conflict of duty, but he failed to inform Tenfu that he was also trading its shares on behalf of the substantial shareholders or take any action to manage the conflict.

### **Breach of the HKEX Listing Rules**

The HKEX Listing Committee found that Mr. Tseng had breached HKEX Listing Rule 3.08 in failing to take any action to avoid, manage or disclose to Tenfu the conflict of duty that arose on his agreeing to purchase the company's shares on behalf of the two substantial shareholders at the same time as purchasing its shares on behalf of Tenfu. The fact that Mr. Tseng did not benefit personally from the transactions was irrelevant: he should have taken steps to avoid or properly manage the conflict.

### **Public statement involving criticism under HKEX Listing Rule 2A.10**

The HKEX Listing Committee criticised Mr. Tseng and required him to undertake 15 hours of training.

The HKEX's Statement of Disciplinary Action is available *here*.

### **3. HKEX Disciplinary Action against a Former Director of Christine International Holdings Limited**

Mr. Dun-Ching Hung (**Mr. Hung**), a former director of Christine International Holdings Limited (**Christine International**) had failed to undertake 15 hours of training as directed in a previous disciplinary action against Mr. Hung and other directors of the company. The HKEX Listing Committee found Mr. Hung's breach of its training direction to be intentional and egregious and determined that this demonstrated that he was not suitable to act as a director of the company.

#### **Imposition of a director unsuitability statement with follow-on action under HKEX Listing Rule 2A.10A(2)(b)**

The HKEX Listing Committee censured Mr. Hung and issued a director unsuitability statement directing that:

- it considered Mr. Hung to be unsuitable to act as a director or senior management member of Christine International or any of its subsidiaries; and
- Christine International's listing should be cancelled under HKEX Listing Rule 2A.10A(2)(b) if Mr. Hung continued as a director or senior management member of the company or its subsidiaries 14 days after the Listing Committee's statement of disciplinary action.

The HKEX's Statement of Disciplinary Action is available *here*.

### **4. HKEX Disciplinary Action against two Former Directors of Suchuang Gas Corporation Limited (Delisted)**

The case involved Mr. Su A. Ping (**Mr. Su**), the former chairman and an executive director of Suchuang Gas Corporation Limited, and Mr. Du Shao Zhou (**Mr. Du**), a former executive director (together, the **Directors**). During an investigation into whether the Directors had fulfilled their duties and obligations under the HKEX Listing Rules, the HKEX Listing Division sent investigation and reminder letters to the Directors to which they failed to respond in time or at all.

#### **Breach of the HKEX Listing Rules' obligation to cooperate in HKEX investigation**

The HKEX Listing Committee found that the Directors had breached HKEX Listing Rule 3.09C in failing to cooperate in the investigation. It noted in particular that the Directors' obligation to provide information reasonably requested by the HKEX did not lapse after their resignation and after the issuer's delisting. The HKEX Listing Committee considered the Directors' failure to discharge their responsibilities under the HKEX Listing Rules to be a serious breach of the Listing Rules.

The HKEX Listing Committee censured the Directors and issued a statement directing that they were unsuitable to act as directors or senior management members of the company or its subsidiaries.

The HKEX's Statement of Disciplinary Action is available *here*.

### **5. HKEX Disciplinary Action against four Directors of China General Education Group Limited**

The case involved Mr. Niu Sanping (**Mr. Niu S**) and his son, Mr. Niu Jian (**Mr. Niu J**), former executive directors of the company and the company's former chairman and CEO, respectively, and two other executive directors of the company, Mr. Niu X and Ms Zhang. The four individuals are referred to together as the **Relevant Directors**.

The disciplinary action related to problematic transactions conducted shortly before and after the company's listing in July 2021. Mr. Niu S and his son are the company's controlling shareholders.

Shortly before the company listed and in order to shore up demand for its shares on listing, Mr. Niu S entered into a pre-IPO investment agreement on behalf of the company with a third party, Tai He International Group Limited (**Tai He**). Under the terms of the agreement, Tai He would subscribe for around HK\$100 million of the company's shares in the IPO, and in return, the company would lend HK\$25 million to Tai He and subscribe for HK\$60 million of investment products designated by Tai He, although the company would not receive any return on those investments.

The pre-IPO investment agreement was allegedly rescinded three days before the company listed following the receipt of advice to do so. However, it was later discovered that the company had entered into two transactions on substantially the same terms as its obligations under the investment agreement: (i) a HK\$25 million loan to a borrower designated by Tai He (**Loan A**) procured by Mr. Niu S and Mr. Niu J and approved by the Relevant Directors; and (ii) a HK\$60 million investment in a fund introduced by Tai He (**Fund**). The company made a loss of HK\$5 million on Loan A. It received a repayment of HK\$54.45 of the amount invested in the Fund but received no return on its investment.

The company also lent HK\$40 million interest free to a friend of Mr. Niu J (**Loan B**). No due diligence or risk assessment was conducted, apparently because Mr. Niu J was satisfied that the borrower could repay the loan. Loan B was made shortly before the company's listing and the amount was similar to the amount of the borrower's subscription in the company's IPO. The company denied that Loan B and the borrower's IPO subscription were related. Loan B was repaid in full.

An internal controls review revealed deficiencies in the company's internal controls: it lacked investment risk controls and a loan management mechanism. There were no internal control policies or procedures relating to the granting of loans and payments to third parties at the time of the transactions described above which prevented other board members detecting the problematic transactions.

### **Breaches of the directors' duties under HKEX Listing Rule 3.08**

The Relevant Directors were found to have breached HKEX Listing Rule 3.08 in several ways:

- Mr. Niu S entered into the pre-IPO investment agreement without informing the rest of the board or obtaining professional advice. He and Mr. Niu J procured the company to grant Loan A. Mr. Niu X and Ms Zhang approved the grant of Loan A without questioning its rationale. The Relevant Directors failed to ensure the conduct of proper due diligence on the borrower and the recoverability of Loan A.
- The Relevant Directors failed to exercise due skill, care and diligence in approving the company's investment in the Fund. They could not demonstrate the commercial rationale for the company's investment in the Fund, especially since the pre-IPO investment agreement had been rescinded. They also failed to conduct proper due diligence on the Fund and the Fund manager and lacked even basic information as to its investment objective and assets. They did not consider any other investment products.
- Mr. Niu S and Mr. Niu J used the company's money to make Loan B to Mr. Niu J's friend. There was no commercial rationale for the grant of Loan B since it did not bear interest. Mr. Niu S and Mr. Niu J failed to: (i) act for proper purpose; (ii) be answerable to the company for the application of its assets; (iii) avoid actual and potential conflicts of duty; and (iv) exercise sufficient skill, care and diligence.
- The Relevant Directors did not ensure the company had an effective internal control system at the relevant time.

The HKEX Listing Committee censured Mr. Niu S and Mr. Niu J. It also censured two Mr. Niu X and Ms Zhang, and directed them to attend training.

The HKEX's Statement of Disciplinary Action is available *here*.

## **6. HKEX Disciplinary Action against three Former Directors of YNBY International Limited (Formerly Ban Loong Holdings Limited)**

The HKEX Listing Committee censured and imposed a director unsuitability statement with respect to three former directors of the company for failing to cooperate with an HKEX Listing Division investigation into (among others) whether they had discharged their duties and obligations under the HKEX Listing Rules.

The HKEX Listing Committee noted that it considers failure to cooperate in an HKEX investigation to be a serious breach of the HKEX Listing Rules and that a director's obligation to cooperate does not lapse after a person ceases to be a director of an issuer.

The HKEX's Statement of Disciplinary Action is available *here*.

## **7. HKEX Disciplinary Action against three Former Directors of National Arts Group Holdings Limited (Delisted)**

Three former directors of the company (**Directors**) approved the company's acquisitions of two target companies holding property units under construction in Malaysia. At the time of the acquisitions, the target companies had not paid the developers for the property units in full. Despite this, the company paid in full by issuing new shares valued at HK\$108.8 million to the vendors. The vendors and/or their related parties agreed to be responsible for the target companies' outstanding payment obligations to the developer. A lock-up arrangement was put in place for the consideration shares allotted to one of the vendors, although the company later agreed to its partial release. The Directors failed to prevent the consideration shares being sold without the company's consent and both vendors sold the consideration shares shortly after the acquisitions. The company was wound up by the court without the property units having been delivered.

### **Breaches of directors' duties under GEM Listing Rule 5.01**

The Directors were found to have breached their directors' duties under GEM Listing Rule 5.01 in failing to exercise reasonable skill, care and diligence to safeguard the company's interest in the acquisitions. In particular:

- the Directors should have been aware of the risks that the vendors might not honour their obligations to pay the outstanding amounts owed to the developers and that the developers might not complete construction. Before the second acquisition, the HKEX had warned the company of construction delays and difficulties in obtaining project updates experienced by another listed issuer on a similar project;
- the Directors failed in their duty to manage these risks despite having been told that another listed issuer had experienced problems on a very similar transaction;
- the Directors should have at least conducted due diligence on the vendors' and their related parties' financial capability to meet the outstanding payment obligations;
- the Directors should have taken steps to properly monitor the projects, including that the outstanding payments were made and that construction was progressing. They failed to ensure that the company received timely updates on these matters; and
- the Directors should have put arrangements in place to prevent the vendor in the first acquisition from selling the consideration shares.

The GEM Listing Committee criticised the Directors and made their future appointment as a director of any HKEX-listed company conditional upon their completion of directors' training.

The HKEX's Statement of Disciplinary Action is available *here*.

## **8. HKEX Disciplinary Action against China Zhengtong Auto Services Holdings Limited and Five Former Directors**

In this case, the HKEX Listing Committee criticised the company and censured and imposed a director unsuitability statement with respect to Mr. Wang, the company's former chairman and executive director, and Mr. Shao, a former executive director of the company. It also censured three other former executive directors and made their future appointment as a director of any HKEX-listed company conditional upon their completion of directors' training.

A subsidiary of the company entered into an undertaking in 2016 to pay any shortfall if a company majority-owned by the son of the chairman failed to repay a loan and redeem two investments in a total amount of RMB1.8 billion. In 2020, the 2016 undertaking was replaced by three agreements. Each of the 2016 undertaking and the three 2020 agreements (together) were major and connected transactions of the company, although the company did not comply with the announcement, circular and independent shareholders' approval requirements under Chapters 14 and 14A of the HKEX Listing Rules.

In December 2021, the company was notified of PRC court judgments holding the subsidiary liable for amounts due under the loan and with respect to the two investments and announced the 2016 undertaking and 2020 agreements.

The company's chairman was an executive director and legal representative of the subsidiary when the 2016 undertaking and 2020 agreements were entered into. He approved both without declaring and avoiding his conflict of interest. Nor did he disclose to the other directors who approved the 2020 agreements the fact that they involved a company that was majority-controlled by his son. The company's other directors were unaware of the 2016 undertaking and 2020 agreements until the company was notified of the PRC court judgments in 2021.

## **Breaches of the HKEX Listing Rules**

### ***Listed issuer's breaches of notifiable and connected transaction requirements***

The company was found to have breached the announcement, circular and independent shareholders' approval requirements under Chapters 14 and 14A of the HKEX Listing Rules in relation to the 2016 undertaking and the 2020 agreements.

### ***Breaches by the company's former chairman***

Mr. Wang, the company's former chairman, was found to have breached HKEX Listing Rule 3.08 and his obligations as now set out in HKEX Listing Rule 3.09 to comply with the HKEX Listing Rules and use best endeavours to ensure the company's compliance with the HKEX Listing Rules. The breaches on the part of Mr. Wang included:

- failure to declare and avoid his conflict of interest in the 2016 undertaking and 2020 agreements by disclosing that the company whose obligations were assumed was a connected person of the company and abstaining from approving them;
- in approving the subsidiary's entry into these transactions which were harmful to the company, Mr. Wang did not act in the interest of the company and for a proper purpose;
- failure to exercise his independent judgement in assessing whether the 2020 agreements were in the company's interest. In his submission to the company, he claimed that he had relied on the senior management's and relevant departments' approval of those agreements in deciding to approve them; and
- failure to procure the company's compliance with the HKEX Listing Rules. He did not raise the Listing Rules' implications of the 2016 undertaking and 2020 agreements with the board and failed to obtain compliance advice.

Mr. Wang additionally breached the HKEX Listing Rules by failing to cooperate in the HKEX's investigation.

### ***Breaches by the three former executive directors who approved the 2020 agreements***

The three former executive directors were found to have breached Listing Rule 3.08 by:

- failing to exercise their independent judgement in evaluating whether the three 2020 agreements were in the interest of the company. Even if the agreements were considered non-objectionable by other departments or staff of the company, the directors still had a duty to consider the potential risks for the company in entering into them. In approving the agreements, they failed to protect the company's interest;
- failing to inform the other board members of the 2020 agreements or discuss them with the board, in particular the independent non-executive directors; and
- failing to procure the company's compliance with the HKEX Listing Rules in relation to the 2020 agreements. They should not have placed unquestioning reliance on the company's compliance department and should instead have followed up with the department as to the company's Listing Rule compliance. The size of the transactions alone should have put the directors on notice that they likely triggered obligations under the HKEX Listing Rules, but they took no steps to determine whether this possibility had been considered.

### ***Breach by Mr. Shao***

Mr. Shao was found to have committed a serious breach of the HKEX Listing Rules in failing to cooperate in the HKEX Listing Division's investigation.

- Directors must avoid conflicts of interest and must always put the issuer's interest before their own.
- Before approving transactions, directors must exercise independent judgement in determining whether the transaction is in the issuer's interest.
- Directors are responsible for ensuring the issuer's compliance with the HKEX Listing Rules. Excessive or unquestioning reliance on the issuer's staff can amount to failure on the part of directors to exercise due skill, care and diligence.

The HKEX's Statement of Disciplinary Action is available *here*.

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