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# SFC Holds IPO Sponsor Principals Jointly And Severally Liable In Discharge Of Responsibilities

## Introduction

The Securities and Futures Commission (**SFC**) announced on 20 November 2012 that it has banned Mr. Wong Tang Chung, a former responsible officer and executive director of Mega Capital (Asia) Company Limited (**Mega Capital**), from re-entering the industry for three years from 19 November 2012 for failing to discharge his duties as one of the two sponsor principals and responsible officers obliged to supervise the transaction team on the listing application of Hontex International Holdings Company Limited (**Hontex**) on the Main Board of the Stock Exchange of Hong Kong Limited (**SEHK**).

The listing of Hontex led to a recent landmark case. The SFC alleged that Hontex’s prospectus contained materially misleading and false information. Following Hontex’s acknowledgement of such allegation, the Court of First Instance imposed an order on Hontex to make an offer to repurchase its investors’ shares, which is the first order of its kind to be made under section 213 of the Securities and Futures Ordinance (**SFO**). The SFC also revoked the licence of Mega Capital, the sole sponsor of Hontex’s listing application and imposed a record high fine of HK$42 million.

Wong argued that he should not be held responsible because he played only a secondary role on the listing and the principal officer of Mega Capital in charge of Hontex’s listing was another sponsor principal and responsible officer, Mr Hong Hui Lung. The SFC revoked Hong’s approval as responsible officer and representative licence on 7 June 2012. However, the SFC insisted that Wong and Hong are jointly and severally liable in discharging their roles as sponsor principals.

The press release of the SFC in relation to banning Wong from re-entering the industry is available on the SFC’s website [here](http://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=12PR123) ([see archive](1.pdf)).

## Barring Wong Tang Chung From The Market

The SFC’s investigation found that Wong had failed to discharge his duties as a sponsor principal and a responsible officer on the listing application of Hontex, as a result of which the SFC has barred him from re-entering the industry for three years from 19 November 2012 to 18 November 2015. Wong was licensed under the SFO to carry on Type 1 (dealing in securities), Type 4 (advising on securities) and Type 6 (advising on corporate finance) regulated activities.

### Joint and Several Liability of Sponsor Principals on a Listing Application

Paragraph 1.2.5 of the Additional Fit and Proper Guidelines for Corporations and Authorized Financial Institutions applying or continuing to act as Sponsors and Compliance Advisers (**Sponsor Guidelines**) provides that a corporate finance firm should appoint a transaction team to carry out each sponsor engagement of listing application and each transaction team should include at least one principal who acts as the supervisor of the team.

Paragraph 1.3.3 of the Sponsor Guidelines states that the principal should be involved in the making of the key decisions relating to the work carried out by the transaction team. It is provided that the principal should, among others, be involved in determining the breadth and depth of the due diligence review and making a critical assessment of the results of the due diligence and overall assessment of the adequacy of the due diligence.

The note to paragraph 1.3.3 of the Sponsor Guidelines makes it clear that where circumstances require, a transaction team may appoint more than one principal and such principals shall be jointly and severally responsible in discharging their roles as principals.

### Main Findings of the Investigation of Wong Tang Chung

The main findings of the SFC’s investigation on Wong are as follows:

#### Refusal to accept responsibilities as sponsor principal

Wong claimed that he should not be held responsible because he only took a secondary role on the listing of Hontex and the principal officer in charge of Hontex’s listing was his colleague, Hong, another responsible officer and sponsor principal of the transaction team. Wong further denied responsibilities by claiming that he had not been involved in drafting the prospectus or the due diligence inquiries performed by the transaction team.

His principal involvement in the listing related to giving technical advice to the transaction team, for example providing technical guidance on the direction and sufficiency of the answers provided by Mega Capital in response to enquiries from SEHK.

According to the note to paragraph 1.3.3 of the Sponsor Guidelines, sponsor principals of a transaction team are jointly and severally responsible in the discharge of their roles as sponsor principals. The SFC therefore concluded that Wong could not limit his responsibility to the matters that he involved himself in or shift his responsibility to another sponsor principal.

#### Supervisory failures

The SFC found that Wong failed to properly and adequately supervise the transaction team on Hontex’s listing. He admitted that he did not read most of the emails relating to Hontex’s listing application even though emails were copied to him. Wong also failed to fully assess the quality and adequacy of the due diligence inquiries performed by the transaction team. He did not review the due diligence questionnaires completed by the transaction team with Hontex’s major customers and suppliers. As a result, he failed to realise that material information (such as transaction figures with Hontex) was missing from most of the questionnaires and he failed to instruct the transaction team to follow up on the missing information.

#### Breach of sponsor’s undertaking and filing untrue declaration with SEHK

Wong and Hong jointly signed and submitted the sponsor’s undertaking and declaration to SEHK as sponsor principals to confirm that Mega Capital would/ had made reasonable due diligence inquiries and all information provided to the SEHK was true in all material respects and did not omit any material information. However, the SFC’s findings show that Wong did not take adequate steps to ensure the transaction team had conducted due diligence properly or at all.

## Other Information On The Hontex Case

### Unprecedented Court Order Against Hontex

Hontex is a Fujian-based fabrics manufacturer and seller and was listed on the SEHK on 24 December 2009. Its trading was suspended by the SEHK on 30 March 2010, at the direction of the SFC.

The SFC alleged that, among others, Hontex has materially overstated its financial position including its turnover and the value of its cash and cash equivalents in its prospectus thereby breaching section 298 of the SFO by disclosing materially false or misleading information in its prospectus which was likely to have induced investors to subscribe for and purchase its shares. The SFC commenced proceedings under section 213 of the SFO which authorises the SFC to apply to the Court of First Instance for orders against persons who have breached the provisions of SFO.

Hontex acknowledged in an agreed statement with the SFC that it was reckless in allowing materially false and misleading information to be included in its prospectus contrary to section 298 of the SFO. Based on Hontex’s acknowledgement, on 20 June 2012, the Court of First Instance made an order[[1]](#footnote-34), the first of its kind, under section 213 of the SFO requiring Hontex to make an approximately HK$1.03 billion repurchase offer to its approximately 7,700 public shareholders.

### Revocation of Licence and Fines Against Mega Capital

Following the commencement of legal proceedings by the SFC against Hontex, the SFC also investigated Mega Capital, the sole sponsor of Hontex’s application for listing. On 22 April 2012, the SFC announced[[2]](#footnote-38) that it had revoked Mega Capital’s licence to advise on corporate finance and fined Mega Capital a record high amount of HK$42 million for its failure in discharging its duties as a sponsor. The main findings were as follows:

#### Inadequate and sub-standard due diligence work

The SFC concluded that Mega Capital had not performed proper due diligence on Hontex’s customers, suppliers and franchisees which was crucial for assessing Hontex’s business performance. For example, material information like transaction figures was missing from the questionnaires with Hontex’s suppliers and customers.

#### Failure to act independently and impartially

It was found that important aspects of due diligence work on Hontex’s suppliers, customers and franchisees were sourced from Hontex without Mega Capital’s independent scrutiny and verification. For example, all interviews with suppliers, customers and franchisees were arranged by Hontex and conducted in the presence of Hontex’s representatives.

#### Inadequate audit trail of due diligence work

Investigations found that Mega Capital failed to maintain adequate documentation of their due diligence planning and significant aspects of due diligence work.

#### Inadequate Supervision of its staff

Most of the due diligence work was handled by junior and inexperienced staff of Mega Capital without sufficient supervision.

#### Breach of sponsor’s undertaking and filing untrue declaration with the SEHK

In view of the above failures and deficiencies in Mega Capital’s due diligence work, Mega Capital was found to be in breach of its undertaking to SEHK due to its failure to use reasonable efforts to ensure that all information provided to SEHK for Hontex’s listing application was true in all material respects and did not omit any material information. The declaration that Mega Capital had made reasonable due diligence inquiries also appear untrue.

### Revoking Licence of Hong Hui Lung

Hong was a former managing director of Mega Capital and was one of the two responsible officers and sponsor principals of Hontex’s listing application along with Wong. On 7 June 2012, the SFC has revoked the licence of Hong to act as a representative and the approval for him to as a responsible officer[[3]](#footnote-47). The major findings of the SFC are similar to those in the investigation on Wong:

#### Refusal to accept responsibilities

Hong tried to shift responsibility to Wong by denying that he was in charge of the supervision of the transaction team of Hontex’s listing application. The SFC stated that Hong has failed to realise that he and Wong were jointly and severally liable in discharging their roles as sponsor principals.

#### Supervisory failures

Hong admitted that he had not read most of emails relating to Hontex’s listing application. The SFC concluded that the evidence revealed that Hong failed to properly and adequately supervise the transaction team.

#### Breach of sponsor’s undertaking and failing untrue declaration with the SEHK

In the sponsor’s undertaking and declaration to SEHK, Hong and Wong jointly signed as sponsor principals to confirm that Mega Capital had made reasonable due diligence inquiries and all information provided to the SEHK was true in all material respects and did not omit any material information. However, as discussed above, Hong merely relied on Wong and the transaction team without performing any quality assurance role himself and thus failed to take reasonable steps to ensure due diligence was conducted in accordance with the requirements of Practice Note 21 of the Listing Rules.

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1. A copy of the SFC’s press release in relation to the court order against Hontex can be obtained [here](http://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=12PR63) ([see archive](2.pdf)). [↑](#footnote-ref-34)
2. A copy of the SFC’s press release in relation to revocation of licence and fines against Mega Capital can be obtained [here](http://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=12PR39) ([see archive](3.pdf)). [↑](#footnote-ref-38)
3. A copy of the SFC’s press release in relation to the revocation of Hong’s licence can be viewed [here](https://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=12PR59) ([see archive](4.pdf)). [↑](#footnote-ref-47)