# Client Alert

August 2019

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## The SFC's continued clampdown on corporate fraud and misconduct

The Securities and Futures Commission (SFC) has frequently emphasized its commitment to combatting corporate fraud and misconduct in recent years. Continuing with these efforts, in July 2019, the SFC issued a Statement on the Conduct and Duties of Directors when Considering Corporate Acquisition or Disposals (Link) ("**Statement**"). The Statement outlines recurring types of misconduct in relation to corporate acquisitions and disposals that have given rise to concerns and, in some cases, led to intervention by the SFC.

Our alert discusses recent enforcement trends and the repercussions of failing to comply with the SFC's requirements. We also set out practical steps that listed companies and management can take to mitigate their risks.

If you have any questions on the topics covered or need further clarification on any particular issue, please do not hesitate to get in touch with your usual contact at Baker McKenzie, or any of the lawyers listed here.

### Recent enforcement trends

The SFC has shown no hesitation in taking action against suspected misconduct. It will directly intervene at an early stage of a transaction of a listed company. Its aim is to prevent harm to investors and to protect the integrity of our markets. The SFC has continued to actively seek disqualification orders in addition to other sanctions.

Earlier this year, the SFC commenced disqualification proceedings against two former executive directors (who were also the chairman and the chief executive officer respectively) of a listed company in relation to a very substantial acquisition. The SFC alleged, among other things, that the two individuals breached their directors' duties as the listed company was prevented from acquiring the target at a substantially lower price. The former chief executive officer was alleged to have failed to make "*sufficient enquiries*" about the relationships among the parties concerned in the acquisition (including the chairman).

In June 2019, the SFC commenced proceedings against a former company secretary (who also served as the chief financial officer and later as an executive director) for failing to discharge his duties as he did not "*properly inquire*" into certain withdrawals. The withdrawals were alleged to amount to a substantial portion of the proceeds from the company's global offering of its shares. They were allegedly made without proper approval from the board of directors and did not serve any genuine commercial purpose. There was no indication that the former company secretary benefited from those withdrawals.

### What it means to listed companies and senior management

Directors and professional advisors should comply with their duties when evaluating or approving acquisitions or disposals. The SFC will promptly intervene in suspected cases of serious misconduct (e.g. transactions which appear to be oppressive, unfairly prejudicial or fraudulent). In doing so, it will exercise its powers to compel production of information and conduct interviews.

This is not the first time that the SFC has issued guidance on transactions by listed companies. The SFC's guidance includes a note on directors' duties in the context of valuations in corporate transactions (issued in May 2017) (Link). Directors and managers of listed companies should familiarize themselves with the SFC's expectations and guidance.

In recent years, we have handled a number of investigations in which the SFC examined the transactions by listed companies and the roles played by members of management. The SFC reviewed the records relating to the decisions of directors and senior management in these investigations. Directors and senior managers were asked to explain and justify their decisions by reference to internal records as well as information in the public domain.

The SFC has reminded directors that they have a duty to exercise independent judgement regarding proposed transactions. They should not rely on third party opinions or advice to an unreasonable extent[1]. As a general rule, courts are slow to interfere with the business judgment and decisions of directors, provided that it is exercised in good faith and not for irrelevant purposes. However, as reflected in its guidance, the SFC takes an active approach in overseeing the decision-making process of listed companies. The SFC will closely examine contemporaneous records for potential gaps or inconsistencies. They will rigorously question the company's rationale and expect detailed justification for every single step of the decision-making process.

In view of the current trend, listed companies, directors, senior managers and advisors should regularly review their procedures for evaluating and approving transactions. They should ask questions to ensure that their decisions are defensible, test the reliability of information presented to them, engage with the process and refrain from rubber-stamping recommendations from other parties. If working parties identify red flags, they should take steps to ensure the problems are resolved promptly and properly. Most importantly, efforts should be documented and records should be kept.

## Actions to consider

You may consider taking the following practical steps to mitigate your risks:

1. Directors and senior managers should be fully informed of the transaction background, valuation, assumptions, etc.
2. Non-executive directors should make inquiries and devote sufficient time and attention to familiarize themselves with the proposed transaction.
3. Exercise independent judgment and avoid reliance on unsubstantiated information or speculative comments made by other working parties.
4. Engage and seek help from professional advisors and ensure their independence.
5. Conduct thorough due diligence in transactions.
6. Maintain a full and complete set of records (in particular how red flags are identified and resolved).
7. Seek legal and other professional advice from the outset.
8. Seek legal advice if you are approached by a regulator.

[1] SFC Regulatory Bulletin, February 2019.

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