

Case Bulletin: 2020/05

Too Little & Too Late! Listco and its Directors Found in Breach of Disclosure Requirement

In 2013, a new statutory regime came into force under Part XIVA of the Securities and Futures Ordinance (Cap. 571) (“SFO”), largely due to concerns that the framework governing listed companies’ disclosure of inside information (or price sensitive information as it was commonly known), previously set out in the Listing Rules lacked “statutory teeth”. Under the new regime, civil proceedings can be brought by the Securities and Futures Commission (“SFC”) in the Market Misconduct Tribunal (“MMT”) against a listed company, its directors and other senior officers, and the MMT is empowered to fine the company and its directors up to HK\$8 million.

In a recent decision¹, the MMT found the Company and five of its directors culpable of the Company’s failure to disclose in a timely manner inside information concerning an acquisition proposal in breach of sections 307B(1)& G(2) of the SFO. It also found that the five directors had failed to take all reasonable measures to ensure that proper safeguards existed within the Company to prevent it from breaching its disclosure obligation.

The Company was unable to rely on the “safe harbour” defences under sections 307D of the SFO, because:

- (a) it had failed to take reasonable precautions for preserving the confidentiality of the information, and the confidentiality in the information was not preserved (s.307D(2)); and

¹ Magic Holdings International Limited (“Company”).

(b) it had not announced the inside information as soon as reasonably practicable after it became aware of its leakage, and also because it failed to take reasonable measures to monitor the confidentiality of the information (s.307D(4)).

I. Background

1. The Company was listed on the Hong Kong Stock Exchange in 2010.
2. Some preliminary meetings between the Company's founders and a party interested in acquiring the Company were held in early March 2013, when its shares were trading at around the HK\$3.00 level.
3. The MMT found that, as a matter of fact, the inside information concerning a takeover proposal at an acquisition price of not less than HK\$5.5 per share came into existence on 27 April 2013.
4. The MMT also found that the significant rise in share price from HK\$4.00 to \$4.85 between 26 April and 8 May 2013 was material and there was no plausible explanation other than the confidentiality of the inside information had not been preserved.
5. However, the Company did not make any disclosure until a public announcement on 2 August 2013. A joint announcement between the Company and the offeror was made on 15 August 2013 that the Company's shares would be cancelled in exchange for payment of HK\$6.3 in cash for each share and the listing of the Company on the HKEX would be withdrawn.

II. Key Points

1. Under section 307A of the SFO, "inside information" means specific information about the corporation, its shareholder/officer, or its listed securities/derivatives, that is not generally known to the persons who are accustomed or would be likely to deal in the listed securities of the corporation but would if generally known to them be likely to materially affect the price of the listed securities.

2. In June 2012, the SFC published the *Guidelines on Disclosure of Inside Information* (“**Guidelines**”) to assist companies to comply with their disclosure requirement. Paragraph 60 of the Guidelines identify some examples of “reasonable measures” to ensure that proper safeguards exist to prevent a breach of a disclosure requirement, including:
 - (a) establish controls for monitoring business and corporate developments and events so that any potential inside information is promptly identified and escalated;
 - (b) authorize one or more officer(s) or an internal committee to be notified of any potential inside information and to escalate any such information to the attention of the board;
 - (c) maintain an audit trail of meetings and discussions concerning the assessment of inside information;
 - (d) restrict access to inside information to a limited number of employees on a need-to-know basis. Ensure employees who are in possession of inside information are fully conversant with their obligations to preserve confidentiality;
 - (e) designate a small number of officers or executives with the appropriate skills and training to speak on behalf of the corporation when communicating with external parties such as the media, analysts or investors;
 - (f) develop procedures for responding to market rumours, leaks and inadvertent disclosures;
 - (g) provide regular training to relevant employees to help them understand the corporation’s policies and procedures as well as their relevant disclosure duties and obligations;
 - (h) document the disclosure policies and procedures of the corporation in writing and keep the documentation up to date.

3. Directors duty of care, skill and diligence are governed by section 465 of the Companies Ordinance (Cap. 622) and those duties of care are similar to those duties in common law.
4. Whilst any evidence of insider dealing is generally relevant, the elements of insider dealing and loss of confidentiality are different. The SFC did not find any evidence of insider dealing in this case.

III. Findings

1. The MMT found that the Company had failed to maintain any policies, procedures, circulars or guidelines for monitoring business and corporate developments and events such that any potential inside information can be properly identified and escalated.
2. The MMT determined that:
 - (a) contrary to section 307B(1) of the SFO, the Company had failed to disclose the inside information to the public as soon as reasonably practicable after the insider information had come to its knowledge;
 - (b) contrary to section 307G(2)(a) of the SFO, the negligent conduct of the chairman and an executive director² resulted in breach by the Company of the disclosure requirement and each of them is in breach of the disclosure requirement;
 - (c) contrary to section 307G(2)(b) of the SFO, each of the chairman, a non-executive director, and three executive directors did not take all reasonable measures from time to time to ensure that proper safeguards existed to prevent the Company's breach of the disclosure requirement and are each in breach of the disclosure requirement.
3. The MMT disagreed with the alleged categorization of "Owner-operated Listco" to justify any failure to document disclosure policies and procedures in writing.
4. It is the duty of the officers to reveal information and give instructions to the

² He was also the company secretary.

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lawyers. The validity of legal advice is dependent on the information the client choose to provide to the lawyers. It is not open to a party to claim protection for his failings by reliance on legal advice, when the legal advice was secured by the failure of that party to provide the obviously relevant information to the lawyer in securing the legal advice.

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