Application No. 2 of 2023

IN THE SECURITIES AND FUTURES APPEALS TRIBUNAL

IN THE MATTER OF a Decision made by the Securities and Futures Commission under section 194 of the Securities and Futures Ordinance, Cap. 571

AND IN THE MATTER OF section 217 of the Securities and Futures Ordinance, Cap. 571

BETWEEN

RAFFAELLO CAPITAL LIMITED Applicant

and

SECURITIES AND FUTURES COMMISSION Respondent

Tribunal: Mr. Michael Hartmann, GBS, Chairman
Mr. Webster Ng Kam-wah, JP, Member
Ms. Ivy Chua Suk-lin, Member

Date of Hearing: 20 – 23 January 2025

Date of Filing Final Written Submissions: 24 March 2025

Determination: 22 September 2025

DETERMINATION

Introduction

1. At all times material to this application for review, the Applicant, RaffAello Capital Limited ('RaffAello'), was licensed by the Respondent, the Securities and Futures Commission (the 'SFC'), to carry on Type 6 regulated activities pursuant to the provisions of the Securities and Futures Ordinance (the 'Ordinance'). Type 6 regulated activities encompass the giving of advice on matters of corporate finance and, as in the present case, acting as 'sponsors' to corporations seeking to be listed on the Hong Kong Stock Market.

2. Sponsors, in acting as advisers to corporations seeking listing, play a pivotal role in bringing those corporations to the Hong Kong market. They do so by undertaking a fundamental obligation to ensure that all required information about corporations seeking listing is accurate, complete and not, directly or indirectly, misleading. The means by which a sponsor discharges this obligation is, of course, an investigative one, that is, by way of the exercise of due diligence.

3. In this regard, General Principle 2 of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission ('the Code of Conduct') directs that sponsors must conduct due diligence on an applicant for listing and, in doing so, must exercise due skill, care and diligence in the best interests of clients *and* the integrity of the market.

4. More will be said of the dynamics of 'due diligence' later as it is a concept central to the determination of this matter.

A brief background

5. On 14 February 2017, the Applicant, RaffAello, was appointed to act as sole sponsor to a company seeking listing on the Growth Enterprise Market ('GEM') of the Hong Kong Stock Exchange.

6. At that time, Tsang Kin Hung ('Ricky Tsang') was a director of RaffAello and one of its responsible officers. He was to acquire full ownership of the company in 2018.

7. The company seeking listing on the GEM was Paprika Holdings Limited ('Paprika' or 'the Paprika Group'). The Hong Kong GEM market is not intended for large, well-established businesses. The GEM market serves the needs of small and mid-size issuers looking to raise capital to fund their growth. It follows therefore that, in respect of companies seeking listing on the GEM, potential investors look for growth potential.

8. Paprika, as a holding company, acting together with its subsidiaries, carried on business as sellers of handbags and related accessories, doing so under the brands of 'Paprika' and 'Paprika Edition'. The handbags and accessories sold by Paprika were not 'high-end' luxury items. The evidence shows that the merchandise was aimed rather at the mass market: relatively cheaper items therefore but sold in greater numbers.

9. The founder, CEO and Chairman of Paprika was Leung Shi Wai, Samuel ('Samuel Leung').

10. In order to put Paprika's listing application together and present it to the Stock Exchange, RaffAello, in its role of sponsor, assembled a transaction team. The transaction team consisted of eight persons: five 'core

members' and three 'associates'[1]. Ricky Tsang, RaffAello's sole director, was not a member of the transaction team.

11. The transaction team's responsibilities included the preparation of two documents that are fundamental to all applications for listing on the GEM; first, a draft prospectus and, second, evidence of Paprika's 'track record' over the previous two years.

12. A 'track record' refers to the past performance and history of a company seeking listing, particularly its financial performance and management record. This includes details of earnings, debt levels and, importantly in this matter, growth history. In respect of the Paprika application for listing, the two-year track record period covered the two years ending 31 March 2016 and 31 March 2017.

13. In order to render professional assistance in the listing process, RSM Hong Kong ('RSM') was appointed to act as the reporting accountant while Reed Smith Richards Butler ('RSRB') was appointed to act as legal advisor.

14. The Paprika Group did not itself manufacture handbags and accessories. These were manufactured and/or obtained for it by various suppliers. One of the suppliers, which at all times was held out as being an independent business, was API Trading Company Limited.

15. The Paprika Group marketed and sold its handbags and accessories to both retail customers and to wholesalers which then 'on-sold' the merchandise. During the track record period the retail network of the

[1] Under the relevant Code of Conduct, a sponsor is obliged to ensure that it has sufficient staff to satisfy its obligations and responsibilities.

Paprika Group covered 15 retail stores and two concessionaire counters in Hong Kong.

16. The Paprika track record showed that retail sales were the dominant driver, constituting something like 90% of revenue. As for the wholesale side of the business, constituting the remaining 10% of revenue, the Paprika Group made sales to various wholesale businesses which would then on-sell the products to their own retail customers in Hong Kong and also to Mainland customers.

17. Paprika's Application for Listing was submitted on 14 June 2017, some two and a half months after the closure of the two-year track record period. A number of amended applications were submitted at a later time but it is important to recognise that it is this first application which is the centre of focus in this application for review.

18. The SFC has focused on the fact that, at the time of its original submission, Paprika's Application for Listing was required to be effectively complete; in short, it was a regulatory requirement that all necessary due diligence must have been conducted and completed up to that date. In this regard, paragraph 17(2)(b) of the Code of Conduct directs that:

> "… before submitting a listing application a sponsor should complete all reasonable due diligence on a listing applicant except in relation to matters that by their nature can only be dealt with at a later date."

19. According to the prospectus filed as part of the listing application on 14 June 2017, over the two-year track record period the Paprika Group had experienced a very significant growth in revenue: ideal for potential GEM investors. The prospectus further revealed the following, namely, that –

a. The revenue of the Paprika Group as a whole had increased by 57.8% from $56,980,000 in the year ended 31 March 2016 to $89,894,000 in the year ended 31 March 2017.

b. Retail sales had made up 90.5% and 88.5% of the group's revenue in the two years of the track record.

c. Although wholesale trade made up just 10% of the Group's revenue, that trade had, in fact, increased by 96% from $5.1 million to $10 million.

d. Concerning cash proceeds, they would be deposited into the Group's designated bank accounts as soon as reasonably practicable after the relevant date of sale. Cash pending delivery to the bank for deposit would be kept in safes located in each retail store.

20. The listing application further revealed that three of the Paprika Group's top five suppliers, accounting for 53.4% of the Group's total purchases in the year ended 31 March 2017, were new suppliers: corporations which had only commenced doing business with the Paprika Group in 2016. This included API Trading Company Limited.

21. More particularly, the listing application stated that, in respect of wholesale revenue, over 90% of the increase in sales had been attributable to purchases made by a single independent third party, a company called Novi eBusiness Limited.

22. As it was, upon consideration of the listing application, both the SFC and the Stock Exchange expressed concerns as to the accuracy and/or reliability of the declared earnings contained in the two-year track record

period. In respect of these concerns, between July 2017 and January 2018 RaffAello, as sponsor, conducted further due diligence, made a number of written submissions and, in addition, filed six further revised proofs of the prospectus.

23. On 19 December 2017, due to the lapse of more than six months from the date on which the application for listing had been filed, Paprika was required to re-submit the listing application. This it did.

24. Eventually, however, on 16 April 2018, with queries still to be resolved, the listing application was formally withdrawn. The application has not been resuscitated.

The institution of disciplinary proceedings by the SFC

25. Some three years after this abandonment, in terms of a document dated 11 June 2021, the SFC served on the Applicant a Notice of Proposed Disciplinary Action pursuant to section 194 of the Ordinance. It was said in the notice that the SFC was of the preliminary view that RaffAello, in discharging its obligations as sponsor, had been guilty of 'misconduct' in that it had failed to perform all reasonable due diligence in respect of the Paprika Group before submitting the listing application and accordingly was not fit and proper to remain licensed.

26. 'Misconduct', as alleged by the SFC, is defined in section 193 of the Ordinance as, *inter alia*, an act or omission relating to the carrying on of any regulated activity for which a person is licensed or registered which, in the opinion of the Commission, (that is, the SFC) is, or is likely to be, prejudicial to the interests of the investing public.

27. It was the SFC case, therefore, that RaffAello's 'misconduct', that is, its asserted failure to conduct all reasonable due diligence, was to be judged as at the date of filing of that application, that is, as at 14 June 2017, this being the date at which, for all essential purposes, the integrity of the listing application had to be judged.

28. It was the contention of the SFC that RaffAello's culpability, that is, its failure to conduct reasonable due diligence, was to be judged within the context of two issues - which will be looked at in greater detail later - which may be described as follows -

a. a failure to conduct adequate due diligence concerning retail sale transactions effected at Paprika retail outlets in Hong Kong;

b. a failure to ascertain the true independence of two companies that had reportedly conducted arm's length dealings with the Paprika Group during the two-year track record period as well as their true commercial substance, these companies (already mentioned above) being: Novi eBusiness Limited, the largest wholesale purchaser of merchandise from the Group, and API Trading Company Limited, a major supplier of merchandise to the Group.

29. The assertion made was that the culpability contained within the two areas set out above had been brought about by a failure on the part of RaffAello, prior to the filing of Paprika's listing application, to examine with professional scepticism the accuracy and completeness of statements and representations made, or other information given to it in the course of the due diligence exercise.

30. Put simply, that, prior to the filing of the listing application, during the course of exercising due diligence, a number of concerning issues had presented themselves to the RaffAello transaction team, these issues suggesting that fraudulent steps may have been taken to seek to give the impression of boosted revenues - in short, issues of real concern going to the integrity of the listing - but those issues had either been missed or, if identified, had not been investigated with the required level of diligence, too much reliance being placed on Paprika's own representations made through its own management.

31. It was the case for the SFC that, if proved, this failure on the part of RaffAello, relating to what should have been done by it prior to the filing of the listing application, constituted breaches of the Code of Conduct and paragraph 2 of Practice Note 2 of the Rules Governing the Listing of Securities on the GEM Board ('the GEM Listing Rules'). More specifically, it constituted breaches of the following -

a. Paragraphs 17.2(b) and 17.4(a) (reasonable due diligence) by failing to perform all reasonable due diligence on Paprika before submitting the listing application to the Stock Exchange.

b. Paragraph 17.6(b) (professional scepticism) by failing to examine with professional scepticism the accuracy and completeness of information/documents provided by Paprika and being alert to information that contradicted or brought into question the reliability of such information/documents.

c. Paragraph 17.6(c) (appropriate verification) by failing to undertake additional due diligence to ascertain the truth and completeness of the information provided by Paprika after RaffAello became aware of circumstances that cast doubt on the

information provided to it or otherwise indicated a potential problem or risk.

d. Paragraph 17.6(f) (interview practices) by failing to identify any irregularities noted during the interviews with the wholesaler, Novi eBusiness Limited, and supplier of products, API Trading Company Limited, and to ensure any irregularities noted during the interviews were adequately explained and resolved.

e. General Principle 7 (Compliance) and paragraph 12.1 (Compliance: in general) by failing to comply with all regulatory requirements applicable to the conduct of its business activities so as to promote the best interest and the integrity of the market.

32. As to the issue of sanctions, RaffAello was informed that the SFC was of the preliminary view that, by way of sanction, it would be appropriate to issue a press release publicly reprimanding RaffAello and, in addition, to fine it a sum of $13 million.

33. RaffAello sought to contest the preliminary findings of misconduct, both as to culpability and the imposition of sanctions. Correspondence then followed with RaffAello seeking to persuade the SFC that it had not discharged its obligations as sponsor in a culpable manner.

34. In a final Decision Notice dated 8 May 2023, however, the SFC stood by its preliminary decisions concerning culpability.

35. As to sanction, the SFC no longer insisted that the Applicant was not a fit and proper person to remain licensed, conceding that, in the circumstances of the case, while it would remain licensed, there should still

be a public reprimand. Having regard to RaffAello's submissions as to its difficult financial circumstances, it was ordered that the fine to be imposed should be reduced to HK$4 million.

36. RaffAello then applied (out of time[2]) pursuant to section 217 of the Ordinance for a review of the SFC decision, both as to the findings against it of culpability and the determinations related to sanction.

The role of this Tribunal

37. It is now well settled that applications for review before this Tribunal are not to be determined as an appeal of the classic kind is to be determined by a court of appeal. Instead, applications for review before this Tribunal must be determined *de novo,* that is, as a full merits review with the Tribunal acting as if it is the original decision maker. It does not mean that it ignores what has gone before. It does mean, however, that it exercises its independent judgement, arriving at its own decision. It does so in respect of liability and, if required, in respect of appropriate sanctions too.

The burden and standard of proof

38. The burden of proof remains on the SFC. Accordingly, it remains for the SFC to prove its case. As for the standard of proof, the civil standard, that is, proof on the balance of probabilities, applies.

The dynamics of due diligence

39. The nature and extent of the concept of 'due diligence' has been considered by this Tribunal on a number of occasions. In this regard, in *Sun*

[2] The Chairman of the Tribunal heard arguments as to whether RaffAello should be permitted to proceed even though its application was filed out of time. Leave was granted as was an application to file expert evidence.

Hung Kai International v SFC[3] , it was said -

> "It is clear to us that the regulatory framework insisting on the exercise of due diligence by each and every sponsor is critical to the orderly and transparent working of the market. That is why emphasis is placed on the dual obligation of a sponsor, an obligation not only to the client but, equally importantly, to the integrity of the market. In an orderly and transparent market investors must be able to place trust, first, in the fact that the listing of a company has been founded by the Stock Exchange on the consideration of full and accurate information and, second, that the information contained in the prospectus is also full and accurate. The route to ensuring such trust must rest principally on the sponsor, the party responsible for the management of the listing. It must rest principally on the conduct of an objective, professional and scrupulous investigation of all material relevant to the listing and the initial public offering; in short, on the conduct of reasonable due diligence."

40. As the Tribunal continued -

> "All investment involves risk. The point is that investors must be able to assess the risk by relying on accurate and relevant information. If they are unable to do that then trust in the market is undermined."

41. Looking more closely at the role of sponsors, in *Yi Shun Da Capital Limited v SFC*[4] the Tribunal emphasised that -

> "… in undertaking its role, a sponsor must examine the accuracy and completeness of representations made to it by the representatives of the company seeking listing and do so with the necessary degree of professional scepticism. The requirement to adopt an attitude of professional scepticism places on the shoulders of a sponsor the requirement to make a critical assessment of relevant information, doing so with a questioning mind and – of central importance in the present case – being alert to information that brings into question the reliability of relevant statements and representations."

42. The Tribunal recognises, of course, that a sponsor is not required to provide counsel of perfection. It also recognises that, viewed

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[3] Application No. 3 of 2013, 27 January 2014.

[4] Application No. 4 of 2020, 19 October 2021.

through the more leisurely prism of hindsight, it may unconsciously be too easy to elevate reasonable due diligence to a level that requires unassailable diligence. The Tribunal recognises therefore that there will be cases when, even if reasonable due diligence is carried out, not every concern will be identified and dealt with. The method by which a sponsor discharges its dual obligation is by employing reasonable skill and care, tempered always with a healthy but rational degree of scepticism, doing so in the best interest of its client and – importantly – the integrity of the market.

43. Paragraph 17.4 of the Code of Conduct provides that -

> "Where the sponsor becomes aware of circumstances that may cast doubt on information provided to it or otherwise indicate a potential problem or risk, the sponsor should undertake additional due diligence to ascertain the truth and completeness of the matter and information concerned."

44. Of particular importance in this present matter is the fact that, if there is a requirement placed on the sponsor to make a critical assessment of particular information, most certainly of information that presents potential concerns, there is a need in the sponsor's due diligence records to make a note of what has been done. If issues of concern are identified, it is not sufficient for the sponsor simply to investigate the matter, make a bald note of that fact, if making any note at all, and to move on. It is to be remembered that the sponsor is not the only guardian of the public interest in the listing of a corporation. All listing applications are scrutinised by the SFC and the Stock Market itself and those authorities need to be assured that matters of concern - 'red flags'[5] - have been identified by the sponsor and given the necessary

[5] 'Red flags' are a posting of concern, including apprehension of the fraudulent manufacture of sales figures and the like in order to artificially boost revenue and make a corporation seeking listing look more profitable than in truth it is. Their true nature and extent must be identified and dealt with and, if that is not possible, the existing risk must be made known to the market.

level of consideration.

45. This is not to suggest that the sponsor must write an exhaustive report of everything that is stumbled upon in its due diligence records. But it is to suggest that, if a matter of concern is identified by a sponsor in the course of the exercise of due diligence, a coherent note should be made of what has been discovered and what has been resolved.

46. In the present case, for an extended period after the filing of the application for listing, exchanges took place between the sponsor and the SFC, those exchanges essentially being aimed at attempting to resolve concerns that had in many instances, either in whole or in part, been identified by the sponsor prior to the listing application being made. Coherent notes on the part of the sponsor made at the time due diligence was carried out would no doubt have resolved those concerns in a short period of time and at far lesser cost.

47. Perhaps the guidance most directly relevant to the present matter is to be found in paragraph 17.4 of the Code of Conduct which provides that -

> "Where the sponsor becomes aware of circumstances that may cast doubt on information provided to it or otherwise indicate a potential problem or risk, the sponsor should undertake additional due diligence to ascertain the truth and completeness of the matter and information concerned."

48. Importantly, that paragraph concludes by saying -

> "Over reliance on management representations or confirmations for the purpose of verifying information received from a listing applicant cannot be regarded as reasonable due diligence."

Looking to the core issues in dispute

49. The essential assertion made by the SFC, the burden of proof being on it, is that RaffAello failed to examine with the required level of skill and professional scepticism the accuracy and completeness of statements and representations made, or other information given to it by management and staff of the Paprika Group, and further failed to be alert to information that contradicted or brought into question the reliability of those representations. In short, that there was, in the circumstances prevailing, a lack of due diligence.

50. The core issue for determination, therefore, is the adequacy of the due diligence conducted by RaffAello; whether it met the standard of rigour required of it by the Code of Conduct and relevant regulatory provisions or whether it has been demonstrated that it fell below that standard.

51. Although, during the course of argument, assertions were made that certain transactions falling for scrutiny may have pointed to fraudulent steps being taken to seek to boost revenue figures, proof of this has never been integral to the SFC case. There has therefore been no burden placed on the SFC to demonstrate that the application for listing made by Paprika was, in fact, to a greater or lesser degree, built on manufactured figures.

52. The burden placed on the SFC has been to demonstrate, first, that, on a consideration of all relevant material, matters of concern should have been raised as to the integrity of the listing application and, second, in light of that concern, and the need generally for a sceptical approach, that there was a failure by the RaffAello transaction team to conduct reasonable due diligence *before* the submission of the listing application to the Stock Exchange and the SFC.

The SFC's underlying assertions of culpability

53. As to the broad, underlying allegations of culpability made against RaffAello by the SFC, these have included the following -

a. RaffAello failed to take due diligence measures that would get to the bottom of the red flags. Conducting interviews with the management of the Paprika Group and sales staff, and third parties, would plainly not suffice. RaffAello placed substantial emphasis on the fact that it verified the existence of the sales and supply transactions (namely, that the transactions actually had happened and money actually had been exchanged). But that missed the point. It was not the existence of the transactions *per se* that mattered but whether the transactions had been genuine commercial transactions or in fact manufactured.

b. RaffAello all too often 'went through the motions', its interviews being perfunctory and all too often devoid of any attempt to understand the true dynamics of matters. Put another way, it failed to adopt an attitude of professional scepticism and to make a critical assessment of all relevant information.

c. RaffAello, it seems, at least during this application for review, placed substantial weight on the fact that it had been supported in its due diligence by the reporting accountants and, to a much lesser degree, by its lawyers. This, however, fundamentally misunderstood the regulatory imperative that it was RaffAello itself which was principally responsible for the accuracy of the contents of the prospectus.

Assertions underlying RaffAello's case

54. Ms. Cindy Kong, leading counsel for the Applicant, RaffAello, in her very vigorous and full set of submissions, set out a number of fundamental contentions which, she argued, proved that the SFC, in its very extended review of RaffAello's due diligence, had elevated the requirement for reasonable due diligence to a requirement for unassailable due diligence. As she put it, the SFC had built its case "on nothing but criticisms based on hindsight and taken out of context"; in short, in her contention, the SFC had based its case on criticisms divorced from the reality of how due diligence exercises must, in practice, be conducted.

55. In this regard, the Tribunal accepts, of course, that it must consider matters within the context of reality by having regard to what was known to the sponsor at the time or what should reasonably, in the circumstances prevailing at the time, have been further investigated by the sponsor.

a. Discretion

56. Ms. Kong submitted that, in light of the fact that every exercise of due diligence will have to meet the challenge of new facts, new circumstances and new business imperatives, sponsorship teams had to be given significant discretion, this including a discretion to determine in good faith whether, on information obtained and assessed, explanations should be accepted as being reasonable or whether, in all the circumstances, there should be further investigation. That, of course, is correct. Sponsorship is not a book-marking exercise. Each and every application for listing will present its own issues. But, of course, it also follows that a discretion to act does not excuse a failure to act when that failure, judged objectively, is culpable.

b. Proportionality

57. Ms. Kong also sought to support her submissions with an argument as to proportionality. As it was put by her, many of the issues in this listing related to a small proportion of Paprika's total sales. In the context of the listing application as a whole, these issues, she said, would never have been considered to be of material concern by any reasonable investor.

58. The difficulty with this proposition, however, is that, while isolated errors can of course be corrected, and no doubt are corrected on a daily basis when listing applications are made, if those isolated errors, when viewed in context, constitute a pattern or appear to be part of some methodology undermining the reliability of the listing application then obviously they constitute matters of concern of potential importance and cannot simply be left.

c. The role of reporting accountants and legal advisors

59. In the course of submissions to the Tribunal, Ms. Kong made reference to what she described as a 'fundamental observation', namely, that, in preparing Paprika's application for listing, the RaffAello transaction team had worked together with RSM, the reporting accountants, and RSRB, the lawyers[6].

60. Ms. Kong emphasised that, in the exercise of due diligence, the reporting accountants were required to confirm that there was no risk of material misstatement due to fraud in the financial information contained in the listing application and this confirmation had been given. It was Ms. Kong's submission that surely, in the circumstances, notwithstanding the

[6] For their full names, see paragraph 13 above.

strict wording of the Code of Conduct and/or regulations, the RaffAello transaction team must have been entitled to give due weight to these findings of regularity.

61. In this regard, however, the Tribunal notes that the Code of Conduct is specific in ruling that a sponsor cannot abrogate responsibility for due diligence. In this regard, paragraph 17.6(g) directs that -

> "A sponsor cannot abrogate responsibility for due diligence. Where a sponsor engages a third party to assist it to undertake specific due diligence tasks … the sponsor remains responsible in respect of the matters to which the specific tasks relate. A third party's work, in itself, would not be sufficient evidence that a sponsor has discharged its obligation to conduct reasonable due diligence."

62. It is further to be noted that RSM, in their letter of engagement, stated in clear terms that they would not take on any responsibility for guaranteeing adequacy of disclosure in respect of matters appearing in the prospectus. In this regard, the terms of limitation of responsibility[7] read -

> "In relation to the contents of the prospectus, we will address ourselves solely to such financial and other information in the prospectus as is identified in this engagement letter and *we will make no representations as to the adequacy of disclosure in the prospectus or as to whether any material facts have been omitted."* [italics added]

63. That said, of course, the exercise of due diligence by a sponsor will often involve seeking the advice of accountants, lawyers or other professionals. In the opinion of the Tribunal, it must follow therefore that, in any particular case, if there is evidence that a sponsor has consulted with such

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[7] On behalf of the Applicant it was suggested during the course of argument that standard form provisions of this kind adopt an overly formalistic and artificial view of the realities of the due diligence process. The reality is that the reporting accountant is involved in the preparation of the IPO documents and must be satisfied with the business rationale of the listing applicant's various transactions. The Tribunal does not deny that this may well be the case, perhaps in the majority of instances. But standard form contracts are common and are binding.

professionals in respect of any particular concerns, that will no doubt be supportive of due diligence.

64. In this regard, the Tribunal agrees with the testimony of Mr. Philippe Espinasse, the single expert called by the SFC, who said that, if RaffAello had harboured concerns as to any red flag issues, and if it was of the opinion that the reporting accountants could assist in resolving those issues, the obligation would then have been on RaffAello to consult regarding those issues.

65. It follows, therefore, that, absent consultation as to specific matters of concern, it would not have been reasonable for the RaffAello transaction team to adopt a blanket assumption that the reporting accountants must - independently - have spotted and considered the same issues that it had spotted, also concluding that they were not of concern. As it was put by Mr. Espinasse: "In light of the many (and I would argue, material) red flags identified by RaffAello, such red flags should in fact specifically have been discussed in detail with RSM [the reporting accountants] and also have been the subject of additional verification procedures on their [RaffAello's] part".

66. That said, it is significant that no evidence was put before the Tribunal during the course of the hearing to confirm that, at any time prior to the filing of the listing application, there had been any consultation between RaffAello transaction team and the reporting accountants or advising lawyers as to any particular 'red flag' issues and how best those particular areas of concern must be dealt with, if at all, in the listing application.

67. The Tribunal also notes that it is in many ways this asserted failure to follow up red flags rather than just accepting explanations given by the management of Paprika that lies at the heart of the SFC's case.

Expert evidence

68. As indicated above, the SFC called one expert witness, Mr. Philippe Espinasse, who, during his career as an investment banker, has worked on the execution of approximately 65 initial public offerings and who has considerable experience as an expert witness, having been involved in some 22 cases, the majority being in Hong Kong.

69. Although criticised by counsel for RaffAello, the Tribunal found Mr. Espinasse to be an impressive witness, clearly highly qualified and experienced, careful in his answers and nuanced: in short, an authoritive witness.

70. For the Applicant, RaffAello, two expert witnesses were called. They were Chung Wai Chuen, ('Alfred Chung') an accounting expert, and Cheung Leung ('Simon Cheung'), an expert in the area of sponsorship work.

71. Simon Cheung, a certified public accountant in Hong Kong, Australia, and the United Kingdom, experienced in matters of corporate finance, stressed the importance of the reporting accountant in the due diligence process -

> "In the context of verifying the veracity of revenue, while the sponsor should conduct its own due diligence work and is accountable for the overall presentation, the reporting accountant typically assumes primary responsibility for auditing the financial statements. Although a sponsor must conduct its own due diligence, it is not surprising if sponsors rely, to a certain extent, on the reporting accountant to act as a gatekeeper, ensuring that the financial information disclosed is accurate and is in compliance with the relevant regular requirements…"

72. That said, as Simon Cheung confirmed in the course of his testimony, and as the Code of Conduct directs, the sponsor remains the "key driving force" behind the sponsorship process.

The testimony of Tsang Kin Hung

73. Ricky Tsang was a responsible officer and a Type 6 licensed person with the SFC. At all material times, he was a director of RaffAello and from mid-2018 onwards he was the sole director of the company. Unsurprisingly, he gave evidence on behalf of his company.

74. The difficulties that he faced, however, lay in the fact that he was never a member of the transaction team responsible for the sponsorship exercise. His knowledge of matters, therefore, especially those of a critical nature, was essentially hearsay, being derived from discussions with members of the transaction team, those discussions, in the main, taking place in order to respond to queries from the SFC (and the Stock Exchange) after the application for listing had been filed.

75. During the course of his testimony, it was manifest that Ricky Tsang was not a disinterested witness; indeed, the opposite was the case and all too often, rather than simply admitting that he had no clear knowledge of a particular matter, he would seek exculpatory answers or, as Mr. Nip identified in his submissions on behalf of the SFC, his evidence would be reduced essentially to a matter of submissions.

76. In summary, his testimony did not assist the Tribunal, certainly not in respect of the core matters that fell for determination.

The importance of looking to the factual issues in the relevant time frame

77. As indicated earlier[8], the SFC has focused on the fact that, at the time of its original submission on 14 June 2017, Paprika's Application for

[8] See paragraph 17 above.

Listing was required to be effectively complete; in short, it was a regulatory requirement that all necessary due diligence must have been conducted and completed up to that date. In this regard, paragraph 17(2)(b) of the Code of Conduct directs that:

> "… before submitting a listing application a sponsor should complete all reasonable due diligence on a listing applicant except in relation to matters that by their nature can only be dealt with at a later date."

78. Accordingly, the question of whether due diligence had or had not been performed by RaffAello fell for determination by this Tribunal as at 14 June 2017.

79. It is appreciated, of course, that queries would have been raised by the SFC and/or the Stock Exchange in the period immediately following the filing of the application for listing and that evidence of those queries and answers may well be relevant to the issue of due diligence performed prior to the listing.

80. Regrettably, however, in the present case, the task of the Tribunal was complicated to an appreciable degree by the failure on the part of counsel representing RaffAello to clearly separate matters of due diligence executed prior to 14 June 2017 and matters of due diligence executed after that date, often several months later, in an extended effort to try and rescue the application for listing.

The first broad issue to be determined: was there a failure to conduct reasonable due diligence in respect of retail transactions conducted at Paprika's retail outlets?[9]

81. According to Paprika's listing application, its retail network was contained within Hong Kong, covering 15 retail stores and two concessionaire counters in departmental stores. Retail sales, when compared with Paprika's wholesale sales, brought in 90% of revenue. In short, Paprika was for all essential purposes a Hong Kong retail business invested in retail outlets.

82. In this regard, of central importance was the finding of the track record that in its two-year period, growth in revenue had risen from$56,980,000 for the year ended 2016 to $89,894,000 for the year ended 2017.

83. For the RaffAello transaction team, being in a position to confirm the integrity of the retail growth, would therefore have been of central importance.

84. In seeking to meet its obligations in this regard, a principal tool of RaffAello's due diligence was the conduct of an exercise of 'retail sales vouching'[10]. This may be described as an exercise in terms of which business records are considered in detail to see if they properly support entries made in the accounting records. The purpose is to substantiate the existence, the validity and accuracy of such entries. Confirming the 'existence' verifies that recorded transactions actually occurred; that they are not fictitious. Confirming the 'validity', verifies that they are records of genuine, honest,

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[9] See paragraph 28 which records that two broad issues fall for determination.

[10] In its exercise of due diligence, the RaffAello transaction team undertook a number of measures which included making site visits to retail stores and concessionaire counters; conducting interviews with sales managers and sales staff in the retail stores; checking the retail sales of the concessionaire counters and participating in a mystery online shopping exercise through a mainland e-commerce platform.

arm's length retail sales. Confirming 'accuracy' confirms that they correctly and fully record what took place. Retail sales vouching, as a data-driven exercise, can therefore identify potential risks such as inventory mismanagement or fraud.

85. In conducting this exercise, RaffAello chose as its 'target period' a single period of just 22 days (within a full two-year track record period), those days running between 20 February and 13 March 2016 and within this period chose a limited number of 'sample days' so that documentary evidence related to retail transactions could be examined within the ambit of those 'sample days'.

86. When conducting this exercise, the RaffAello transaction team came across a number of areas of possible concern. It is in respect of three of those areas that, on later examination, the SFC found that there had been a failure of due diligence. For purposes of identification, those three areas may be described as follows

a. the issue of 'consecutive cash transactions';

b. the issue of 'credit card bulk purchases';

c. the issue of the 'POS Test invoices'.

87. In the conduct of its due diligence, of course, while it would have been incumbent upon the RaffAello transaction team to investigate individual matters of concern such as the three matters just listed, it was also incumbent upon it to adopt a more strategic overview, that is, to look to the impact of all three areas of concern when considered together.

The issue of 'consecutive cash transactions' ('CCTs')

88. In the conduct of its exercise of retail sales vouching, the RaffAello transaction team came across evidence of the following -

a. That on the sample days within the target period of just 22 days, a series of sales transactions had taken place, each transaction involving the sale of multiple handbags, these sales taking place within very short spans of time, within 10 minutes or less of each other, the handbags being sold for similar (or the same) amounts of money. The transactions, which were cash transactions, appeared to be Group-wide. The RaffAello transaction team gave these events the description of 'consecutive cash transactions'.

b. These CCTs were important generators of revenue. The evidence showed that on the sample days there had been 230 such transactions involving the sale of 1,431 handbags. What was noteworthy was that the sales constituted 90% of the total cash sales on those sample dates and 41.9% of the total overall sales.

c. In respect of the banking of these significant cash proceeds, however, there were certain questionable features; significantly, the fact that the proceeds of the CCTs appeared to be banked at a different time from the cash proceeds of the other standard, across the counter, transactions and, on occasions, appear to have been banked into a separate branch near to the headquarters of the Paprika Group.

89. The RaffAello transaction team sought explanations for this

unusual form of retail purchasing from the management and staff of Paprika; essentially, it seems, being satisfied with these reports as fully supporting the integrity of the transactions. In this regard, it appears that the transaction team was satisfied with the following explanation -

a. That the CCTs arose out of - and were explained by - a marketing scheme to increase the sale of merchandise by identifying certain handbags as 'Rocket' products, these products being endorsed by celebrities. As it was reported by RaffAello (in less than coherent language) -

> "The promotion of 'Rocket' products which the [Paprika] Group would like to create a popular demand for amongst their target customer group and stimulate customer traffic; that the actual retail price typically ranges from HK$99-$299."

b. As to the fact that the sales invoices had been very closely related in time (so much so that the RaffAello transaction team described them as being 'consecutive'), the explanation had to lie in the fact that potential buyers would seek to secure purchases ahead of physically visiting the retail outlet, making payment and collecting the handbags. The invoices, therefore would be made out ahead of time. In the opinion of the Tribunal, this, on its own, however, was not a convincing explanation for why the transactions were so close together in time. If, for example, it could be shown that, on the morning a promotion was announced, the CCTs were clustered together shortly after the retail outlets opened for business, that could be an explanation. But there appears to have been no such specific - or similarly specific - explanation.

c. As for the banking of the cash proceeds of sale, it was explained by Paprika management that the fact that not all cash proceeds (obtained from ordinary retail cash sales as well as 'Rocket' sales) were banked together into the local bank of the retail outlet at the end of the business day could be put down to three things; first, a shortage of staff members to physically count all cash proceeds and deliver them for banking; second, the remote location of some of the banks and, third, the factor of 'human error'.

90. The RaffAello transaction team also conducted interviews with members of Paprika staff. It was the answer of most of the staff that these transactions had been in respect of products made available during promotional periods and that the purchasers would, in the main, on-sell the items to their own customers. It was accepted that, if there was a staff shortage, banking of cash proceeds from the retail outlet may be delayed overnight or for longer. However, no staff members mentioned the asserted 'remoteness' of bank branches.

91. The Tribunal notes that the RaffAello transaction team, in order to better understand the mechanics of the Rocket promotional system, arranged for members of the team to attend a promotion event. It appeared to be confirmed at this event that a significant number of people purchasing Paprika merchandise in bulk were doing so by way of business, on-selling - often through the internet - to their own customers. In order to prove how it could be done, a member of the RaffAello transaction team had been able to purchase a Paprika product through a third-party online shop which had itself apparently purchased the product direct from Paprika.

92. During the course of the hearing, the Tribunal was informed

that, after interviewing Paprika management and staff, the RaffAello transaction team had accepted that the explanations given to account for the integrity of the consecutive cash transactions had been accepted as being reasonable as a matter of commercial common sense - despite the fact that they made up something like 90% of cash sales on the sample days - and had seen no reason to look any deeper.

93. Leading counsel for the SFC, Norman Nip SC, rejected the assertion that, when all relevant circumstances were taken into account, any such acceptance could have been reasonable. He was critical of the thoroughness and incisiveness of the approaches made by the RaffAello transaction team to the Paprika management and staff. Mr. Nip stressed that most of the interviews had been by telephone and the recorded answers had invariably been just a couple of lines. Invariably no follow-up questions had been put. It was stressed that, on the evidence, the entire process of due diligence had been superficial, one of 'just going through the motions'.

94. In looking to the relevant evidence as a whole, the Tribunal agrees that, surprisingly in the circumstances, there appears to have been little, if any, challenge to the answers received from the management and staff of Paprika and, equally, little, if any, cross checking of relevant information obtained during the course of due diligence. As it was emphasised by Mr. Espinasse, the expert witness for the SFC, parties from whom information is obtained must be challenged on issues of concern, or possible concern, that arise out of that information.

95. As it was, after the filing of Paprika's listing application, the examination by the SFC of matters relevant to the CCTs gave rise to a number of concerns which may (broadly) be described as follows -

The Nina Chan involvement

96. When the RaffAello transaction team had first looked into the matter, it was discovered that a single member of the Paprika sales staff, a woman by the name of Nina Chan, had processed about 90% of the CCTs. Just two other members of staff had handled the balance. A study of relevant documentation also revealed that in very quick succession she had handled (or processed) orders in different stores in different parts of Hong Kong; for example, in Tsuen Wan first and then, five minutes later, in San Po Kong. Clearly, she had been delegated to deal with all CCT matters when it was possible.

97. That raises the question, of course, of why it was necessary to have a single person managing all requests to benefit under this sales promotion scheme (when that was possible) no matter how the requests were instigated: whether over the telephone or by a visit to any of the numerous retail outlets.

98. As it was, the CCTs contained repeated sales of exactly the same number of handbags on the same day for exactly the same price at different stores, Nina Chan dealing with them, and making out the invoices, often in minutes of each other. That raises another question: were these transactions packaged in some way? Were purchasers required to purchase a certain quantity in any of the promotions?

99. The mechanics of the ‘Rocket’ promotions do not appear to have been so complicated; customers chose how many items they wanted and arranged to make payment by cash. No suggestion was made that the rocket promotions were constructed as a ‘privilege’ club of some sort available only to particular purchasers.

100. On the face of it, it would be more normal than not for a potential customer to be able to go to any store in order to partake in the sales promotion, especially as the stores were spread around Hong Kong. That would enable each retail outlet to deal with its own customers and earn its own commissions. But that was not done. All 'Rocket' sales had to go through that one person: Nina Chan (if she was on duty).

101. It may have been of course that Nina Chan understood the dynamics of the promotions and was trusted, therefore, in all good faith, to deal with them from the sales side. But as a matter of thoroughness, surely the RaffAello transaction team needed to better understand the nature and purpose of her central role, especially having regard to its significance in the generation of such closely connected cash sales.

102. In the opinion of the Tribunal, it is a matter of concern that the RaffAello transaction team did not seek (with greater energy) to interview Nina Chan in order to better understand the true dynamics of her role at the helm of the CCT scheme. Yes, it is true that, by the time RaffAello took on the role of sponsor, Nina Chan was no longer employed by Paprika. That said, however, there is no indication of any concerted attempt to contact her even though, on the evidence, it appears she was still in Hong Kong[11].

Evidence of consistent inflating of the value of CCT invoices

103. On rare occasions, of course, in any auditing function, an invoice that has been understated or overstated will be found. In respect of the invoices that had been inflated in value, these being invoices discovered by the SFC in the course of its own investigations, it appeared to be a fundamental argument on behalf of RaffAello that it was simply not possible

[11] At a much later time, Nina Chan was, in fact, interviewed.

for sponsors, no matter how diligent, to 'chase every rabbit down every hole' and that, as it was, the amounts involved in the issue of the inflated invoices was really insignificant when looking to the totality of the monetary values involved in Paprika's trading.

104. The Tribunal does not agree. In the present case, the inflated invoices discovered by the SFC were not entire rarities. In addition, of very real importance, the evidence was one way: that is up, really, if ever, down.

105. Nor, when considered in context, could the inflation figures be dismissed as being of no evidential value. To the contrary, they were, in the opinion of the tribunal, of very clear evidential value. They gave rise to important questions. For example, how were these inflated figures dealt with in the accounts of Paprika? There was certainly no evidence of them being disgorged.

106. In the opinion of the Tribunal, in the present case, any suggestion that attempting to find the inflated invoices would have amounted to an attempt to 'find a needle in a haystack' must also fail. As it was put by Mr. Nip, there were occasions when members of the RaffAello transaction team conducted reviews of invoices for particular individual stores in respect of particular days. Within those parameters the total number of invoices would not have been great and yet none of the inflated invoices appear to have been found or, even if found, acted upon. In this regard, in final submissions, Mr. Nip pointed to the findings made by the SFC that at one store (Domain) on 6 March 2016, 10 out of 32 invoices (31%) were found to be inflated while on the same day, at another store (Kowloon City Plaza) 11 out of 16 invoices (69%) were found to be inflated.

107. In respect of what the Tribunal is satisfied *was* a practice of

over-invoicing in the two year track record period, the following is an individual example. It relates to invoice R061600955. That part of the invoice which revealed details of the merchandise sold recorded the sale of 7 handbags at a price of $499 each, this making for a total of $3,493. However, that part of the invoice which gave the total payment due stated a figure of $4,130. In short, there had been an over-invoiced amount of $637. This, considered on its own, is a significant figure, certainly significant enough to have been corrected by the purchaser. There was however no evidence of this.

108. At core, the Tribunal's concern is that evidence of inflated invoices that had been accepted at face value, with no evidence of correction, is an indication that, while one or two may have been overlooked, the bulk of them must have been processed in the full knowledge of both the individual payer and the management of Paprika that they were inflated in value. Most payers - especially if they are making purchases by way of business - will check that the amounts they have to pay tally with the amounts stated on the face of their invoices; none, it may be presumed, wantonly give away their money.

109. Evidence, therefore, of inflated invoices that have been paid without correction, unless entirely isolated, is - in a case like the present one - *prima facie* evidence that monetary figures have been manipulated with the connivance of both the party making payment and the party receiving payment. Put bluntly, it is *prima facie* evidence of fraud. Regrettably, however, any evidence of over-invoicing was missed entirely by RaffAello.

Discrepancies as to the true retail sale prices

110. When the RaffAello transaction team first questioned the management of Paprika, it was informed that the 'consecutive cash

transactions' entailed the purchase of 'Rocket' products, these being products sold by way of promotion, the price of the items typically ranging from $99 to $299. Later investigations, however, revealed that the merchandise sold under the promotion had ranged in price from $499 to $890, more than double the apparent 'special promotion prices' described by the Paprika management.

111. This raises the question of just how thorough the RaffAello transaction team had been in their investigation of the price dynamics of the 'Rocket' promotions.

Dealing with the cash proceeds

112. The available evidence before the Tribunal further indicated that the cash proceeds raised by way of the CCTs were, it appears, dealt with separately from other cash proceeds (for example, over the counter sales of individual items); they were banked at different times, often later, and, it appears, were banked at different branches, invariably (so it seems) at a branch near Paprika's head office. The proceeds of the 'consecutive cash transactions' were, therefore, kept separated from other cash proceeds. That begs the question: why?

113. During the course of submissions made by Ms. Kong, counsel for RaffAello, it was said that, presumably because of a lack of manpower, sales managers would often deposit the cash proceeds from the CCTs into the bank near Paprika's head office in Lai Chi Kok. In the view of the Tribunal, however, this raises another concern, one that questions the need to bank the CCT proceeds in a different bank from the one used to bank other cash proceeds earned by each retail outlet. For that to have been a practice - one conducted, it appears, by the sales managers - it points again to the fact that the proceeds of the CCT were kept sealed from other cash proceeds.

114. In his submissions made to the Tribunal on behalf of the SFC, Mr. Nip laid emphasis on what he described as the superficial and inadequate level of due diligence conducted in respect of the CCT issue by RaffAello's transaction team. In this regard, his submissions were supported by Mr. Philippe Espinasse, the expert witness called by the SFC. In his witness statement, Mr. Espinasse said that, bearing in mind that the issues set out above all fell within a limited 'sample' period of just 22 days, they would have caused him concern; in short, in his opinion, they constituted 'red flags'. As he put it -

> "In my opinion and experience, the risk with such types of red flags is that some sales may in fact have been inflated, not being genuine commercial transactions or indeed even non-existent."
>
> "Such issues would have been all the more critical in view of the fact that retail sales accounted for 90% of Paprika's revenue during the period under review in the listing application. Further, more than 80% of retail sales were generated by Paprika's retail stores.
>
> In addition, I am instructed that many such consecutive cash transactions (a total of 230, involving the sale of 1 431 handbags) occurred during what was a short period of time of just over three weeks."

115. In his witness statement[12], Mr. Espinasse stressed that these issues were of importance and should have raised concern as to just how widespread they may be.

116. In respect of the thoroughness of RaffAello's due diligence, Mr. Espinasse noted that in a number of cases there appeared to have been a failure to verify the identities of people being interviewed, for example, by way of copies of identification documents or business cards being retained. This, he said, appeared, on its face, to contravene not only best practice on the

[12] Adopted into his oral evidence.

part of a sponsor but to contravene the Code of Conduct too[13].

117. Mr. Espinasse stressed that, on the information available to him to review, it appeared that all the confirmations obtained by the RaffAello transaction team had come from Paprika itself, either through it accounts department or sales department or other employees and that no attempt appeared to have been made to seek the views of independent parties or to consider independent procedures. Mr. Espinasse was concerned that in the circumstances there had been an over-reliance on management's representations or confirmations for the purpose of verifying information.

118. On the basis of the matters set out above, the Tribunal is satisfied that, in respect of the issue of consecutive cash transactions - in respect of which the RaffAello transaction team had done little more than accept explanations given to it by Paprika management and staff - there was a clear failure of due diligence, a failure that may very well have gone to the fundamental issue of the integrity of the listing.

The issue of the bulk purchase of handbags by credit card

119. In conducting its exercise of retail sales vouching, the RaffAello transaction team came across evidence that on the sample days around 240 credit card transactions had been made in different retail outlets in Hong Kong in terms of which just 11 individuals had made extensive purchases of handbags.

120. To this should be added the discovery that, in respect of these bulk purchases from retail outlets by way of credit card payments, the SFC again came across a number - close to a dozen - of inflated invoices. Again,

[13] See paragraph 17.6(f)(iii) of the Code of Conduct.

the final amount due on the face of those invoices was always overstated never understated; again, therefore, indications of an attempt - by slow steps - to add to Paprika's revenue stream.

121. When questioned as to why these bulk credit card purchases - covering the purchase of 1,862 handbags for a total price of $1,399,910, representing more than 83% of the credit card sales on those days - should have taken place at a retail level and not, as normally expected, at a wholesale level, the management of Paprika informed the RaffAello transaction team that -

a. Certain Paprika products had been purchased in bulk at retail prices, no doubt for onward sale, because those products had not been made available to purchase at wholesale prices;

b. As to why only retail purchases were possible, it was said that these purchases must have been made during the promotion of 'Rocket' products; very marketable products, therefore, but only sold at retail prices; and

c. it had to be remembered that significant purchases would have been made by 'grey goods' traders, that is, by parallel importers, who knew that the merchandise would fetch a premium price in the Mainland.

122. It seems that a matter of particular concern for the RaffAello transaction team was the discovery that, among the 11 credit card purchasers, three of them had a direct trading relationship with the Paprika Group and, to a greater or lesser degree, a personal relationship with Samuel Leung, the CEO of Paprika. These three persons were -

a. Mok Siu Kam ('Mok'), the director and sole shareholder of Novi eBusiness, the largest wholesale purchaser from the Paprika Group (purchasing handbags and accessories to the value of $8,421,000 in the year ending 31 March 2017) and a man well known to Samuel Leung, the CEO of the Paprika Group.

b. Choi Sui Ki, Ricky, ('Choi'), a director and shareholder in API Trading Company, the fifth largest supplier of handbags and accessories to the Paprika Group in the year ending 31st March 2017, selling goods to Paprika to the value of $3,180,000.

c. Chan Kin Fai, Raymond ('Chan'), a director and shareholder of Twinflies Company Limited, an even larger supplier of handbags and accessories to the Paprika Group.

123. In respect of Mok, the immediate question must have been why it was that the owner of Paprika's biggest wholesale purchaser of handbags, a man known personally to Samuel Leung, had nevertheless been required to purchase 'Rocket' handbags at retail prices.

124. Mok was, in fact, interviewed on two occasions prior to the listing application being filed. In these interviews, Mok said that he would, as a matter of business practice, purchase Paprika products on a wholesale basis and resell them in the Mainland via online portals. As to the credit card purchases under scrutiny, he said that he had been forced to make the purchases on a retail basis because the handbags in question had been special promotional items. These were items, it would seem, for which there was particular demand in the Mainland. Presumably, therefore, they had to be purchased in Hong Kong for onward transmission to the Mainland on a retail basis.

125. On behalf of RaffAello, Ms. Kong emphasised that Mok's business in the Mainland had been substantial. By way of example, she submitted that, between January and July 2017 approximately 14,000 items had been sold via JD.com. As Ms. Kong put it, having regard to the size of the business in the Mainland, it was necessary from time to time to obtain merchandise that was being promoted and was therefore of particular interest to buyers. The 'Rocket' handbags fell into this category.

126. Choi, director and shareholder of API Trading, a major supplier to the Paprika Group, was also interviewed by members of the transaction team, the obvious question being why it was that, as an actual supplier of handbags to Paprika, he would see it as being commercially advantageous to also act as a purchaser of handbags, even if they were marketed by way of promotions, for the purpose of reselling them in the Mainland.

127. Choi said that, from the beginning of April 2015 to the end of March 2017, he had made personal purchases in his own name on more than 12 occasions, the total value of these purchases being in the region of $170,000. He said that he would resell these handbags to Mainland merchants who managed portals on Taobao or WeChat. He said that, in doing so, he looked - personally - to make a profit margin of between 15% and 20%.

128. Choi claimed that the Paprika Group had not been aware of his activities and that Samuel Leung, the Chairman of Paprika, had, in fact, refused to sell him products for resale as a wholesale dealer.

129. Chan, director and shareholder of Twinflies, another major supplier to the Paprika Group, said that he had made two lots of purchases from the Paprika Group, one in January 2016 valued at $100,000 and another two months later valued at between $110,000 and $120,000. He said that he

had purchased the products in his personal capacity for resale in the Mainland through friends. He also claimed that Samuel Leung had refused to sell him products for resale as a purchasing agent.

130. On behalf of RaffAello, it was submitted by Ms. Kong that the version of events recounted by Mok, Choi and Chan each made good commercial sense. The three may have had close trading relations with the Paprika Group on a corporate basis but this did not prevent them from seeking to enlarge their personal profits by involving themselves in the business of parallel importing into the Mainland.

131. More specifically, it was claimed that Paprika, in refusing to sell its special 'Rocket' items on a wholesale basis, had clearly - and sensibly - been acting in its own best interests.

132. In the circumstances, it was submitted that the RaffAello transaction team, in accepting an entirely credible version of events, had discharged its obligation of due diligence.

133. The Tribunal is not able to agree with that submission. Again, what was presented was an unusual set of trading circumstances that raised concerns, a set of circumstances that had been identified by the RaffAello transaction team as requiring investigation. Those concerns must have been related to the possibility that the trading relationship was not genuine; indeed, that it may have been non-existent, simply invented (by trading associates) so that - over a period of time - the slow accretion of further revenue by Paprika could be demonstrated.

134. In such circumstances, it was necessary to seek to verify the trades in an objective manner. One way of doing so would have been to track

individual trades, confirming that they had in fact being made at the prices alleged and that there was objective evidence of this. Again, however, there appears to have been no concerted attempt made to verify the assertions made by Mok, Choi and Chan; no question, for example, of seeking documentary verification of the purchase, shipping and resale of any consignments of the handbags; in short, no attempt to obtain independent evidence that the sales had, in fact, been made and had, in fact, been made for the purposes asserted.

135. The Tribunal notes that RaffAello had itself engaged a purchasing agent who was provided with RMB409 and was able to purchase a handbag from one of Paprika's retail outlets for $299: evidence therefore that, looking at the numbers, it was possible to make a profit by way of parallel importing. This, however, did little more than prove what was already well known, namely, that items purchased in Hong Kong could be re-sold in the Mainland at a profit. The concerns at hand, however, were more specific; namely, whether, if it all, in respect of Mok, Choi and Chan, there had, in fact, been any sales as alleged and, if so, whether it could be demonstrated that they had been legitimate arm's length transactions.

136. On behalf of the SFC, it was also said that a study of the relevant invoices had shown that the same signature had been used on recurring credit card slips. As Mr. Nip, for the SFC, described it: "it [was] noted that the same signature was used for each credit card bulk purchase (regardless of the card holder) but a different signature was applied on each occasion. A corollary of this is that, for each cardholder, their signature differed on each occasion."

137. The Tribunal, however, in considering the quality of RaffAello's due diligence, has not taken this essentially forensic issue of different signatures into account. As it was put by Mr. Espinasse, the expert witness for the SFC -

> "… I agree with RaffAello that the identification of suspicious signatures on credit card slips constitutes a form of forensic due diligence which a sponsor is not required to undertake."

138. This was, of course, a statement of general applicability. Clearly, there would be occasions when the evidence of suspicious signatures is so obvious that it would be a clear failure of due diligence not to investigate the matter. This was essentially the submission made by Mr. Nip, for the SFC, namely, that, in the circumstances of the present case, there was no excuse for failing to spot the suspicious nature of many of the signatures on the credit card slips.

139. That said, having studied the copies of the signatures contained in the bundles of exhibits, the Tribunal is not satisfied that the probability of suspicious signatures must have been noticed in the course of conducting reasonable due diligence.

140. In the course of her submissions, Ms. Kong, for RaffAello, again emphasised her 'proportionality argument'. Again, in the prevailing circumstances, the Tribunal is unable to accept that as being a valid argument. First, the funds involved were not inconsequential. Second, more importantly, they pointed to a possible extended pattern of conduct.

141. In the opinion of the Tribunal, the RaffAello transaction team had been correct to single out and investigate the unusual activity in the lead up to the listing application in which just 11 persons - three of them being in a close trading relationship with Paprika - had made bulk purchases of handbags from Paprika. The failure lay in the fact that, having identified the concern, there was a lack of reasonable due diligence to ensure that it was fully and accurately explained.

142. The core failure lay in the fact that, on the evidence, it is clear that the transaction team was content to accept the explanations given by the implicated persons without any form of independent investigation: perhaps some focused audit. In this regard, the Code of Conduct states in unequivocal terms that over reliance on management representations for the purpose of verifying information cannot be regarded as reasonable due diligence[14].

The issue of the 'POS' invoices (and the six $27,007 transactions)

143. As stated earlier in this determination, when conducting its exercise of 'retail sales vouching', RaffAello's transaction team came across three particular areas of concern. The third area of concern was identified by the transaction team in the following cryptic manner: 'POS test was counted as actual sales'.

144. This note recorded the fact that members of the RaffAello transaction team had discovered four invoices in Paprika's financial records, each of them endorsed in handwriting with the capital letters 'POS' or 'POS Test' (or similar), the letters 'POS' seemingly standing for 'Point of Sale'.

145. On the face of it, leaving aside the ambiguous 'POS' endorsements, the form of the invoices and the fact that they had been discovered in Paprika's current financial records suggested that they were first-hand evidence of recent financial transactions.

146. However, when the members of the RaffAello transaction team spoke with the management of Paprika and also members of the sales staff, they were informed that the documents, it seems, were not original invoices but were instead copies of earlier invoices, these copies now being used to

[14] See paragraphs 47 and 48 of this Determination supra.

train new staff, especially in respect of the transition to a new accounting system: hence the endorsement of 'POS' - 'Point of Sale' - on these copy documents.

147. This, it was said on behalf of the SFC, had to give rise to the concern that, whether they were left there by mistake or knowingly, bearing only an ambiguous handwritten endorsement, they could be mistaken for original invoices and recorded as actual sales. In the result, there would be a duplication of sales, distorting the true sales figures.

148. During the course of the hearing it was argued on behalf of RaffAello that, viewed in the round, the amounts involved in this issue were of very small moment and that, having made inquiries and considered matters generally, RaffAello must surely have been entitled to exercise discretion not to pursue the matter further.

149. Again, however, the Tribunal must disagree. Stepping back and viewing the various matters of concern that the RaffAello transaction team had discovered, including this issue of the endorsed invoices, there had to be concerns that, to a greater or lesser degree, there may have been attempts to manipulate Paprika's finances in order to make it appear to the market that its revenues were more robust then in truth they were.

150. As it is, in the months after the listing application had been made, the SFC conducted its own independent due diligence and, in doing so, came across a number of concerns in respect of the endorsed invoices.

151. This is illustrated by the SFC's consideration of one 'POS'

invoice dated 16 January 2016[15] which, it was found, had been included in the daily cash takings of Paprika's Yuen Long Plaza retail store for that day. The invoice itself was made out for the sum of $27,007 and was included as part of the store's daily cash takings which that day came to $31,283.50. That single invoice, therefore, made up the great bulk of the cash sales that day.

152. When analysed, however, it had been shown that the 'POS' invoice had seemingly been inflated in value, being $11,085.00 greater than the aggregate price of the articles sold and detailed on the face of the invoice. That was an 'error' of considerable magnitude and it is highly unlikely that an arm's length buyer, certainly somebody looking to on-sell, would overlook such gross over-invoicing. But, according to the records, the amount of $27,007 had been duly paid. Here again, therefore, was *prima facie* evidence of an over-invoicing scheme.

153. Of further concern to the SFC was the fact that the proceeds of this invoice had been banked-in separately from the proceeds of other sales made at the same retail store on the same day. In this regard, the records showed that the full cash amount of $27,007 due under the 'POS' invoice had been deposited into one bank while the balance (made up of other cash sales that day) had been deposited into another bank a day later.

154. Two matters of concern therefore arose; first, there was evidence of gross over-invoicing evident on the face of the POS invoice and, second, that over-invoiced sum had been deposited into a bank account the day before the balance of the cash sales made at the store on 16 January 2016 had been deposited into a separate bank account.

[15] The invoice was number R041600202 and bore the marking 'POS Test Invoice'.

155. In addition to this, it was further discovered by the SFC that on 16 January 2016 a further five cash sales - including a second 'POS' invoice - detailing the same handbag models, in the same quantity and over-invoiced in the same amount had been made out, all being banked by way of split payments in the same manner as the amounts due under the 'POS' invoice.

156. After the filing of Paprika's listing application, the SFC made inquiries with the RaffAello transaction team about the concerns that its own enquiries had generated and was, it seems, informed that -

a. The transaction team had, in fact, in the course of its due diligence, made inquiries with the sales staff and had been given to understand that the transactions for $27,007 had all been related to pre-order/promotional sales in terms of which Paprika sales staff issued invoices to secure the discounts with the actual payment being received later.

b. As for the split banking, that is, the banking of each amount of $27,007 into one bank ahead of the balance of the cash sales for the day, this balance being paid into another bank, that was likely caused by the fact that the sums of $27,007 were intrinsic to the special promotions and were accordingly banked separately.

c. Due to the technical constraints of the old POS system, the selling price of items, once entered, could not be changed. Discounts had, in fact, been awarded. It was simply the case that the old 'Point of Sale' system had not permitted a particular selling price, once put into the system, to be changed to reflect those discounts. For that reason, the sales staff would take no

notice of the individual prices for each item shown on the face of the invoices but only to the final figure.

157. That said, as it was noted by the SFC, there was no evidence of this in any of the due diligence documents produced by RaffAello, documents such as vouching summaries and reports.

158. In addition to which, what was now being put forward simply gave rise to further questions. For example, it was difficult to see how the detailed invoices for $27,007 contained any discount; to the contrary, they appeared very much to reflect substantial increases in prices.

159. The Tribunal agrees with the SFC that the significance of the POS test invoices should be considered in the context that they, alongside the other matters of concern that were discovered, pointed to a possible intentional, that is, fraudulent, manipulation of figures in order to present a more attractive picture to would-be investors. That is not to say that it was proof of such a fact. It was, however, in the opinion of the Tribunal, cause for concern, a concern which, on the basis of any concerted due diligence, the RaffAello transaction team may well have been able to confirm or disprove.

160. In the circumstances, the Tribunal is satisfied that there was, in respect of this issue, a failure of due diligence on the part of RaffAello.

The failure to expand the exercise of due diligence

161. Having looked at the three matters relevant to Paprika's retail sales, it is a matter of concern for the Tribunal that, on the evidence, the RaffAello transaction team appears not - at any time - to have considered an expansion of its exercise of 'retail sales vouching' in order to see if the matters

of concern that had been discovered in the limited exercise were, in fact, of broader scope. Regrettably, it was not done.

162. This is not to say that, in the present case, this failure has been determined by the Tribunal to be a failure of reasonable due diligence. This matter was not argued before the Tribunal. The Tribunal does say, however, that there may be occasions when, in all the circumstances - looking, for example, to the true extent of possible misconduct - it may become necessary to consider expanding the breadth of an investigative test founded essentially on choosing samples.

The second issue: was there a failure of due diligence evidenced by a failure to confirm the independence and the commercial substance of two companies that were said to have substantial dealings with the Paprika Group, namely, Novi eBusiness Limited ('Novi') and API Trading Company limited ('API')?

163. The Paprika prospectus made clear to potential investors that both Novi, and API were trading companies of substance. In respect of Novi, it was held out as being the Paprika Group's largest wholesale customer, making purchases from Paprika of $3,813,000 in 2016 and $8,421,000 in 2017. In respect of API, it was held out as being the fifth largest supplier of merchandise in 2017, supplying goods to the value of $3,180,000 to Paprika in that year[16]. In the prospectus, therefore, there could be no doubt as to their commercial substance.

164. Equally, the prospectus made clear that both companies were independent third parties, the clear reading being that, unless otherwise stated, they traded with the Paprika Group at arm's length.

[16] The reference to years in this paragraph is a reference to the years as calculated in the two-year track record supporting Paprika's listing application.

165. As to the independence of Novi, a wholesaler, the Paprika Group prospectus declared -

> "We also sell our products to various Independent Third Party wholesalers [eg Novi] who would on-sell our products via (I) online sales platforms in the PRC …"

166. As to the independence of API, a supplier of goods to Paprika, the prospectus declared -

> "All of our five largest suppliers during the Track Record Period were Independent Third Parties. None of our Directors, their respective close associates or any of our shareholders (whom to our knowledge of our directors owned more than 5% of our issued share capital) had any interest in any of our five largest suppliers during the Track Record Period."

167. In the course of final submissions, Mr. Nip, on behalf of the SFC said that "One ordinarily expects third party suppliers and wholesalers of a retail company, and certainly one seeking to be listed, to be independent companies of substance and to deal with the retail company at arm's length."

168. It was Mr. Nip's submission, however, that there were numerous red flags that raised concerns as to two matters, first, the true independence of both Novi and API as business entities and, second, the true nature of their business affairs. As Mr. Nip put it, these were red flags that the RaffAello transaction team either missed or failed adequately to consider in context prior to the filing of Paprika's listing application.

a. Concerns as to the independence of Novi

169. Novi was described in the prospectus as a wholesaler company that made substantial purchases from Paprika. Novi described itself as a company that profited from the parallel market by importing the merchandise

it purchased from Paprika into the Mainland and selling it there over the internet. The terms of Novi's agreement with Paprika included the provision that Novi would sell at a minimum price that was no lower than the actual retail price in Hong Kong.

170. As mentioned earlier, Novi's sole shareholder and single director was Mok Siu Kam ('Mok') who was first interviewed by members of the RaffAello transaction team on 5 April 2017, some two months before the filing of Paprika's listing application. This meeting was held in Hong Kong in a building called the Golden Dragon Industrial Centre, the office/warehouse bearing a plaque with the name of Novi.

171. At that time, there were no concerns expressed by the RaffAello transaction team as to the independence of Novi or the fact that it traded at arm's length with the Paprika Group.

172. As it is, however, investigations conducted after the filing of the listing application on 14 June 2017 revealed potentially worrying questions as to Novi's true position of independence during much, if not all, of the two-year track record period.

173. On 3 October 2017, several months after the listing application had been filed, Mok was questioned by the RaffAello transaction team as to the circumstances in which he had acquired his sole shareholding in Novi.

174. Mok then admitted to a relationship dating back some time with Samuel Leung, the CEO of the Paprika Group. Mok said that Samuel Leung had wanted their trading relationship to be given a corporate footing. Mok had agreed and was informed by Samuel Leung that arrangements could be made for him to receive the issued shares in a company called Paris Fur

(International) Limited ('Paris Fur'). In addition, so that the name of the company was made relevant, it was agreed that, upon transfer of the shares to Mok, the name of the company would be changed to Novi eBusiness.

175. Although a desire to operate on a corporate basis would not necessarily have been surprising, exactly why Samuel Leung had wanted the arrangement to be put in place was never explained by Mok. Nor did Mok ever explain why, in order to set up this new corporate relationship, it was agreed that he should be given the shares in an existing company by Samuel Leung as opposed to incorporating his own company.

176. 'Shelf companies' of course are often transferred in a similar fashion for the sake of commercial convenience. This company, however, had a somewhat unusual history, a fact (seemingly) not learnt by the RaffAello team until well after the Paprika listing application had been filed. By way of an outline, as the Tribunal best understands it, events making up this history may be described as follows -

a. Hon Ming San, Stephen ('Stephen Hon') had been a shareholder in the Paprika Group prior to its attempt at listing, holding 15% of equity. On its face, therefore, this suggested he would have been a person of some significance in the Paprika Group and would certainly have had a relationship with Samuel Leung, Paprika's CEO.

b. In addition, Stephen Hon had also been the executive director of a listed company, China Smarter Energy Group Holdings Limited ('China Smarter').

c. In this regard, it should be noted that a company secretary of China Smarter, a man named Suen To Wai, was listed in the

Paprika prospectus as being a proposed independent non-executive director of Paprika.

d. Investigations by the RaffAello transaction team discovered the fact that one of the subsidiary companies of China Smarter, a company named Rising Group International Limited, held the shares in Paris Fur (that being the previous name of Novi).

e. In May 2015, Rising Group International Limited, had transferred its shares in Paris Fur to a man named Choi Sing Kay.

f. According to Mok, it would have been a few months later, in about August/September 2015, that Samuel Leung and Stephen Hon introduced him to Choi Sing Kay so that Choi Sing Kay could transfer his shareholding in Paris Fur to him. The agreement for the transfer of shares had been entered into at about this time, said Mok, that is, in August/September 2015.

g. According to Mok, it was from this time, that is, from August/September 2015, that all dealings were put on a corporate basis, that is between the Paprika Group and Novi even though he did not learn until later that the 'formalities' of share transfer and name change of Paris Fur to Novi had not yet taken place.

h. As the Tribunal understands it, it was not until some five months later, on 8 February 2016, that independent evidence demonstrated that the formal transfer of shares took place and the name of Paris Fur was changed to Novi eBusiness.

177. What the evidence reveals therefore is that - if Mok is believed,

it was probably from about September 2015 but certainly from 8 February 2016 - that the new corporate arrangement had been put into place in the mistaken belief, on Mok's part at least, that he had already received the shares of Paris Fur and the name had been changed to Novi.

178. The question is: why was it that Samuel Leung, the CEO of Paprika, the company seeking listing, should have suggested that Mok should deal in future with Paprika on a corporate basis and, importantly, why would he then make arrangements for people closely related to Paprika to transfer the shares in a company with the history set out above?

179. On behalf of RaffAello, Ms. Kong submitted that, on any ordinary understanding of the evidence, it was clear that the transfer of the shares in the company to be renamed as Novi, had been carried out as an everyday independent transaction allowing Mok to formalise his trading relationships with Paprika. As Ms. Kong put it, it was sensible for Mok to acquire the company from someone connected to Samuel Leung, given that it was Leung who had requested Mok to incorporate Novi in order to formalise their trading relationship. In such circumstances, it was argued, it would have been natural for Mok to have accepted Leung's assistance in the transfer of an otherwise non-performing shelf company.

180. The Tribunal does not accept this submission. Mok's acquisition of Novi has to be looked at within the broader context and, if this is done, questions must arise as to the true intent of the broader corporate scheme, particularly as to the integrity of that scheme.

181. What at the very least these corporate manoeuvres show, is that, at a relatively early stage of the two year track record period leading directly to the application for listing on the GEM Exchange, far from maintaining an

arm's length distance in matters of their mutual dealings, there was - to the contrary - close liaison between Mok and Samuel Leung, the CEO of Paprika, as to fundamental changes in corporate structures.

182. To this must be added one other matter that reveals a close relationship between the Paprika Group and Mok, one that, when considered in the broad context of matters, suggests that Samuel Leung, the CEO of Paprika, felt able to utilise that relationship to Paprika's advantage. The matter may be explained as follows -

a. Mok partnered with two Mainland companies in order to sell Novi's products. The companies were Guangzhou Gaoling Trading Co. Ltd and Guangzhou Shangxing Trading Co. Ltd. The founder of the one company and the supervisor of the other was a man by the name of Guan Zhihua ('Guan'). He and Mok would therefore have had close business dealings together.

b. Guan, however, had also been authorised by Samuel Leung, CEO of the Paprika Group, to receive payments from a number of suppliers of merchandise to the Paprika Group. In a report to the SFC and the Stock Exchange made in August 2019, the RaffAello transaction team reported that Samuel Leung, Paprika's CEO, had explained this by saying that, since the Paprika Group had no bank account in the Mainland he had encountered difficulties in settling payments. In the result, as Guan was a partner of Mok, he had asked Guan to assist in making payments.

c. Again, at the relevant time, that is, as at the time when the listing application was made in June 2017, this suggested state of

affairs raised more questions than it answered. Put bluntly, what had actually been going on and why?

d. In this regard, Ms. Kong submitted that much later, well after the listing application had been lodged, Mok had explained to members of the RaffAello transaction team (who were visiting Novi's warehouse in the Mainland) that he was required to borrow the names of the two companies, Gaoling and Shangxing, in order to, carry out Novi's trading business on PC platforms as only China registered companies were entitled to manage and operate online business in the Mainland.

e. As Ms. Kong put it, this was a sensible explanation. Perhaps, yes, if supported by evidence. But again it showed - at best - a shift in emphasis. The original explanation, it seemed, had been related to the fact that the Paprika Group had no bank account in the Mainland. Now, however, the explanation was centred apparently on the licensing of online businesses in the Mainland.

183. Would the matters detailed above, absent open and explicit explanation made at the time of the listing application itself, have been of concern to potential investors? In the view of the Tribunal, clearly - yes, if only because it threw up concerns as to the true nature of the trading relations and the issues of why due care may not have been taken to ensure that the companies dealt with each at arm's length.

184. Regrettably, however, those issues appear not to have been discovered by the RaffAello transaction team prior to the application for listing or, if discovered, not adequately explored.

185. In the opinion of the Tribunal, more emphatic due diligence exercised earlier, that is, before the filing of the listing application in early June 2017, may well have come up with open and explicit explanations acceptable to the 'gatekeepers', that is, to both the SFC and the Stock Market, and also to potential investors generally. That, however, was not done.

186. All too often in these proceedings, with the greatest of respect to Ms. Kong's force of argument on behalf of Paprika, she has been forced effectively to rely on information that was only obtained well after the application for listing had been filed when the matters at issue before this Tribunal relate essentially to what should have been determined prior to the filing of the listing application.

b. Concerns as to the independence of API

187. API was described in the Paprika prospectus as the fifth largest supplier of handbags and accessories to the Paprika Group in the year ending 31 March 2017, selling goods to Paprika to the value of $3,180,000. The controlling director and shareholder in API was Choi Sui Ki, Ricky ('Ricky Choi')

188. The company, however, had not been incorporated in Hong Kong by Ricky Choi. API's history of incorporation was, in fact, very similar to that of Novi. Again, the incorporation process appears to have come through Samuel Leung, the CEO of Paprika.

189. As with Novi, the original 'owner' of API - then named Wellike Services Company Limited - had been the listed company, China Smarter.

190. On the same day that the shares in Novi had been transferred to

Mok, the shares in API had also been transferred to Choi Sing Kay who, in turn, later transferred those shares to Ricky Choi. Ricky Choi said that he had not previously known Choi Sing Kay but had been introduced to him by Samuel Leung and Stephen Hon. It was Ricky Choi who changed the name of the company to API.

191. More than that, it was discovered by the RaffAello transaction team that, in truth, API had only been an intermediary between the Paprika Group and the true supplier, a company called Lung Yiu.

192. As summed up by counsel for the SFC, Lung Yiu had been a supplier to the Paprika Group in 2016. In the following year, however, an arrangement had been put in place in terms of which Lung Yiu, now acting as a manufacturer of handbags and accessories, would supply the manufactured goods to API which would then supply them to Paprika.

193. As pointed out by counsel for the SFC, in 2016, the Paprika Group's business with Lung Yiu had been minimal, just $41,000. In the following year, however the Paprika Group's business with API, seemingly as an intermediary only, was valued at $3,180,000.

194. The Tribunal accepts of course, that reasonably complex trading relationships may, in the evolution of those relationships, both naturally and properly, result in increased complexity in the relevant corporate structures. The Tribunal also accepts that, in any listing application, there may properly be a desire to 'put matters in order' before the listing application is set in motion and that this may itself create complexity.

195. In the present instance, the issue of whether Novi and API were themselves independent third parties always dealing with the Paprika Group

at arm's length, is itself an issue set in a reasonably complex set of corporate happenings. The one matter that does shine out, however, is the fact that, in respect of both companies, fundamental issues of structure were not only recommended to them by the top management of the Paprika Group but that, as the preponderance of evidence shows, the mechanics of putting the structures in place were effectively managed by that same management. That, of course, begs the question: was there, in the circumstances, a failure by way of due diligence to ensure that the independence of both Novi and API had been maintained?

196. In his submissions on behalf of the SFC, Mr. Nip put the matter bluntly when he said -

> "In particular, almost all the issues indicate that Novi and API were nominee companies of Mok and Ricky Choi, so it was necessary for the Applicant [RaffAello] to investigate the relationship between Mok, Ricky Choi and Samuel Leung."

197. The suggestion made is that, despite appearances to the contrary, it was the top management of Paprika that set up both companies, Novi and API, doing so indeed at about the same time, in order to benefit the Paprika Group rather than the companies themselves. In the opinion of the Tribunal, as a determination of fact, that may or may not have been the case.

198. What is apparent, however, is that all relevant circumstances related to the manner in which both Mok and Ricky Choi came to control Novi and API suggests the very real possibility that it was, at the very least, for the mutual benefit of the Paprika Group and those two companies. That being the case, there was a burden placed on the shoulders of RaffAello to conduct due diligence in respect of the transactions in order to determine whether those transactions had been *bona fide*, the two companies remaining as independent

bodies trading at arm's length with the Paprika Group or whether, to a great or lesser degree, their independence had been compromised.

199. Regrettably, in respect of both Novi and API, there does not appear to have been any concerted attempt made by the RaffAello transaction team to identify, first, what in fact had taken place in order to bring about the change of shareholding and the change of name of Novi and API and, importantly, why that had taken place.

200. Perhaps, with a more rigorous investigation conducted before the filing of Paprika's listing application, it would have been found that, despite initial concerns, all involved parties had been acting in good faith - and always at arm's length - in order to construct a more efficient, more profitable trading edifice. Regrettably, however, in the view of the Tribunal, that investigation - that exercise of due diligence - did not take place.

a. Concerns as to the substance of Novi

201. Novi held itself out as a company that profited from the parallel market by importing the merchandise it purchased from Paprika into the Mainland and selling it over the internet. The terms of Novi's agreement with Paprika included the provision that Novi would sell at a minimum price that was no lower than the actual retail price in Hong Kong.

202. As mentioned earlier, Novi's sole shareholder and single director was Mok who was first interviewed by members of the RaffAello transaction team on 5 April 2017, some two months before the filing of Paprika's listing application. This meeting was held in Hong Kong in a building called the Golden Dragon Industrial Centre, the office/warehouse bearing a plaque with the name of Novi.

203. In the interview with members of RaffAello's transaction team, Mok said that the products purchased from the Paprika Group were delivered to Novi's warehouse in the Mainland. There was no suggestion that the products were stored on any kind of interim basis in Hong Kong. Goods were delivered, he said, to the Mainland warehouse in "one to two days".

204. In the same interview, and in several subsequent interviews that took place after the filing of the application for listing, Mok was able to gives details of how Novi operated its Mainland online stores - T.mall.com, JD.com and VIP.com - and was able to provide the RaffAello transaction team with sales data.

205. It should be said that several months *after* the filing of Paprika's listing application, members of the RaffAello transaction team (together with representatives of the reporting accountants and the legal advisors) made a visit to Novi's warehouse in the Mainland. On this visit, it was found that a working warehouse, one stocking Paprika products - was in place. While this was, of course, well after the application for listing had been lodged, it was nevertheless evidence of some value reflecting back to what would, or may well have been, the situation earlier in the year.

206. In its exercise of due diligence, however, prior to the listing application, RaffAello had contracted a company called Central Business Information Limited ('CBI'), giving to it the mandate to obtain further details related to Novi.

207. In order to fulfil this mandate, CBI had gone to the same building where the meeting with Mok had been held on 5 April 2017: the Golden Dragon Industrial Centre. CBI's report had been received by RaffAello on or about 7 June 2017, a week or so before the filing of the listing

application.

208. It was the case for the SFC that the report should have caused the RaffAello transaction team considerable alarm as to the true substance of Novi as a viable trading entity. That is because, when CBI reached the Golden Dragon Industrial Centre in order to visit Novi's offices, they could not find any sign or other identification. CBI had to report back that the identification of Novi's office - which had been visited in April when Mok had been interviewed there by members off the RaffAello transaction team - was no longer to be found in the business directory in the lobby of the building nor even at Unit A on the 18/F of the building where Novi's premises had been.

209. That said, in describing the premises, even though the 'Novi' sign was gone, CBI had reported that it was "maintained as an office with storage area where a number of cartons were piled up. About two employees were working in the office which consisted of computers and office equipment." The report had continued by saying: "A discreet enquiry was conducted with an employee who confirmed the Subject's [Novi's] existence. No further information regarding the subject was provided."

210. By way of a more general check, CBI report had further recorded that Novi did not appear to have any published contact information in Hong Kong: no telephone number, no fax number, no Internet address or website and no email address publicly available. As to a search of the Internet, the report said that it had revealed no business information regarding Novi.

211. It is understandable that the CBI report, if accepted at its face, would have given rise to very considerable concern, the question being: was it the case that, just days before the listing application was to be filed, Novi, a major wholesale purchaser, had abruptly closed its doors, this being done so

soon after the close of the two-year track record exercise?

212. That said, again at a much later time, after the filing of the listing application, in answer to a question from the SFC as to the reaction of the RaffAello transaction team to the CBI report, the answer provided by the transaction team was as follows -

> "The CBI search report was circulated to our team, our team has reviewed and has considered all the findings, we have not identified any material issues."

213. That answer is understandable if, on the evidence available to the RaffAello transaction team at the time, its members understood that Novi was essentially a commercial entity based in and operating in the Mainland. In this regard, in light of its interview with Mok on 5 April 2017, that is, before the filing of the listing application, the RaffAello transaction team was, of course, aware that Novi's business was entirely focused on the Mainland and that, while merchandise may have been purchased in Hong Kong, it was delivered directly to Novi's warehouse in the Mainland. The Golden Dragon Industrial Centre appeared to have no role to play in Novi's commercial operations other than as an office of convenience.

214. In light of this information - namely, that, even if Novi shared an office/warehouse in Hong Kong with other companies, for all substantive purposes, its business operations were located in and conducted from the Mainland - it is perhaps not surprising that, when the RaffAello transaction team received the CBI report, it did not identify any "material issues". Put more directly, the CBI report, on its own, did not suggest to the RaffAello transaction team that Novi had shut down as a going concern.

215. Nor can it be argued with any conviction that CBI's failure to

learn of any of Novi's Hong Kong contact details must have raised alarm bells. As mentioned above, even if Novi was registered in Hong Kong, its business operations were entirely focused on the Mainland. Accordingly, such details were essentially superfluous in Hong Kong.

216. What should also be said is that, in the months following the filing of Paprika's listing application, when seeking to answer the many queries raised by the SFC and the Stock Exchange, the RaffAello transaction team certainly seemed capable of contacting Mok when the need arose. In this regard, in November 2017, some five months after the filing of the listing application, when it was seeking to answer various questions raised by the SFC and the Stock Exchange, it conducted a further face-to-face interview with Mok concerning Novi and its business operations.

217. In all the circumstances, in the opinion of the Tribunal, it has not been demonstrated on a balance of probabilities that in early June 2017 the RaffAello transaction team had failed in its obligations of due diligence by continuing to accept that, even if Novi had taken down its signs at the Golden Dragon Industrial Centre, it remained a functioning trading concern.

b. Concerns as to the commercial substance of API

218. Just as CBI had been commissioned by RaffAello to obtain details of Novi, it had similarly been commissioned to obtain details of API. It was unable, however, to find any Hong Kong telephone number nor any trade references or information related to the company on the Internet. In addition, a site visit to API's registered address was unsuccessful.

219. Equally importantly, the RaffAello transaction team had discovered that for the latter part of the track record period, API had not been

operating as a supplier of merchandise to the Paprika Group but had changed its role from an actual supplier to that of an intermediary only. Why that was the case appears not to have been clearly answered. Certainly, little, if anything, was put before the Tribunal as to the true financial consequences of that change of role. On the face of it, it appeared that API had still made sales substantial to Paprika. But how could that be the case if it was now acting as an intermediary only?

220. Put in plain terms, there had to be concerns as to API's true business model, whether the prospectus was, in the circumstances still accurate or whether it required amendment. That concern was of fundamental importance because it defined the commercial substance, if any, of API.

221. Regrettably, in the opinion of the Tribunal, whatever may have been discovered at a later stage, in June 2017, when the application for listing was filed, that concern had either not been identified or, if understood, had not been considered with sufficient vigour. Either way, the Tribunal is satisfied that, in respect of the commercial substance of API, if any, there had been a failure on the part of RaffAello to conduct due diligence.

Summary of findings

222. The first broad issue that fell for determination in this matter was focused on whether RaffAello, in its role of sponsor, had failed to conduct reasonable due diligence in respect of transactions conducted at Paprika's retail outlets in Hong Kong. This broad issue encompassed three sub-issues which have been described in the body of this determination as follows -

a. the issue of consecutive cash transactions;

b. the issue of credit card bulk purchases, and

c. the issue of the POS test invoices.

223. In respect of each of these sub-issues, the Tribunal has found RaffAello to be culpable of a lack of due diligence.

224. The second broad issue that fell for determination in this matter was focused on whether RaffAello, in its role of sponsor, had failed to conduct reasonable due diligence in seeking to determine whether two companies that (supposedly) had substantial dealings with Paprika were themselves companies of commercial substance and, in conducting business relationships with Paprika, had done so as independent third parties. In respect of each of the two companies, Novi and API, the Tribunal has found as follows -

a. as to the issue of whether each company, in conducting business dealings, had done so as an independent third-party, the Tribunal found that RaffAello had been culpable of a lack of due diligence.

b. as to the issue of their commercial substance, in respect of Novi, the Tribunal was of the opinion that it had not been demonstrated that there had been a failure of due diligence on the part of RaffAello. In respect of API, however, the Tribunal was satisfied that RaffAello had been culpable of a lack of due diligence.

Sanctions

A. The SFC's determination of the 'sanctions issue' made prior to proceedings taking place before this Tribunal

225. In its Notice of Proposed Disciplinary Action dated 11 June 2021, the SFC informed the Applicant that it was of the preliminary

view that it was not fit and proper to remain licensed and that it should, in addition, be publicly reprimanded. As a monetary sanction, the SFC proposed a fine of $13 million, this sum being calculated as follows -

a. in respect of the failures related to the issue of 'consecutive cash transactions', a fine of $4 million;

b. in respect of the failures related to the issue of 'credit card bulk purchases', a fine of $4 million;

c. in respect of the failures related to the issue of 'POS Test Invoices', a fine of $2 million;

d. in respect of the failures related to API and Novi, a fine of $3 million.

226. In seeking to contest the SFC's provisional assessment, it was (among other matters) emphasised on behalf of RaffAello that it was a small corporate finance house that had incurred losses between 2018 and 2021 and that, importantly, it was able to show by way of financial statements prepared by its accountants that, as at December 2022, its total asset values stood at just $6.35 million. That being the case, the proposed fine of $13 million would render the company insolvent, putting it out of business. The consequences would be deeply prejudicial to ongoing sponsor engagements and would, of course, severely impact the livelihood of the company's employees.

227. Having considered the submissions made on behalf of RaffAello, while the SFC did not accept that its proposed fine of $13 million had been wrong in principle or at odds with the facts known to it at the time, it nevertheless determined that, in light of RaffAello's particular financial circumstances, the fine should be reduced to one of $4 million.

228. Of importance, there was no longer a finding that RaffAello was not fit and proper to remain licensed. There was therefore no suspension of its licence which meant that, while subject to public sanction (by way of a published reprimand), it would nevertheless be able to continue its business operations.

229. Before this Tribunal, however, it was argued on behalf of RaffAello that, in light of all relevant circumstances, particularly what were submitted to be - at worst, - marginal levels of culpability, even this fine of $4 million (coupled with a public reprimand) was wrong in principle and was excessive, placing the continued existence of the company in jeopardy.

230. It was submitted that, for a relatively small company filling a particular niche in the market, a public reprimand was itself a penalty of substance which could, and would, no doubt have a profound effect on RaffAello's ability to obtain future sponsorship mandates.

B. A preliminary issue - revisiting RaffAello's financial circumstances

231. In final submissions made to the Tribunal, Mr. Nip, for the SFC, sought to revisit the issue of RaffAello's parlous financial standing, the issue which had persuaded the SFC to reduce its fine from $13 million to $4 million.

232. It was Mr. Nip's submission that, on a further study of all relevant financial papers, it was now evident that deliberate steps had been taken by RaffAello to create the false appearance that a proposed financial penalty of any substance would place it in financial jeopardy. Mr. Nip's submissions were founded on the provision contained in the SFC Disciplinary Fining Guidelines that, in assessing any financial sanction, the SFC may take

into account the fact that deliberate steps had been taken to create such a false appearance.

233. It was Mr. Nip's submission that, on the evidence, the single, compelling inference to be drawn was that Ricky Tsang, who had acquired full interest in the company in mid-2018, once he knew his company was under investigation, had made a number of loans of substance, particularly a loan to his own sister's company, all of these loans proving impossible to recover. Indeed, his own sister's company had subsequently gone into liquidation.

234. Mr. Nip based his submissions on RaffAello's relevant financial returns made to the SFC which, he argued, showed that from June 2021 RaffAello had made 'substantial loans to associated companies' which were subsequently written off from December 2023 and thereafter.

235. Ms. Kong, on behalf of RaffAello, strongly opposed any suggestion that any of the constrained assets of RaffAello had been deliberately transferred, hidden or disposed of in order to avoid an appropriate financial penalty being imposed by the SFC. It was, she submitted, an assertion which had been unfairly sprung on her client.

236. The matter that needed to be demonstrated by Mr. Nip, of course, was one of deliberate, that is, intentional, hiding of funds. The mere fact that poor business decisions had been made, including ill-advised loans, would not of themselves be sufficient unless they gave rise to the compelling inference that they had been made in order to avoid the probable surrender of those funds at a later time to the SFC.

237. Ms. Kong, on behalf of RaffAello, accepted, of course, that the

company had undergone severe financial difficulties over the past few years and that, financially, it remained in a very difficult situation. It was her submission, however, that the company's accounts clearly showed that, due largely to the Covid crisis and its resulting financial stresses, a number of RaffAello's Mainland clients had been unable to pay fees. In the result, in 2023, most of these fees had to be written off. Expressed broadly, it was Ms. Kong's submission that prevailing difficulties in the market had been principally responsible for RaffAello's dire financial problems and that there was no evidence of any real weight that dishonest steps had been taken to hide assets.

238. It was also pointed out by Ms. Kong that, in light of the seriousness of the allegations made, it was concerning that her client had not been cross examined in any depth as to the issue.

239. In the opinion of the Tribunal, while the matters placed before the Tribunal by Mr. Nip as to the movement of funds did raise a level of concern[17], and may well have pointed to the exercise of poor business skills, it was not possible for the Tribunal, on a consideration of all the evidence placed before it during the hearing, to conclude that either Ricky Tsang, or any of those employed by him in RaffAello, must have taken deliberate steps to place funds beyond the reach of the SFC.

C. General principles relevant to assessing a financial penalty

240. As the Tribunal understands it, there was no disagreement of substance between the parties as to the relevant considerations in determining an appropriate sanction; these considerations being underpinned by the need

[17] Particularly regarding a substantial loan made to a company controlled by Ricky Tsang's sister, a company in financial difficulties at the time the loan was made.

at all times to maintain and promote confidence in the Hong Kong securities and futures industry. In the judgment of the Tribunal, that must be fundamental. Any material loss of confidence places the entire industry in peril.[18]

241. In respect of the imposition of a financial penalty, the SFC Disciplinary Fining Guidelines must be taken in consideration. In the view of the Tribunal, having regard to the circumstances of this matter, the following provisions are of particular relevance -

Whether the conduct in question was intentional, reckless or negligent

242. It was at all times accepted that RaffAello's culpability was founded on the negligence only of its officers. There was no suggestion that it had acted intentionally to somehow deceive; no assertion of bad faith was demonstrated. Nor was it demonstrated that any of the officers of the company had acted recklessly in the discharge of their duties of due diligence. Accordingly, culpability had to be assessed at the lowest scale of the three forms listed, namely, on the basis of negligent conduct.

243. Negligence itself, of course, has divisions of seriousness. The negligence displayed in this case, in the view of the Tribunal (as earlier set out), lay essentially in a failure to act with professional scepticism and a questioning mind.

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[18] Counsel for both the Applicant and the SFC accepted the correctness of the dicta in *Chu Kwok Shing Godwin v SFC* (SFAT No.1/2009, 30 June 2010; namely, that the purposes of disciplinary sanctions are, first, punishment; second, deterrence; third, where suspension, revocation or prohibition is involved, to ensure that the offender does not have the opportunity to repeat the offence, either for a limited period or indefinitely and finally, and fundamentally, to maintain and promote confidence in the securities and futures industry.

Whether the conduct in question caused loss to the market

244. In assessing an appropriate penalty, the Tribunal considers it to be of importance that no loss was caused to market users or, more generally, to the market itself. After working with the Stock Market and the SFC over an extended period of time in order to try and put the application for listing into acceptable form, RaffAello withdrew the application. It has never been resubmitted. There was, therefore, no loss to any market participants nor any imminent danger that such a loss might occur.

Whether the conduct in question damaged the integrity of the securities and futures market

245. This again is a matter of importance in determining penalty. There was, of course, potential damage to the integrity of the market. The Tribunal accepts, however, that good faith steps were taken by RaffAello to try and put its application for listing into good order but that, once it became apparent that there were simply too many underlying obstacles, the application was withdrawn by it.

Whether the conduct under scrutiny is widespread in the industry

246. While acts of negligence in the sponsorship process do arise from time to time, those acts being so significantly material that they warrant some form of sanction, nothing was put before the Tribunal to suggest that there was any call for industry-wide concern prompting deterrent action in this particular case.

Whether there were sufficient guiding materials

247. As the Tribunal has indicated earlier in this determination, over the years there has been ample guidance as to the nature and extent of due

diligence and the particular importance of the role and responsibilities of a sponsor in that process. The RaffAello transaction team could not therefore have been ignorant of the principles under which they were obliged to act.

248. That said, it was submitted on behalf of RaffAello that such guidance as was available at the time "was relatively open ended", leaving significant room for professional judgment and exercise of discretion. It was argued that this "lack of clear guidance and bright-line rules [must] make any breach by RaffAello less egregious". The Tribunal does not accept this submission. It is impossible to give guidelines which will clearly, without any need to use discretion, be able to make provision for each and every circumstance which may arise. Guidance can be - and is – given. Thereafter, having digested the true meaning and impact of that guidance, it is for the sponsorship team, acting together, to ensure that the guidance is properly understood and followed in respect of individual factual circumstances that will always arise in any exercise of sponsorship.

249. As it was put by Mr. Nip (for the SFC) in the final written submissions of March 2025: "this is not a case which turns on resolving a particular ambiguity as to what the standards require." The Tribunal agrees. It has been instead a case of understanding the guiding principles, as they have (over the years) been set out in straightforward language, and ensuring, in an exercise of due diligence, that those principles are followed in the exercise of due diligence.

D. Assessing the amount of a financial sanction

250. This has not been the easiest decision to make. It is an underlying principle that, in assessing a penalty, one of the principal matters to be taken into account encompasses a consideration of the financial

circumstances of the party subject to that penalty. By way of illustration, a fine of $20 million may be of little, if any consequence, to a major investment bank (far less wounding than the blow to its reputation) but it may be devastating to a small, that is, a 'boutique' sponsorship company such as the Applicant.

251. It is not disputed that RaffAello - which has comparatively always been a smaller company, looking, it seems, to the more modest end of the sponsorship market - is at this time a company under very considerable financial stress. The SFC itself took into account that too great a financial penalty would (in all probability) simply drive the company into liquidation, prejudicing any sponsorship work in the hands of the company and, of course, in all likelihood, meaning that the current employees would be out of work. Hence the reduction of its financial penalty from $13 million to $4 million.

252. There is an important place for smaller companies in the market. The very existence of the GEM market underscores the point.

253. Accordingly, when considering an appropriate financial penalty as a form of punishment, the ability to meet that penalty without going out of business, while not in every instance determinative, must always be a persuasive factor. In this regard, the Tribunal is of the same view as the SFC, namely, that - remembering that fraud or reckless conduct was not identified, nor was there loss to market participants - too stern a financial penalty may simply drive RaffAello into liquidation, giving it no options for survival. It may also send a wrong signal to other smaller companies in the financial market.

254. That said, of course, although not applicable in the present case, the Tribunal accepts that, there will be cases when the degree of culpability is

such that the principle of deterrence must be given full recognition. There may well be occasions, therefore, when the risk of liquidation must simply be accepted.

255. In the present case, looking broadly to the full range and depth of the Applicant's failings in this matter in the discharge of its important mandate, one that seeks to protect the investing public and, of particular importance, one that must also protect the reputation of the financial industry in Hong Kong, the Tribunal determined that a somewhat sterner financial penalty than the one imposed by the SFC, namely, a financial penalty of $4 million, would have been appropriate. In this regard, the Tribunal would have looked to a penalty of between $4.5 and $5 million.

256. That said, the Tribunal has also had to take into account the fact that it came to a determination that RaffAello bore no culpability in respect of one of the matters for which it had been found liable originally by the SFC.

257. In light of that finding, bearing in mind that RaffAello will be subject to a public reprimand, one that will no doubt undermine its reputation, the Tribunal is satisfied that, in all the circumstances, taking into account the various matters urged upon it by counsel for both the SFC and RaffAello, and at all times recognising that it must determine penalty *de novo*, that is, as if it is the original decision maker, the Tribunal has determined that a financial penalty of $4 million, the same amount determined by the SFC would best meet the ends of justice in this matter.

258. The Tribunal has given anxious consideration to whether or not there should be an order of suspension for some period of time. However, along with the SFC, the Tribunal does not consider that in the present case it is required, more especially as a public sanction is to be published.

259. That being the case, the Tribunal orders –

a. that the Applicant company, RaffAello, be subject to a public reprimand, and

b. that it pays a financial penalty of $4 million.

Costs

260. There will be an order *nisi* awarding costs of these proceedings to the SFC, that order to be made final on the 30th day after this determination has been handed down.

Mr. Michael Hartmann, GBS
(Chairman)

APPEALS TRIBUNAL THE SECURITIES AND FUTURES 證券及期貨事務上訴審裁處

Mr. Webster Ng Kam-wah, JP
(Member)

Ms. Ivy Chua Suk-lin
(Member)

Ms. Cindy Kong and Mr. Joshua Yeung, Counsel, instructed by Siu and Co., Solicitors,
for the Applicant

Mr. Norman Nip, SC, leading Mr. Julian Lam, instructed by the SFC,
for the Respondent