Application No. 1 of 2008

IN THE SECURITIES AND FUTURES APPEALS TRIBUNAL

IN THE MATTER OF a Decision made by the Securities and Futures Commission under section 194(2) of the Securities and Futures Ordinance, Cap. 571

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

BETWEEN

CHAN SHUN KUEN, ERIC — Applicant

and

SECURITIES AND FUTURES COMMISSION — Respondent

Tribunal: Hon Mr Justice Stone, Chairman

Mr Kwok Lam Kwong, Larry, J.P., Member

Mr Tang Kwai Nang, B.B.S., J.P., Member

Date of Hearing: 4 and 5 June 2008

Date of Determination: 28 November 2008

DETERMINATION

The application

1. By a Notice of Application dated 2 January 2008, the applicant herein, Mr Eric Chan, applies for review of the disciplinary decision of the SFC, dated 10 December 2007, to fine him a total of HK$200,000.00.

2. This decision was made under section 194(2) of the Securities and Futures Ordinance, Cap 571 ('SFO'), and is a 'specified decision' within the meaning of section 217(1) of that Ordinance.

The factual background

3. The applicant, Mr Chan, first was registered as a securities investment adviser on 25 September 1995.

4. At the time of the matters the subject of the disciplinary action visited upon him, Mr Chan was licensed to carry on Type 6 (advising on corporate finance) activities for South China Capital Limited ('South China') where he was accredited until 19 November 2003; at the date of the SFC disciplinary action, Mr Chan had a clear disciplinary record.

5. Mr Chan's employer, South China, was a licensed corporation under section 116 of the SFO, and was an approved sponsor under the Rules Governing the Listing of Securities on the Growth Enterprise Market

('GEM') of the Hong Kong Stock Exchange; South China was also Mr Chan's employer from 12 December 2000, until he was asked to resign with effect from 19 November 2003.

6. The reason Mr Chan's career with South China came to such an abrupt end focused upon the proposed listing on the GEM of a mainland company known as the 'Sobao Group', a company incorporated in the Cayman Islands whose shares were held by 3 individuals, one PS Cheang (80%), one CH Lam (15%), and one Stacy Chang (5%).

7. The Sobao Group wished to list on the GEM, and pursuant to that desire it had appointed South China as sponsor for such application, which is defined within the GEM Listing Rules as the entity appointed by a new applicant to act as its sponsor for the purpose of ensuring compliance with the GEM Listing Rules, which are made by the Stock Exchange under section 23(2) of the SFO; these Rules periodically are updated, and the version with which this case is concerned is that which was in force in April 2003.

8. These Rules primarily are designed for the protection, information and reassurance of potential investors in the new vehicle which wishes to list on the GEM. For example, Rule 6.03 explains the importance attached by the Stock Exchange to the role of 'sponsor', and states in terms that "the Sponsor is expected to advise the issuer on [its] responsibilities in a competent, professional and impartial manner, so providing reassurance to investors."

9. Rule 6.04 provides that to be eligible to act as such, a sponsor must have been approved by the Stock Exchange, and Rule 6.16 contained a minimum requirement for executive directors to act as "principal supervisors", whilst 6.17 contained a minimum requirement for other licensed or registered members of staff to act as "assistant supervisors".

10. In addition, Rule 6.45 requires the sponsor to be closely involved in the preparation of a listing document, Rule 6.47(2)(c)(i) requires a sponsor to submit to the Stock Exchange a sponsor's declaration prior to the issue of the relevant listing document to the effect that it has satisfied itself to the best of its knowledge and belief that, having made due and careful inquiries, it is satisfied that the listing document is accurate, is complete in all material respects, and is not misleading, whilst Rule 6.47(2) requires a sponsor to make due and careful inquiries about certain specific matters.

11. It is essentially the breach of these requirements – together with non-adherence to the requirements in the Corporate Finance Adviser Code of Conduct – which resulted in disciplinary action by the SFC against the current applicant, Mr Chan, who was appointed "assistant supervisor" for the Sobao Group listing, against the "principal supervisor" within South China, Mr Howard Gorges – who settled on agreed terms the case as was brought against him by the SFC – and against Mr Robin Fox, a manager within South China who had been involved in the Sobao Group listing application, and against whom the SFC also took disciplinary action; the latter's application for review against such disciplinary action has been the

subject of the Determination of this Tribunal in SFAT No 11 of 2007, Determination dated 28 November 2008.

12. In the Determination in relation to the application for review by Mr Fox, we saw fit to describe the Sobao Group listing application, of which South China was sponsor, as "disastrous", particularly in terms of the 'due diligence' and representation aspects which a sponsor in the position of South China was mandated to carry out "with due skill, care and diligence".

13. Demonstratively this did not occur. No fewer than five draft prospectuses were submitted to the Stock Exchange, all of which were rejected, and the detailed questions posed by those responsible at the Stock Exchange for vetting such drafts either were not precisely answered or not properly answered at all; indeed, in the Determination in the earlier application of Mr Fox we suggested that in many respects South China as putative sponsor did little more than act as a sort of 'forwarding service' or 'glorified intermediary' on behalf of the client in terms of basic information and data required by the Exchange, absent proper evaluation thereof, and far less exercise of the required 'due diligence' by South China.

14. The documentary evidence before the Tribunal in this case – which essentially replicates that which was before us in *SFAT 11 of 2007* – in our view wholly vindicates the extensive criticisms as levelled by the regulator in terms of the performance and responsibilities of South China, and certain of its employees, in the context of the proposed Sobao Group listing, in particular in the areas of the veracity and accuracy of the representations made in the draft prospectuses as to the development,

marketing and sales of healthcare food, and whether South China as sponsor had satisfied itself that Sobao Group was able to comply with the basic qualifications required for listing under Chapters 11 and 24 of the GEM Listing Rules, whether the Sobao Group had fulfilled Rule 11.12 in respect of its active business pursuits period, lists of the top five customers and suppliers, and for further disclosure in the prospectus of whether each product was self-developed or otherwise.

15. In his detailed and helpful skeleton submission, Mr Beresford, counsel for the SFC in this application, has taken the trouble to set out in detail the precise sequence of events and correspondence as transpired between the relevant department of the Stock Exchange responsible for vetting material sent by South China on behalf of the Sobao Group, with particular focus upon the searching queries as raised by the regulator, the Hong Kong Exchange, South China during the period from 9 May 2003 to 30 September 2003.

16. For present purposes suffice to say that this historical narrative does not make edifying reading from the viewpoint of South China in terms of the adequate and proper fulfillment of its role as sponsor of this listing application. To the contrary. These exchanges of correspondence amply tend to demonstrate the deficiencies in performance of the due diligence process which under the Rules was the responsibility of the sponsor.

17. To take but one example: on 28 July 2003 the Stock Exchange sought further details of the apparent relationship between Sobao Group and an entity known as ‘Southern Pharmaceutical’ – which was said to have

assisted Sobao Group in carrying out product research and development work – and the Exchange also sought an explanation of why this information had *not* been disclosed in the first draft prospectus as submitted to the Stock Exchange.

18. On 1 August 2003 South China provided the Stock Exchange with a copy of a purported research and development co-operation agreement dated 1 March 2003 between Southern Pharmaceutical, Sobao Holdings (a BVI company) and Zhuhai Sobao which purported to ratify an oral arrangement dating from January 2000. South China represented that it had taken the view that the previously undisclosed information was not material; the letter containing this information was signed by Eric Chan, the applicant herein, and gave the names of Eric Chan, Robin Fox and Aron Leung as the persons authorized to conduct day-to-day communication with the Stock Exchange.

19. Thereafter, on 18 August 2003 South China represented to the Stock Exchange that: (i) it had been aware of the research and development arrangement with Southern Pharmaceutical since the beginning of its due diligence work in October 2002; (ii) that the written Research and Development Agreement had been entered into on 1 March 2003; and (iii) it knew of the written Research and Development Agreement in or around April 2003, and thereafter repeated these representations by letter to the Stock Exchange dated 27 August 2003.

20. Shortly thereafter, on 30 September 2003, South China represented to the Stock Exchange that it had been informed about the verbal

arrangement between Sobao Group and Southern Pharmaceutical when it carried out due diligence, and that it had requested Sobao Group to document the arrangement; once again this letter gave the names of Eric Chan, Robin Fox and Aron Leung as the persons authorized to conduct day-to-day communication with the Exchange.

21. The Stock Exchange plainly (and in our view, understandably) was not satisfied with these responses, and on 9 October 2003, Sobao Group's listing application was rejected by the Exchange.

22. This Stock Exchange letter of rejection of 9 October 2003 makes reference to the draft proofs of the proposed listing prospectus and related documents, and notes its active concern as to whether the company, Sobao Group Limited, was able to demonstrate that it had "actively pursued" one focused line of business throughout at least the 24 months immediately preceding the date of submission of the listing application ('the ABP Period') as required under Rule 11.12 of the GEM Listing Rules, (in this regard citing chapter and verse) with reference to the apparent R&D and other contractual arrangements with Southern Pharmaceutical) to the effect that this contention plainly had *not* been made out on the documentation as submitted; this letter concluded thus:

> "Based on such facts [as specified in the preceding 5 subparagraphs] and the other documentation and information submitted, the Listing Division is of the view that the Company has not adequately demonstrated that it has actively pursued one focused line of business during the ABP Period as required by Rule 11.12. Therefore, in light of your statement that all relevant information required to address our above concern has been submitted as of 30 September 2003, the Division has decided to reject the listing application of the company."

Subsequent SFC action

23. Consequent upon the final rejection of this proposed listing of Sobao Group, the SFC investigated the events which had led to such rejection, and conducted a number of wide-ranging interviews with personnel of South China who had been involved, including Messrs Aron Leung, HK Law, KF Cheang, Robin Fox and Eric Chan.

24. Once again, Mr Beresford has taken the trouble to set out in detail in his written submission the interview sequence, wherein, so far as we can see, different versions of events were related in terms of that which had happened with Sobao Group – for example, HK Law said that South China never had advised Sobao to formalize the oral agreement with Southern Pharmaceutical until after the Stock Exchange had asked about the arrangement – and, again, so far as we can see, different interviewees took steps to lay the blame on others for mistakes which obviously had occurred: for example, on 11 December 2003, Eric Chan is recorded as saying that Robin Fox, the manager in charge, had been responsible for reviewing the prospectus, and that he had "delegated" the project jointly to Robin Fox and Aron Leung, but that since Robin Fox could not read Chinese, Aron Leung had acted as "the contact person" with the listing client, whilst in this same interview, Eric Chan accepted that Messrs Fox and Leung reported to Patrick Cheng and himself, whom in turn both reported "periodically" to Howard Gorges, who also had reviewed all the documents.

25. For his part, at his interview on 31 July 2004, Aron Leung said that, apart from asking Sobao Group for agreements with sub-contractors, South China did not do any due diligence, he had been given no instruction

as to what due diligence needed to be done with regard to these sub-contractors, and when asked who was in charge of this job, he had responded:

> "…it was probably Eric Chan….It was probably not until a few days before the Form 5A was submitted [by South China to the Stock Exchange] that Eric Chan instructed Robin Fox to supervise my work. Since then, until I left South China, most of the things I did were first given to Robin Fox to peruse before giving them to Eric Chan to read. Having said that, sometimes I would report directly to Eric Chan. So, I believe Robin Fox might not understand or know all the things that happened before he was involved with this job concerning Sobao Group…"

The SFC disciplinary proceedings against Eric Chan

26. After conducting its interviews and investigations, the SFC decided to issue disciplinary action against Eric Chan, the "Assistant Supervisor" within South China in terms of the Sobao listing; as earlier noted, proceedings also were instituted against Mr Gorges, the South China Principal Supervisor (which in the event were compromised by agreement on terms) and against Mr Fox whom, again as earlier noted, also made application for review to this Tribunal of the penalty imposed upon himself by the SFC.

Notice of Proposed Disciplinary Action

27. By letter dated 12 September 2006 the SFC issued its Notice of Proposed Disciplinary Action under section 194 of the SFO against the present applicant, Mr Chan. This letter, which is in the usual detailed form, is some 21 pages and 80 paragraphs in length, speaks for itself, and we refer to its contents in outline only.

28. In substance, the regulator took the view that Mr Chan was guilty of misconduct and/or was not fit and proper to remain licensed because, when acting as Assistant Supervisor on the sponsorship of the listing application of Sobao Group Limited he had failed in 4 distinct areas:

(a) to ensure that the representations made and information provided by South China or Sobao was true, accurate, complete and not misleading;

(b) he had failed to conduct and/or ensure that due and careful enquiries on Sobao's business had been conducted;

(c) he had failed to properly and diligently supervise persons working on the Sobao listing; and

(d) he had failed to keep and/or ensure that proper books and records and a proper audit trail of work was kept, in each instance citing chapter and verse in terms of alleged breach of the relevant General Principle and CFA Code of Conduct.

29. After rehearsing these allegations in detailed fashion, wherein (at paragraph 6) the regulator identified the staff members of South China responsible for the Sobao listing application as Mr Gorges, Principal Supervisor, Mr Chan as Assistant Supervisor, Mr Robin Fox as a manager of South China, and Mr Aron Leung, an associate of South China, the SFC set out its preliminary conclusions (at paragraphs 64-70), which *inter alia* stressed the importance of the sponsor's "gate keeping role" to ensure that its scrutiny of the affairs of the company sought to be listed is properly conducted, the better to ensure the credibility of the company and the accuracy of the prospectus, so that the investing public is able to make "an informed decision by assessing the risks and potential of the company", and

that an inadequate sponsor who has made little effort to understand the company constitutes "a threat to the investing public as well as to the equities market itself…"

30. However, the regulator concluded, as Assistant Supervisor, with day to day responsibility for the listing, Mr Chan was obliged to be "actively involved" in the work undertaken "but, in short, you did not actively participate or adequately supervise South China's sponsorship of the Sobao listing", noting that the bulk of the due diligence was placed on the most junior member of the team [Aron Leung] with limited prior involvement in IPO assignments and no corporate finance experience before joining South China in September 2002, whilst Mr Chan's claim that he had delegated supervision of Leung to Mr Robin Fox appeared "flawed", since Fox was not involved until a month before the listing application had been lodged and therefore well *after* the initial and limited due diligence had been performed.

31. In the event, the SFC proposed to suspend Mr Chan's licence under the SFO for a period of 12 months, and set out (at paragraph 73) why it was considered that this was an appropriate penalty in all the circumstances, relying primarily on the extensive degree of deficient due diligence, the seriousness of untrue statements having been made to the regulators, the HK Stock Exchange, the fact that in the circumstances Sobao should not have been put forward by South China as a suitable candidate for listing, as then had become "abundantly clear to HKEx", and also in light of the potential impact that an inappropriately prepared IPO may have on investors and on the credibility of Hong Kong's stock markets.

32. It is also worth noting that in arriving at its provisional view as to penalty the SFC took into account the fact that Mr Chan had no prior disciplinary record.

Mr Chan's representations in response

33. On 13 November 2006 Mr Chan submitted lengthy written representations to the SFC.

34. We will not here repeat them in detail, and touch only upon their substance.

35. Suffice to say that Mr Chan submitted that in so far as his role in the Sobao listing was concerned, although he had brought Sobao as a client to South China, and although he was the nominated Assistant Supervisor of the Sobao Group listing, he was frequently travelling on business and was not physically in Hong Kong, and hence he had delegated his work and supervisory duties to Mr Robin Fox, who was expressly designated at a January 2003 meeting to be in charge of supervision of staff due diligence and the drafting of the prospectus, and that he, Mr Chan, considered himself in the circumstances simply to be playing a marketing and promoting role, that it was not his duty to understand Sobao's business, but instead was the duty of Mr Gorges and Mr Cheng, the Responsible Officers of South China, and also of Mr Fox, who was the person in charge of due diligence and supervision of staff due diligence together with the drafting of the prospectus; as such, Mr Chan maintained that he was responsible for neither due diligence nor the drafting of the prospectus.

36. As to the alleged research and development of Sobao, its co-operation agreement with Southern Pharmaceutical was said to have been in existence since early 2000, and had been reduced into writing in March 2003, and the non-disclosure in the 1st draft prospectus regarding this research and development co-operation arrangement with Southern Pharmaceutical had been reasonable at the time since there was then "no active involvement" by Southern Pharmaceutical, and South China had not considered that the non-disclosed information was material as Sobao's research and development was relatively simple; however, the prospectus had been amended in its fourth draft to satisfy this SEHK requirement.

37. With regard to issues of subcontracted manufacturing, it was submitted that there were no established rules as to how to carry out due diligence prior to the introduction of Practice Note 21 of the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong, and the decision as to how much detail was required in the prospectus was the responsibility of the Responsible Officers and of Mr Fox; besides Mr Chan himself had visited most of the business production sites and Sobao's laboratory site, and the surveyors, Norton Surveyors, had visited Sobao's lab on 25 March 2003 on South China's instructions, its findings were consistent with Leung's site visit memo and it was considered that further site visits were unnecessary. Nor was it normal to disclose the names of sub-contractors in the 1st draft prospectus, due to "confidentiality concerns", and the due diligence work as carried out by South China was sufficient to address both public concerns and the risk exposure of South China and of the public.

38. Mr Chan further pointed out that in terms of penalty the Sobao issue had prevented him from earning a basic salary for the last three years, (by reason of having been forced to leave South China and having been unable to obtain alternative employment in the field with this investigation hanging over him), that he bore no responsibility for the matter, and that he had "contributed to the industry".

Final decision of the SFC

39. By its Notice of Final Decision, dated 10 December 2007, the SFC concluded that Mr Chan had been guilty of the failures and breaches of the Code of Conduct as earlier set out, and as reproduced in this Final Notice, and thus that he was guilty of misconduct and that his fitness and properness to remain licensed had been called into question for the purpose of section 194 of the SFO.

40. Paragraph 8 of this Notice states that the SFC had decided to fine Mr Chan the sum of HK$200,000, and not to impose the 12 month period of suspension the regulator originally had been minded to impose. The SFC stated that in coming to this decision on penalty that it had taken into account Mr Chan's representations, and further the delay in his 'transfer of accreditation' request, which had been lodged in June 2006, but which had been held up by this matter. However, the SFC did not consider that the entire period from the date upon which such application had been lodged should be given weight, given the complexity of the investigation and the lengthy process thus required, and that "considering all of this, we have commuted the remaining notional suspension that would be left after taking into account a reasonable proportion of the time your licensing application

had been held up and commuted it to a fine we think appropriate", and that this approach had been taken because "we believe a fine would have less effect on your career than a suspension."

41. In terms of the reasons for its final decision, the SFC set these out in great detail in this Notice (at paragraphs 9 – 33 thereof).

42. Once more, we intend to do no more in this Determination than to summarise the main thrust within that which, if we may say so, is a careful and detailed examination and analysis of the position regarding the failure of this Sobao listing, and of Mr Chan's involvement therein.

43. In this regard the regulator took as its theme that whilst conceptually work may be delegated, as an Assistant Supervisor the GEM Listing Rules provide that *"At least one of the principal supervisors and one of the assistant supervisors must be actively involved in the work undertaken by the Sponsor in connection with any proposed application for listing by a new applicant"*, and that if Mr Chan, who was the sole Assistant Supervisor, was not in a position to discharge his responsibilities of an Assistant Supervisor, he should not have assumed this role.

44. The SFC went on to say that it did not accept that delegation of Mr Chan's work to Mr Fox, whom in any event they had found to have failed in his duties) was an excuse.

45. Thereafter, in explaining its reasons, the regulator embarked upon an analysis of what was said, and by whom, in interviews at the SFC,

referring to disagreements between the interviewees, including Messrs Cheng, Fox, Leung and Ivy Lock (a junior member of the team), noted that Mr Chan disagreed with their evidence, and concluded that "on balance, we consider their evidence more cogent as it was comparatively more contemporaneous with the events in question than [Mr Chan's] subsequent submissions".

46. The SFC emphasized that Mr Chan had been named on the Form 5A, as submitted to the regulator, as Assistant Supervisor, and that, as such, he had assumed responsibility for the role:

> "Given that you held yourself out to the SEHK as the Assistant Supervisor it is not open for you to shift the responsibility of supervising the listing application to others by claiming the work was delegated to another person given that you are required to be 'actively involved'. With your experience in the industry, you ought to have known that being named as the Assistant Supervisor in the Form 5A lodged with the SEHK was not a trivial matter…"

47. The SFC was in no doubt that Mr Chan was expected to be actively involved at all stages of the listing application, and that covering letters to the SEHK mentioned that if clarification or information was required, the Exchange should contact either Fox, Leung or himself. The regulator also emphasized that in the 'pre-vetting' system employed when new listings were being considered, the SEHK does not investigate the truth of claims and statements in documents but only asks questions – as indeed it did in this case, on very many occasions – and that it therefore relied on the sponsor, in particular the Principal Supervisor and Assistant Supervisor, "to reasonably assure the quality and reliability of responses as well as scrutinize the applicant: "you were in a position to help reasonably ensure

representations made to the SEHK were true and accurate and that the companies took reasonable steps to comply with relevant regulations. You did not do so, and failed to pay due regard to the Listing Rules…"

48. The nub of the criticism, therefore, was that Mr Chan ought to have performed "an instrumental role" given that he had been Assistant Supervisor, and that the regulator did *not* consider that his responsibility was mutually exclusive to those of other team members, in particular Mr Fox, "nor that their participation absolved you of your duties", and the fact that Mr Chan may not have been physically present in Hong Kong at the relevant times did not absolve him of his involvement and responsibilities.

49. Thereafter there followed a detailed account of what did, or did not happen in terms of due diligence, representations and so forth, with particular reference to the 'research and development co-operation agreement' with Southern Pharmarceutical, and whether representations made in this regard by South China had been untrue, and whether in any event it should have been included in the draft prospectus, and whether indeed South China had been as informed about this element as it had maintained; in addition adverse and critical comments were made about earlier non-disclosure of material subcontracting contracts: "We do not accept your submission that the identity of sub-contractors was confidential", and further that South China had a duty to consider this information to its reasonable satisfaction: "It is the duty of the sponsor to make reasonably full disclosure, as the purpose of due diligence is to ensure that the listing applicant is a viable company and potential investors are provided with

material information to enable them to make an informed decision as to whether or not to invest in the listed company…"

50. After commenting further on other arguments raised by the applicant, at the end of the day, the SFC summarized its position thus (at paragraph 29 *et seq*):

> "… we are not convicted that your involvement was limited and that all your duties and responsibilities were properly delegated to others. Your role as an Assistant Supervisor was fundamental to the listing process. We do not consider your submissions that you were an Assistant Supervisor in name only acceptable because you had to be actively involved. We consider that you failed to carry out the work expected of you as an Assistant Supervisor and considered that you assumed a supervisory role.
>
> As a licensed person, you were and are required to carry out your duties in a supervisory role properly and to reasonably ensure that those whom you supervise are properly performing their duties. As an experienced member of the team and also being named on record as the Assistant Supervisor, it was necessary for you to take reasonable steps to rectify or clarify matters, that is, for you to be actively involved.
>
> It is not acceptable that you did not take steps to satisfy yourself with a reasonable degree of comfort and understanding about the listing application even if you were not physically present in Hong Kong and to shift the blame to individual staff members by alleging that you delegated your duties and responsibilities…
>
> Having carefully considered your representations, we consider that the matters raised in your representations either have been explored in the NPDA or are not sufficiently exonerating to remove the need for the proposed disciplinary action. It remains our view that your fitness and properness has been called into question and that you are guilty of misconduct for the purpose of section 194 of the SFO."

51. Mr Chan was, and is, aggrieved at these conclusions, and accordingly has launched this application for review before this Tribunal.

52. We repeat the view expressed in the Determination in the review application in the case of Mr Robin Jonathan Fox, in SFAT No 11 of 2007, that we consider that it was unfortunate that these applications, which cover the identical factual matrix, should not have been scheduled to have been heard at the same time or one after the other; as matters have stood, only timetable vagaries have enabled us to consider these matters cohesively.

Viva voce evidence

53. Mr Chan chose to give evidence before the Tribunal as part of his application for review. No other *viva voce* evidence was called on his behalf.

The argument

54. Counsel acting for the applicant, Mr Vincent Chin, submitted a useful skeleton argument on his client's behalf, which consisted primarily of an analysis of the constituent elements of the breaches of duty alleged against Mr Chan, in terms of failure to provide accurate representations, failure to ensure the conduct of due inquiries, failure of supervision and so forth.

55. He suggested that in the context of a listing application, the provision of additional information within drafts of a prospectus as submitted to HK Stock Exchange did not automatically entail that a sponsor had failed to make material disclosure, particularly when HKEx makes known to a sponsor that a certain element of the purported applicant's business was of particular import in the view of the Stock Exchange; nor, he

said, did it follow that where a listing application has failed that the sponsor or the applicant itself necessarily had committed disciplinary wrongdoings by breach of the Listing Rules or of the various codes issued by the SFC.

56. Mr Chin submitted that the listing application of Sobao represented just such a case; what had happened was that HKEx had taken the view that R&D and subcontracted manufacturing activities were central issues in determining whether or not Sobao had satisfied ABP requirements, the sponsor, South China, had not initially shared those views, but in the event had deferred to the Exchange and had provided further information in a bid to satisfy the concerns which had been expressed, but "ultimately to no avail".

57. It was, he continued, "reasonably conceivable" that both the applicant and South China had acted in good faith, but still had failed to anticipate the "particular business angles" upon which the Exchange had laid so much stress, and that, in terms of material non-disclosure, there had been no satisfaction, in terms of the "high degree of probability" that was required in a disciplinary case of this type, that the applicant had contravened the relevant codes, rules or guidelines in having to provide additional information to the Exchange.

58. A like argument was propounded in terms of the alleged failure to conduct due inquiries in terms of Sobao's business and its R&D aspects: "the applicant clearly did not anticipate that HKEx would take such miniscule interests in the subcontracting details", and there were no particular requirements in the GEM Listing Rules, he said, for personal visits

to sites not belonging or leased to the listing applicant, and in any event, Practice Note 2 clearly permitted a sponsor to engage a professional third party to undertake due diligence work on its behalf, as had occurred with the instruction of Northern Appraisals by South China, which had inspected the office, laboratory, workshop and land site of Sobao.

59. Mr Chin maintained that in terms of business common sense, it was conceivable, indeed obvious, that Sobao would be likely to engage differing manufacturing subcontractors, and to have required Sobao to have named a few of these subcontractors in the prospectus would be to have bound Sobao to those subcontractors at the risk of making false disclosure in the prospectus, "thereby depriving Sobao of the freedom of engaging different subcontractors", which would not have made commercial sense. Such emphasis on subcontracted manufacturing was, counsel submitted, once again not anticipated by South China at the outset, but was a view to which South China ultimately deferred.

60. As to the issue of Mr Chan's failure to supervise staff of South China who were delegated to work on the Sobao listing, his client did not wish to "disparage" the role of Assistant Supervisor in the listing process, but Mr Chin maintained that on the evidence the applicant simply had not failed to discharge his supervisory responsibilities which came with the role of 'assistant supervisor'.

61. Whilst with regard to the question of failure to ensure the keeping of proper books and records and to provide an audit trail, this simply was not substantiated.

62. In his written submissions Mr Chin took the Tribunal through the various statutory provisions and Codes of Conduct, and further laid stress on the delay by the Enforcement Division of the SFC which had occurred in his client's case, emphasizing that the SFC had commenced enforcement action in October 2003, and had issued a Notice of Final Decision more than 4 years later, on 10 December 2007, which was unacceptable in terms of delay.

63. Moreover, in terms of his client's application to the Licensing Division for transfer of accreditation in June 2006, he suggested that the Enforcement Division had acted in bad faith in advising the Licensing Division of "procrastinate" on Mr Chan's licensing application.

64. What was more, said Mr Chin, it was clear from certain correspondence about the delay which had occurred that the Enforcement Division "had already prejudged the merits of the applicant's case", notwithstanding that a Notice was not issued until 10 December 2007.

65. This sequence of events led Mr Chin to submit that his client had suffered a *de facto* suspension of 16 months – from his application for transfer of accreditation in June 2006 to KGI, and to the latters' withdrawal of such application on 11 October 2007 – which was 4 months longer than the term of 12 months' suspension initially proposed in the Letter of Mindedness, so that even were the Tribunal not to be with the applicant on the substantive appeal, the applicant would submit that he had already been sufficiently punished by such *de facto* suspension, and that the existing fine of HK$200,000 was "excessive and gratuitous in the circumstances".

66. In turn, this led Mr Chin to suggest, in answer to a direct question from the Tribunal, that in the circumstances there should be an appropriate reduction in the fine from HK$200,000 to HK$100,000.

67. For the SFC, Mr Beresford submitted a typically precise resumé of the matters raised by this application. There were, he said, three basic issued which had been raised:

> First, whether the SFC had applied unreasonably high standards for the relevant time to the questions of what was 'reasonable disclosure' in the listing process, what was proper 'due diligence', and what was to be expected of the role of an Assistant Supervisor within the relevant sponsor;
>
> Second, whether the time taken in the determination of the disciplinary proceedings had caused a *de facto* suspension to the applicant's licence; and
>
> Third, whether the penalty as now handed down in the Notice of Final Decision is appropriate in principle and in amount.

68. As precursor to proffering answers to these issues, Mr Beresford usefully took the opportunity to survey the relevant law which had been raised on this application.

69. He pointed out that an act or omission relating to the carrying on of any regulated activity for which a person is licensed or registered and which, in the opinion of the SFC, is or is likely to be prejudicial to the interest of the investing public or to the public interest, is 'misconduct' within the meaning of section 193(1)(d) of the SFO.

70. He also suggested, correctly in our view, that the applicant's conduct was to be evaluated against the standards imposed by the GEM Listing Rules and the relevant Codes of Conduct which were in force at the time of the alleged infractions.

71. As to the issue of 'reasonable disclosure', whilst a sponsor is not without more responsible for its client's misrepresentations (see CFA Code of Conduct, paragraph 5.6), nevertheless it is responsible for its own misrepresentations, a responsibility which falls to be assessed within the context of the sponsor's responsibility to use all reasonable endeavours to ensure that the listing document was prepared to the required standard and that no relevant information had been omitted or withheld (see CFA Code of Conduct, paragraph 5.8), to understand the business of the client (*op cit.*, paragraph 6.1), and that the GEM Listing Rules requiring that the sponsor be closely involved in the preparation of the listing document, and to make due and careful inquiries that the information contained in the listing document is accurate and complete in all material respects and is not misleading, all matters which are reflected within the Issuer's and Sponsor's Declaration contained within the important Form 5A (at paragraph 22 thereof.)

72. The duties on a sponsor did not cease at the 'reasonable disclosure' requirement, Mr Beresford stressed.

73. In terms of 'due diligence', a sponsor's responsibility under the GEM Listing Rules to make due and careful inquiries is an activity within General Principal 2 of the Code of Conduct, which requires a sponsor to act with due skill, care and diligence, in the best interests of the client, and in

the integrity of the market. Moreover, a sponsor specifically represents and declares, within Form 5A, that it has "made due and careful inquiries".

74. As to the requirement of supervision, Mr Beresford submitted that a regulated person will fail to meet the standard of supervision set in paragraph 4.2 of the Code if he has failed to supervise the activities of another in circumstances in which his duty of care, whether imposed by contract or the general law, placed him under an obligation so to do, or where with knowledge he has participated in, or given his sanction to, the misconduct.

75. Looked at in the round, counsel for the SFC said, it was wholly clear that the allegations made by the regulator as to the deficiencies on the part of the applicant in this listing process could be seen to have been clearly made out; in fact, he suggested, it was not obvious why, given the facts as they now were known, that this application had been pursued in the manner that it had.

76. There were, he said, two aspects to the accuracy of the representations: those in the prospectus, and those in the written submissions to the Stock Exchange.

77. As to the prospectus, the 1st draft had stated that all existing products of the Sobao Group were developed by the Group, which simply was untrue, because Sobao had not developed its products on its own, but jointly with a third party, Southern Pharmaceutical; whilst as to the written submissions to the Stock Exchange, on 18 August 2003 South China had

made three representations: one, that they had been aware of research and development arrangements with Southern Pharmaceutical since the beginning of due diligence, that is, in October 2002; second, that the written research and development agreement had been entered into on 1 March 2003; and third, that it had known of the written research and development agreement in or around April 2003.

78. In fact, these representations were repeated on 27 August 2003, and they each were false, indeed plainly false; from the known sequence of events, it is clear that South China had had no idea that Southern Pharmaceutical were engaged or involved until June or July 2003, the allegation that the written research and development agreement had been entered into on 1 March 2003 was a "convenient date", no more, prior to the date that the listing application was filed on 29 April, and plainly was false, as was the allegation that South China knew of the agreement in or around April 2003, again before the original listing application had been filed.

79. Again when regarded in the round, therefore, the SFC fully was entitled to have come to the conclusion that that they did in relation to these representations, in light of the information both in the draft prospectus and in the correspondence, a matter which Mr Beresford characterized as "very serious misconduct".

80. Further, counsel submitted, manifestly there had been a striking failure to conduct adequate due diligence; in fact, in his interview, Mr Leung, who was the person charged with the task, actually had said so. He had said that he didn't know what to do, he wasn't told what to do, and in May 2003,

after Mr Fox had become involved, questionnaires had been located which had been started to be sent out, which clearly indicated what sort of due diligence ought to have been carried out before the first draft prospectus had been filed.

81. It was clear, said Mr Beresford, that South China had not conducted due diligence in terms of the research and development of Sobao's products – they had made this claim in the prospectus but they simply did not know what had been done – and in relation to the sub-contracted manufacturing arrangements, they again had no idea whom the subcontractors were, and what the terms were of these subcontracts; in fact, they had not sighted these subcontracts, and, ironically, one of the two subcontracting parties named on 18 May 2003 had been terminated with effect from 1 March 2003, and thus this whole aspect had been "a complete shambles".

82. In terms of the applicant's, Mr Chan's, failure to supervise the persons under him who were working on the Sobao listing, there were three specific SFC complaints: first, in the due diligence relating to the R&D; second, the lack of proper supervision in the drafting of the prospectus; and third, failure to ensure a site visit to Sobao's laboratory and factory – the history of events indicated that the first site visit took place on 16 July 2003 at the request of the Stock Exchange, as Mr Chan had said.

83. Thus, counsel submitted, it was obvious that most, if not all, of the activity for the listing application took place between 29 April 2003, when the application was made, and the date of final rejection of the

application, which was on 9 October 2003, which as an exercise in careful and independent verification spoke for itself.

84. The fourth complaint, that is, the failure to keep proper books and records, was maintained, Mr Beresford said, but was a matter naturally following on the other complaints and had no independent grounding.

85. But it was abundantly clear that in the unfortunate circumstances of this case that the SFC was entitled to make the findings that it did, none of which had been damaged in this application for review, and thus that the misconduct in question clearly was established.

86. With regard to the plea made on behalf of the applicant in terms of the '*de facto* suspension', counsel pointed to the fact that whilst section 122(2) of the SFO empowered the SFC to approve the accreditation of a licensed representative to another licensed corporation, section 122(3), which was in mandatory terms, provided that the SFC "shall refuse" to approve an accreditation application or a transfer of accreditation application "unless the applicant satisfies the Commission that he will be competent to carry out his duties to the requisite standard as a licensed representative for and on behalf of the licensed corporation concerned", and that it thus was incumbent upon the SFC to be so satisfied, especially when it was on clear notice that the applicant's fitness and properness had been impugned.

87. In terms of the 'bad faith' allegation mounted by the applicant against the SFC in the context of delay, Mr Beresford drew the attention of the Tribunal to the words of Sir Anthony Mason NPJ in *HKSAR v Lee Ming*

Tee (2003) 6 HKCFAR 336, who, when dealing with an allegation that senior SFC officers had deliberately and improperly terminated an investigation in order to avoid compromising the standing of the subject of the investigation who was acting as an expert witness in a criminal trial in which the SFC was interested, had observed (*op cit*., at para 72):

> "…that conclusion was not to be reached by conjecture nor, as the respondent submitted, on a mere balance of probabilities. It was to be plainly established as a matter of inference from the proved facts…In the particular circumstances, it was for the respondent to establish as a compelling inference that very senior officers of the SFC had deliberately and improperly terminated the investigation into Meocre Li's conduct for the ulterior purpose alleged, sufficient to overcome the inherent probability that they would have done so."

88. In this regard the applicant had not come close to hitting this high standard, Mr Beresford submitted, and thus the allegation as made should be ignored.

Decision

89. This Tribunal is unanimous in its view as to this application, which in our judgment has no merit whatever, and must be dismissed.

90. We have carefully considered the circumstances of this case, and the arguments variously propounded before us on both sides of the Bar table, and we find it difficult to understand why this review application was pursued given its lack of intrinsic validity.

91. We are in no doubt whatever that this purported listing application, which ultimately was rejected, was an extremely poor effort on

the part of the sponsor, South China; indeed, in the Determination in the parallel case of Mr Fox, to which earlier we have made reference, we also stated in terms that this was a "disastrous listing application", and there is nothing in the very similar evidence we have heard in this case – substantially the like primary documentation has been utilized before us – to alter this view, which, if anything, has hardened during the course this subsequent hearing in the context of the case of Mr Chan.

92. In fact, if we may say so, this proposed application strikes us as an object lesson in how a sponsor should *not* have conducted a proposed IPO.

93. As to the allegations made by the SFC against the present applicant, Mr Chan, we are in no doubt that the first three categories of allegation, namely the issues of disclosure, due diligence and supervision, have been more than made out; we think that the fourth head, that of retaining inadequate books and records, has not been established, and it is a little surprising, in light of the factual congruity of the two cases, that in the case of Mr Fox this head was abandoned and not pursued, but nevertheless that it was maintained in the present application. Clearly Mr Beresford had no instructions to give up the point; equally clearly, he did not wish to say a great deal about it, and thus for present purposes we have ignored it.

94. We do not wish to be unkind, but we feel impelled to say that, contrary to the situation with Mr Fox, who essentially gave a good account of himself in the witness box, and whom in the circumstances we considered at least had some reason to feel hard done by in the circumstances, to the

contrary Mr Chan was a very poor witness indeed, and one who created a most unfortunate impression in the minds of this Tribunal.

95. It may be that this case has been long ongoing, and has preyed on his mind to such an extent that Mr Chan has lost all sense of perspective and, if we may say so, any grasp of objective reality when it comes to this listing application and his own part therein, a phenomenon which in our experience is not uncommon in instances in which persons become 'fixated' by cases in which they personally are involved and/or are the subject of investigation and sanction.

96. We are bound to say that the transcript of his evidence makes most unhappy reading, and confirms, if such was necessary, our instinctive impression at the time when we heard Mr Chan's *viva voce* evidence; perhaps in the circumstances the kindest observation we can make is that in terms of this case that Mr Chan seemed to have lost all perspective.

97. In a nutshell, it is our view that Mr Chan appeared to have no concept whatever of ministerial responsibility, and wished to attach blame *everyone except* himself for the lamentable state of this proposed listing application, whether it be his superiors or subordinates in South China, the Stock Exchange or indeed the SFC; in his lexicon, all others were at fault, but on his version of events *not* and *never* himself. If we may say so, we did not find this an edifying spectacle.

98. Mr Chan gave the impression that the fact that he had delegated much of the work to South China staff was wholly sufficient to discharge the

responsibilities which under the rules lay upon him as 'Assistant Supervisor', although we are bound to observe, also, that in the course of his at-times irascible evidence, that we did not think that, at bottom, he had any real grasp of the nature of the responsibility of such an 'assistant supervisor' within the context of the tasks and obligations laid down by the regulations in context of sponsorship of a proposed new GEM listing.

99. In fact, he appeared to have taken the view that having secured the client for South China for the purpose of obtaining a listing on the GEM Board, that he could afford to leave the vital 'vetting' and supervisory and due diligence task of a sponsor to others, in particular singling out Mr Fox for the deficiencies in the due diligence process, notwithstanding that Mr Fox clearly had come relatively late in terms of participation in the Sobao Group listing application.

100. On his own case Mr Chan appeared to take the view that he bore no responsibility whatever for *any* of the deficiencies which had occurred in the Sobao case – in fact, at one stage we were not sure even that he accepted that there had been any real problems therewith, and in substantive terms he appeared to be 'in denial' about the whole affair.

101. In the course of his evidence Mr Chan variously purported to disavow the content of letters which had been sent in his name, he purported to characterise as "trivial" the various detailed (and in our view highly pertinent) queries which obviously were causing relevant officials within the Hong Kong Stock Exchange real and substantial doubt, all of which is amply

illustrated within the detailed Exchange/sponsor correspondence regarding the circumstances and integrity of this proposed listing of the Sobao Group.

102. At one stage the applicant even went so far as to characterize the attitude of the HKEx (and also, it seemed by necessary implication, the SFC, and even at one point, we think, the Tribunal itself) as being "unfair" and "biased" against him, and in one instance Mr Chan went so far as to use the term "fraud" in terms of one specific matter which had been raised in correspondence by the Hong Kong Stock Exchange, although it is right to record that, when faced with the express terms of the material upon which the HK Exchange had based its critical query, Mr Chan saw fit to withdraw this particular allegation; we are, however, constrained to observe that the fact that he felt able thus to characterize matters in such sweeping and pejorative terms perhaps is indicative of his mental outlook in terms of the criticism and sanction by the regulator of his role in this whole unfortunate saga.

103. It is evident that during this entire listing application process for the Sobao that Mr Chan was travelling a good deal, and was away from Hong Kong, and the hard fact is that he simply did *not* accord to the Sobao Group listing application the degree of attention which is warranted and indeed is required by the rules for the position of 'assistant supervisor' within the listing sponsor – as indeed was the conclusion by the SFC in terms of the conduct of Mr Gorges, the principal supervisor, whom, as earlier noted, himself was disciplined by the regulator within a global settlement agreement of which we have had notice, but with regard to which

the details are not relevant in this contested application by Mr Chan for review of the SFC decision.

104. It is also abundantly clear to us that not only did Mr Chan accord this proposed listing little attention, but that South China as sponsor was under pressure from client, Sobao Group, to get this application through, and for the shares to be listed as quickly as possible, and thus, for example (and indeed as Mr Chan admitted to have been the case) when the first draft of the prospectus was submitted it was entirely premature, and "was not 100% fit to be filed", and that in order to keep the peace with an aggressive client (and doubtless in order not to put potential substantial fee income in jeopardy) the decision was taken to "risk it".

105. We further believe that, on the evidence before us, both the sponsor South China, and Mr Chan as 'assistant supervisor', appear to have taken the view that the concept of 'due diligence' involved little more than regurgitating, in appropriate form, information fed to them by or on behalf of the Sobao Group to the Stock Exchange, and thus that the role of the sponsor was, at bottom, in this instance regarded as little more than an uncritical (but nonetheless highly lucrative) 'conduit pipe' between the prospecting listing client and the Exchange.

106. At the end of his evidence before us, the Tribunal most regrettably reached the conclusion, in light of the overall tenor and content of his evidence, that this witness was prepared to say almost anything if he perceived it to justify his stance that he personally should in no way be

penalized for the wholly deficient and negligent sponsorship which occurred, and which underpinned this failed listing of the Sobao Group.

107. Indeed, in light of recent developments worldwide, we are constrained to wonder whether this essentially lax attitude, which we have no doubt existed in South China in the circumstances of this particular sponsorship, finds reflection within the current well documented deficiencies of supervisory and due diligence failings of banks and finance houses in other parts of the world, as now revealed by the current ongoing financial contagion, although for the avoidance of doubt we hasten to add that we have decided this case *entirely* on its own facts as they have been found to exist at the relevant time.

108. In short, therefore, for the reasons given we decline to interfere with the conclusions of the SFC as to liability, which we consider to be firmly and entirely fairly grounded in the circumstances of this case.

109. With regard to penalty, namely the fine of HK$200,000, we have reflected upon the circumstances, and the matters urged upon us by Mr Chin, in particular in terms of the delay which occurred in the transfer of accreditation process.

110. We have taken the view that the issue of delay specifically was taken into account by the regulator in assessing the appropriate penalty, and for our part we see no basis for interfering with that financial penalty.

111. We do not consider in the circumstances that this sum can be regarded as being ‘manifestly excessive’, and we remind ourselves of the oft-stated principle of this Tribunal that unless a something manifestly is wrong or, in colloquial terms, clearly ‘out of whack’, we will resist any desire to ‘tinker’; in our view the regulator is in the best position to assess the situation, and to decide the appropriate penalty, and we are disinclined to ‘second-guess’ any such decision unless there is very good reason so to do.

112. In this case manifestly there is no good reason. In fact, our view is that the applicant is perhaps fortunate in the circumstances not to have been given a suspension, which was the regulator’s initial decision, before it factored in, correctly and no doubt fairly, the ‘delay’ issue, and thus reduced the suspension to a mere monetary penalty.

113. In this connection we note that Mr Beresford usefully has appended to his skeleton argument a summary of previous SFC decisions on sponsorship, together with the relevant press releases consequent thereon, and in this regard we find nothing therein which would cause us to change our view.

114. Accordingly, we also decline to interfere upon this element of the case.

Order

115. It follows from the foregoing that our order upon this application for review is thus:

The application for review by the applicant herein, Mr Eric Chan Shun Kuen, in SFAT No 1 of 2008, is dismissed.

We make an order *nisi* as to costs, which order is to become absolute within 28 days from the date hereof unless application be made either by the applicant or the respondent so to vary such order, that the costs of and occasioned by this application are to be paid by the applicant to the respondent, such costs to be taxed if not agreed.

Hon Mr Justice Stone (Chairman)

Mr Kwok Lam Kwong, JP (Member)

Mr Tang Kwai Nang, JP (Member)

Mr Vincent Chin, instructed by Messrs P H Chin & Co, for the applicant

Mr Roger Beresford, instructed by the SFC, for the respondent