由此

Application No. 3 of 2013

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

SUN HUNG KAI INTERNATIONAL LIMITED Applicant

and

SECURITIES AND FUTURES COMMISSION Respondent

Tribunal: The Hon Mr. Justice Hartmann, NPJ, Chairman

Professor Eric Chang Chieh, Member

Mr. Frederick Tsang Sui-cheong, Member

Dates of Hearing: 6 November, 7 November and 8 November 2013

Date of Determination: 27 January 2014

DETERMINATION

Introduction

1. Sino-Life Group Limited and its subsidiary companies ('Sino-Life') are engaged in the provision of different forms of funeral services. At all material times, about 70% of its activities were in the Peoples' Republic of China and about 30% in Taiwan.

2. In Taiwan, Sino-Life was principally engaged in the sale of funeral services deeds through a team of sales agents operating out of four service centres and the general provision of funeral services to both holders of funeral services deeds and non-holders.

3. Sun Hung Kai International Limited ('SHKI'), the applicant for review, is engaged in the field of finance. Among other licenses held by it, SHKI is licensed to advise on matters of corporate finance.

4. In or about October 2007, Sino-Life resolved to seek a listing on the GEM Board of the Stock Exchange of Hong Kong, the initials GEM standing for 'Growth Enterprise Market'. To guide it in obtaining the listing, Sino-Life employed the services of SHKI to act as its sole sponsor. In due course, SHKI was also to take on the role of joint book runner, assisting in underwriting the initial public offering.

5. The GEM Board is designed for companies which, in most instances, are not as established as companies listed on the Main Board of

the Stock Exchange. As such, a higher investment risk may be attached to companies seeking listing on the GEM Board.

6. That being said, companies seeking to be listed on the GEM Board must present an accurate portrait to the Stock Exchange, the body which determines the application for listing and, if listed, must present an equally accurate portrait to the general investing public by means of its prospectus. A distorted portrait threatens to undermine the transparency and international good standing of the Hong Kong Stock Market.

7. Accordingly, when SHKI accepted the role of sponsor, it accepted the duty to ensure, first, that all procedural requirements for a listing were met and, second, that all information concerning Sino-Life that should properly be before the Stock Exchange in respect of the application and before the investing public in the prospectus was fully, fairly and accurately presented.

8. In a consultation paper published in June 2005[1], the Securities and Futures Commission (the 'SFC') emphasised the central role of a sponsor:

> "Hong Kong, as one of the leading fund-raising centres in the world, has a unique market in which a significant number of listing applicants are incorporated in overseas jurisdictions and/or have the bulk of their operations and assets in Mainland China. Given this special characteristic, sponsors, who act as corporate finance advisers to listing applicants, play a pivotal role in bringing listing applicants to the Hong Kong market and providing investors with information about these companies."

[1] Paragraphs 1 and 2 of the Consultation Paper on the Regulation of Sponsors and Compliance Advisers.

9. In the following paragraph, the SFC expressed concern as to the professional standards of sponsors:

> "Over the past few years, there have been increasing concerns about the standards of sponsors in view of the corporate scandals related to initial public offerings and sponsors' failure to carry out proper due diligence on listing applicants. The market and the investing public have, on various occasions, called for effective measures to raise the overall standard of professionalism in the market, and to take action against sponsors that have failed in their duties."

10. At this early juncture, it is important to emphasise that when a corporate financial adviser (such as SHKI) takes on the role of sponsor, it accepts a dual obligation, that is, to the client of course but equally to the Stock Exchange in respect of the application for listing and to investors generally in respect of the prospectus. What must be underscored is that the sponsor is more than a mere servant of an applicant and must act with independent professionalism in ensuring that all information placed before the Stock Exchange and investors generally is fully, fairly and accurately presented. In this regard, paragraph 2 of Practice Note 2 of the GEM Listing Rules sets out the following statement of principle:

> "The sponsor should make such enquiries as may be necessary until the sponsor can reasonably satisfy itself in relation to the disclosure in the listing document. In undertaking its role a sponsor should examine with professional scepticism the accuracy and completeness of statements and representations made, or other information given to it by the new applicant or its directors. An attitude of professional scepticism means making a critical assessment with a questioning mind and being alert to information, including information from experts, that contradicts or brings into question the reliability of such statements, representations and information."

11. The method by which a sponsor discharges its dual obligation is by the exercise of reasonable due diligence. Whether SHKI met the professional standards expected of it in respect of its exercise of

reasonable due diligence in its representation of Sino-Life is the matter which lies at the centre of this judgment and more will be said of it later. At this early juncture however it suffices, by way of illustration, to refer to two principles contained in the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission[2], a code to which SHKI was at all times made subject.

12. Principle 1 of the Code directs:

> "In conducting its business activities, a licensed or registered person shall act honestly, fairly and in the best interests of its clients *and* the integrity of the market." [Our emphasis]

13. Principle 2 of the Code directs that –

> "In conducting its business activities, a licensed or registered person should act with due skill, care and diligence, in the best interests of its clients *and* the integrity of the market." [Our emphasis]

14. These principles dictate in the most direct terms that the exercise of due diligence must be exercised not only to protect the interests of the client but also to protect the integrity of the market.

15. Principle 7 of the Code relates to compliance, that is, *inter alia* the requirement to conduct due diligence, directing that –

> "A licensed or registered person should comply with all regulatory requirements applicable to the conduct of its business activities so as to promote the best interests of its clients *and* the integrity of the market." [Our emphasis]

16. Sino-Life's application for listing on the GEM Board did not follow a straightforward path. This was because in May 2008 the Stock

[2] Issued in May 2006.

Exchange announced more stringent financial requirements for listing. Applicants were now required to demonstrate that they had achieved a positive operating cash flow of not less than $20 million in aggregate for the two financial years preceding the application.

17. The draft audit report that had been prepared in anticipation of Sino-Life's application revealed a positive operating cash flow materially below that now required.

18. SHKI wrote to the Stock Exchange, requesting a waiver of the new requirement. In its letter, SHKI spoke of the major work already carried out by the accountants in their preparation of a draft audit report. The draft report, however, was not submitted for examination. The Stock Exchange refused to grant a waiver.

19. In the result, the application for listing was not filed - not at least at that time. However, some four months later, in or about October 2008, Sino-Life revived the application for a listing.

20. This time Sino-Life and/or SHKI in its capacity as sponsor did not employ the accountants earlier employed but instead employed new accountants. In respect of the requirement to demonstrate a positive operating cash flow of not less than $20 million in aggregate for the two financial years preceding the application, the new accountants used the second year of the two years appearing in the earlier draft audit report and an additional year. Based on these two years, the audit report prepared by the new accountants met the Stock Exchange's new requirement as to operating cash flow.

21. As to the revived application and the prospectus, mention should be made of the fact that in the prospectus Sino-Life indicated that it intended to spend some $13.1 million raised as a result of the initial public offering to add the finishing touches to and decorate a columbarium situated in Miaoli County in Taiwan.

22. A columbarium is a building containing vaults and niches designed for the storage of the ashes of deceased persons. Sino-Life had neither title to the columbarium nor any secured rights over it. However, it had entered into an agency agreement to sell spaces in the columbarium and anticipated that the money spent on the upgrading of the columbarium would increase sales and boost commissions.

23. On 9 September 2009, just short of two years after SHKI had been engaged as sole sponsor, Sino-Life was successfully listed on the GEM Board. A total of 622,500 shares were allotted in the initial public offering at a price of $0.72 per share. A sum of $124.2 million was raised, higher than expected.

24. After the listing, the SFC began an investigation into the manner in which SHKI had discharged its duties as sole sponsor.

25. In a Notice of Proposed Disciplinary Action issued on 13 February 2012, the SFC informed SHKI that it was considering taking disciplinary action against it pursuant to the provisions of the Securities and Futures Ordinance, Cap. 571 ('the Ordinance').

26. On 31 May 2012, SHKI's then solicitors submitted detailed representations to the SFC in an attempt to explain and repudiate the provisional findings set out in the Notice of Proposed Disciplinary Action.

27. Some 10 months later, on 2 April 2013, the SFC issued its Decision Notice. In that notice, it held that SHKI, in the discharge of its duties as sponsor, had failed to carry out proper due diligence in respect of three principal matters. These three matters, which were the subject of lengthy submissions before us, may be described as follows:

a. The issue of 'the audit reports', that is, a failure to disclose and to explain different cash flow figures for 2007 between the draft audit report prepared for Sino-Life by its first accountants and the audit reports prepared by its second accountants in respect of the listing requirement that a positive operating cash flow of not less than $20 million in aggregate for the two financial years preceding the application be demonstrated.

b. The issue of 'the encumbrances on the Taiwan columbarium', that is, a failure to ascertain and disclose the extent of encumbrances on the title of the columbarium in Miaoli County, Taiwan, that constituted a material risk to the success of Sino-Life's $13.1 million investment in the project.

c. The issue of 'the viability of the columbarium business' that is, the failure to exercise due diligence when putting financial estimates before the Stock Exchange in respect of the commercial exploitation (as agent) of the columbarium.

28. In addition, in the Decision Notice, the SFC found that there had been a failure by SHKI to maintain proper records. Among other directives, this constituted a breach of the Corporate Finance Adviser Code of Conduct, paragraph 2.3 of which directs that:

> "A Corporate Finance Adviser should maintain proper books and records and be able to provide a proper trail of work done upon request by the SFC."

29. The SFC considered the regulatory breaches to be serious. Among other matters, it commented that:

> "The misconduct in this case had the result that a company managed to be listed even though subscribers to the IPO did not, at the material time have access to true, accurate and complete information regarding the listing applicant's financial position and business prospects. The consequence of this misconduct is that investors were not able to make informed investment decisions.
>
> Since Sino-Life was listed, the price of its shares has been declining. As at 27 March 2013, the closing price was $0.23 per share. Compared with the price at which it was listed, i.e. $0.72 per share, it is highly questionable whether this is a company which had the fundamentals to be listed in the first place. This has a direct impact on the integrity of the market and affects Hong Kong's status as a major IPO centre."

30. In the context of SHKI's representations as to liability and penalty, the SFC was concerned by what it considered to be SHKI's lack of awareness of the extent of its responsibilities as sponsor. In this respect, the SFC observed:

> "… SHKI appears to be unaware of the importance of the sponsor's function of making a critical assessment with a questioning mind and being alert to information, including information from experts, that contradicts or brings into question the reliability of such statements, representations and information."

31. As to the sanctions to be imposed, the SFC was of the view that its decision "must send a clear signal that [SHKI's failings] cannot be tolerated in Hong Kong's market. In the result, the sanctions imposed were as follows:

a. that SHKI be publicly reprimanded;

b. that SHKI be fined $15.5 million; and

c. that SHKI's licence in respect of Type 6 regulated activities (advising on corporate finance) be suspended for a period of one year.

32. SHKI applied to this Tribunal pursuant to s.217 of the Ordinance for a review of the SFC's decision both as to liability for any regulatory breaches and as to penalty.

33. This judgment determines the review.

The role of this Tribunal

34. Since the judgment of the Court of Appeal in *Tsien Pak Cheong David v Securities and Futures Commission* [2011] 3 HKLRD 533, it is now settled that this Tribunal, being chaired by a judge sitting with two lay members chosen by the Chief Executive for their impartiality, standing in the community and expertise in the financial services field, has the legislative power, and indeed is eminently suitable,

to make a full merits review of a decision of the SFC. In doing so it exercises its independent judgment, arriving at its own decision. It does so in respect of both liability and sanction.

The standard of proof

35. As we understand it, the leading authority on the issue in this jurisdiction remains *A Solicitor v The Law Society* (2008) 11 HKCFAR 117 in which Bokhary PJ said (at 145 G-H):

> "Only two standards of proof are known to our law. One is proof beyond reasonable doubt and the other proof on a preponderance of probabilities. The strength of the evidence needed to establish such a preponderance depends on the seriousness and therefore inherent improbability of the allegation to be proved."

36. It may be (although it is not necessary for us to find it to be so) that in a hearing before this Tribunal the allegations are so grave - for example, allegations of serious fraud, money laundering or similar - that a standard of proof beyond reasonable doubt is deemed to be the appropriate standard. In the present case, however, what is in issue is whether there has been compliance with regulatory obligations; essentially, whether there has been the exercise of reasonable due diligence and whether the obligation to keep proper records has been honoured. In the result the civil standard, that is, proof on a preponderance of probability, applies.

37. That being said, we accept that the allegations made are serious, the possible consequences by way of sanction if the allegations are substantiated being equally so. We have therefore at all times borne in mind the dictum of Bokhary J that the strength of the evidence needed to

establish a matter on a preponderance of probability depends on the seriousness and therefore inherent improbability of the allegation.

38. In this regard, we can say that the findings made by us in this judgment have been reached unanimously, each of us finding that the evidence supporting those findings is clear and cogent.

The core issue: due diligence

39. In paragraph 4 of its Decision Notice of 2 April 2013, the SFC said that the key concern in its investigation was whether SHKI's conduct as a sponsor in the listing of Sino-Life complied with the extensive framework of rules, regulations and principles of conduct governing the discharge of its licensed activities. In this regard, the SFC looked in particular to the following:

a. the Code of Conduct for Persons Licensed by or Registered with the SFC (the 'Code of Conduct');

b. the Rules Governing the Listing of Securities on the GEM Board (the 'GEM Listing Rules'), and

c. the Corporate Finance Adviser Code of Conduct (the 'CFA Code').

40. Within this regulatory framework, the SFC went on to identify the specific obligations[3] which, in one way or another required the exercise of reasonable due diligence on the part of SHKI, and which it believed SHKI had failed to meet. We have earlier set out certain extracts

[3] The SFC identified 12 obligations.

from the governing regulatory framework in order to illustrate the nature and breadth of the obligation to exercise due diligence imposed on a sponsor. For purposes of further (limited) illustration, we would cite the following.

41. The CFA code (issued in December 2001) directs that a Corporate Finance Adviser must act with due skill, care and diligence and observe proper standards of market conduct: see paragraph 5.1. When acting as a sponsor in relation to an initial public offering, the Corporate Finance Adviser is responsible for the overall management of the public offer and in this regard must put in place sufficient resources to ensure that the public offer and all matters ancillary thereto "are conducted in a fair, timely and orderly manner": see paragraph 5.3. Of significance, is the requirement that –

> "Where a Corporate Finance Adviser is involved in the preparation of any document for public dissemination, it shall use all reasonable efforts to assist its client in ensuring that the document is prepared to the required standard *and no relevant information has been omitted or withheld*." [Our emphasis]

42. Under Chapter 6A of the GEM Listing Rules, a sponsor is required to exercise reasonable due diligence in ensuring that any opinions or forward-looking statements of the directors of an applicant company have been made on bases and assumptions that are fair and reasonable and that all information provided is true in all material respects and does not omit material information: see Rules 6A.04 and 6A.15.

43. The importance of the exercise of due diligence by Corporate Finance Advisers acting as sponsors has been emphasised by

the SFC in a document entitled Consultation Conclusions on the Regulation of Sponsors and Independent Financial Adviser issued in October 2004:

> "Due diligence by sponsors is important because… the Exchange places significant reliance on this work. The Exchange does not have the resources or mandate to gain the detailed knowledge of an issuer's business which the sponsor is expected to have accumulated through its preparation of the applicant the listing. Consequently, the Exchange and the market are entitled to rely on the competence and integrity of the sponsor in assisting the issuer to prepare and present the listing application and listing documents."

44. 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. 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.

45. In his written submissions, Mr. Westbrook SC, counsel for SHKI, spoke of the exercise of due diligence in the following terms:

> "Due diligence is a dynamic process involving an ongoing exercise of judgment based on information available at the time. Inevitably, when critiquing with the benefit of hindsight a wide-ranging and often complex due diligence process spanning many months, there will be exercises of judgment or questions of scope that can be questioned or debated after the event. But in deciding whether issues are sufficiently serious to warrant regulatory sanction, such issues should be considered in the context of their frequency and materiality and by reference to the due diligence as a whole."

46. We do not, in a broad sense, take issue with this observation. But, as Mr. Westbrook himself urged upon us, the issues arising in this review must always be considered in context.

Does a GEM application warrant a modified degree of due diligence?

47. In coming to its findings, the SFC drew no distinction between the nature and breadth of due diligence in respect of GEM and Main Board listings. Mr. Jat Sew-Tong SC, leading counsel for the SFC, concurred with that approach, submitting that we should follow it.

48. However, Mr. Westbrook SC, counsel for SHKI, suggested that there should be a difference. The fact that Sino-Life's application was for a GEM listing, he said, is relevant to the assessment of whether SHKI, as sponsor, failed to conduct due diligence. This is because "it is not sensible or realistic to expect the same level of minute due diligence by sponsors in a GEM listing where the total fee charged, as here, was $1.5 million, when a Main Board listing sponsor charges routinely in the tens of millions." As Mr. Westbrook expressed it, "no one expects a Rolls-Royce for the price of a Mini."

49. We confess to having some difficulty understanding the true thrust of this submission. It appears, on an ordinary understanding, to

constitute a suggestion that a lower standard of due diligence should be expected in respect of GEM applications. Mr. Westbrook rejected any such reading on our part, saying that he was simply asking us to view matters in context.

50. For the avoidance of any doubt, we wish to make it plain that, in our view, there is no difference in the standards of due diligence expected in GEM and Main Board listings. The regulatory framework to which we have made reference implies no such distinction.

51. During the course of argument, it appeared to be implied that, if too onerous standards of due diligence were to be placed on sponsors in GEM listings, sponsors would be frightened away. Put simply, the rewards would fall short of the level of professional endeavour required. That, so it appeared to be implied, may act to undermine the integrity of the GEM Board. We reject any such implication.

52. To employ Mr. Westbrook's metaphor, the same level of care and expertise is required in the manufacture of a Mini as a Rolls-Royce. Both must be fit for purpose. However, the fact that a Mini is a smaller and less sophisticated piece of machinery means that invariably it can be manufactured as fit for purpose more cheaply than a Rolls-Royce.

53. We would also make the observation that the discharge of the responsibility of a sponsor may be linked to other, sometimes more profitable, functions; for example, either directly or through associated companies, in underwriting the listing.

How was SHKI to exercise due diligence in respect of the advice of independent experts?

54. In a number of respects, the SFC findings against SHKI were related to legal advice and accountants' reports received by SHKI. The degree to which SHKI's exercise of due diligence was constrained, if at all, by the fact that the legal advice and the accountants' reports came from independent experts was debated before us at some length. It is therefore appropriate that we set out our general approach to the matter before proceeding to examine the specific failings in due diligence alleged by the SFC.

55. At the material time (that is, when SHKI was conducting its due diligence) paragraph 5.5 of the CFA Code directed as follows:

> "Where reliance on the work of independent experts or other professionals is planned, a Corporate Finance Adviser (including an independent financial adviser) should, inter alia:
>
> a) undertake reasonableness checks to assess the relevant experience and expertise of the firm of experts or other professionals and to satisfy itself that reliance could fairly be placed on their work; and
>
> b) review and discuss with its clients and the experts or other professionals the qualifications, bases and assumptions adopted by the experts or the other professionals in the course of their work and satisfy itself that the qualifications, bases and assumptions have been made with due care and objectivity, and on a reasonable basis."

56. These requirements, however, were expressly exempted in respect of a limited category of experts. In this regard, the CFA code stated:

> "The requirements in paragraph 5.5(b) shall not be applicable in respect of work performed by:

i. …

ii. legal advisers in respect of legal advice rendered by them; and

iii. accountants in respect of the audit of results and accountants' reports derived therefrom."

57. Concerning this exemption, in our opinion the following two matters should be emphasised. First, the exemption does not constitute a prohibition. Accordingly, there may be occasions when prudence dictates that some form of review of independent expert work should be carried out even though it is not mandatory to do so. Second, even if it may be difficult or inappropriate to challenge the correctness itself of the advice or the report, it does not follow that it must be received without any form of question or enquiry. By way of example, legal advice received may quite patently be incorrect because it has confused the facts; equally the advice, even though correct, may not answer the question posed or may only do so in part.

Failure to exercise due diligence, the first issue - the issue of the 'audit reports'

58. As we have said, it was in October 2007 that Sino-Life appointed SHKI as its sole sponsor to manage its application for a listing on the GEM Board. Two months after its appointment, in early December 2007, SHKI appointed the firm of accountants, RSM Nelson Wheeler Certified Public Accountants ('RSM'), to carry out necessary auditing work.

59. When commencing his submissions on this issue, Mr. Jat, for the SFC, said that it was important to bear in mind the nature of an audit. Sino-Life was responsible for preparing the accounts and

submitting them to its accountants for audit. Even though adjustments may have been made by Sino-Life during the auditing process, no doubt from time to time in response to queries raised by the auditors, the accounting figures remained at all times its figures. Put simply, the auditors reviewed what Sino-Life provided.

60. In about March 2008, RSM produced a draft of the audit report required to support Sino-Life's application. No evidence was put before us of any grave concern, indeed any real concern at all, concerning the contents of that draft audit at that time.

61. However, some five or six weeks later, early in May 2008, the Stock Exchange announced a change in the GEM Board's financial requirements. As the SFC described it in its Decision Notice, Rule 11.12A of the GEM Listing Rules now required a new applicant "to have an adequate trading record of at least two financial years, under substantially the same management, comprising a positive cash flow (generated from operating activities in the ordinary and usual course of business before changes in working capital and taxes paid) of at least $20 million for the two financial years immediately preceding the issue of the listing document".

62. In its draft report, RSM had calculated the positive cash flows for the financial years ending 31 December 2006 and 31 December 2007, doing so in renminbi ('RMB'). The results, however, when calculated in Hong Kong dollars, did not meet the required minimum. The positive cash flow for the two years was calculated to be RMB3.767 million for 2006 and RMB7.007 million for 2007. This translated into an aggregate (over the two years) of some HK$10.8 million.

63. No evidence was put before us to suggest that at this time a comprehensive review of the cash flow figures was undertaken to see whether they could permissibly be increased in order to meet the new minimum. Instead, SHKI wrote to the Stock Exchange requesting a waiver of the new, more stringent cash flow requirement. In its letter it spoke of 'the major work' already carried out in respect of the application, that work including the draft audit report prepared by RSM[4]. In short, in advocating for a waiver, SHKI emphasised the advanced stage of the work done or, put another way, its accomplished substance. There was no implication that RSM's draft report, being a draft only, was insubstantial and/or could not be relied upon.

64. The Stock Exchange refused to grant the waiver. In the result, Sino-Life's application for a listing came to a halt.

65. In or about October of that year, however, Sino-Life revived its listing application. SHKI was retained as sole sponsor.

66. Nothing was put before us to describe what happened in the period of hiatus. If there were discussions between Sino-Life, SHKI and RSM to find some permissible way to reassess the basis of the cash flow calculations for 2006 and 2007, we were not informed of them.

67. What we do know, however, is that, when Sino-Life revived its listing application, RSM was no longer employed to produce the

[4] In its letter, SHKI said that Sino-Life had appointed different professional parties in assisting with the listing project, which included RSM, the reporting accountant, and that "major work" had been carried out which included preparing the accountants' report for the years ended 31 December 2006 and 2007 and the first three months for the 2008 tax year.

necessary audit report. In its place, the firm of accountants, CCIF CPA Limited ('CCIF'), was appointed.

68. It does not require an esoteric understanding of the art of accountancy to appreciate that changing accountants 'in midstream' in this fashion may raise concerns on the part of the Stock Exchange and will almost certainly do so when the audited results of the first firm of accountants do not meet minimum requirements while the audited results of the second most certainly do.

69. The importance of explaining any change is underscored by the fact that, as part of the completion of an application for listing on the GEM Board, the Stock Exchange requires completion of a checklist of specific matters. The checklist included the following:

> "Sponsor(s) to obtain a confirmation from the company and its directors that there is no change in the reporting accountants of the group since the preparation for listing up to the present, or alternatively, to provide reasons for the change."

70. SHKI was therefore obliged to inform the Stock Exchange of the change and did so when completing the checklist. The reason for the change, it said, was the cheaper professional charges levied by the second firm, CCIF.

71. Because of the passage of time, CCIF was required to prepare an audit report setting out the positive cash flow figures for the years ending December 2007 and December 2008. Accordingly, the cash flow for one year – 2007 – was shared with RSM.

72. Both CCIF's first draft report and the final report met (and exceeded) the minimum required by the amended listing rules.

73. In its first draft audit report – working of course on figures supplied by Sino-Life - CCIF calculated a positive cash flow for 2007 of RMB12.952 million and for 2008 of RMB10.840 million. In its final report, those figures were more modest, being reduced to RMB10.230 million for 2007 and RMB10.324 million for 2008.

74. 2007 – the year shared by the reports of both RSM and CCIF – showed a marked difference in results. In its draft report, RSM had produced a figure of RMB7.007 million while CCIF in its first draft had produced a figure of RMB12.952 million, an increase of RMB5.945 million. Even in its final report, CCIF's more modest figure remained RMB3.223 million higher, an increase in excess of 45%.

75. Mr. Jat, for the SFC, succinctly summed up the consequence when he said[5]:

> "The bottom line is this. Had the 2007 figure in the RSM report been used, Sino-Life's cash flows in 2007 and 2008 would not have sufficed for it to meet the requirement on GEM. But the 2007 figure was revised upward, and the aggregate became sufficient."

76. Mr. Jat continued:

> "The difference was not only a material matter; it was *critical* to Sino-Life's qualifications for listing." [His emphasis]

[5] Paragraph 70 of his written submissions.

77. As it was, however, no explanation was put before the Stock Exchange in the course of the listing application. Indeed, it appears that no mention was made of the issue.

78. When the application for a waiver had been made in the early part of 2008, RSM's draft report had not been placed before the Stock Exchange. The Stock Exchange did not therefore have the RSM draft report in its files when the final application was lodged. That being so, it had no way of conducting any sort of cross-check unless guided to do so.

79. An oversight may explain the failure to put matters before the Stock Exchange. But the evidence reveals that there was no oversight. The team at SHKI responsible for managing the listing application – known as the 'deal team' - was well aware of the difficulties thrown up by the apparent conflict in the reports of RSM and CCIF and their importance in the context of the listing application.

80. Mr. Edmond Choy, a senior member of the deal team and an associate director of SHKI was aware of the conflict between the two reports within a few days of CCIF's report being put before him. Both he and another, more junior team member, Mr. Weber Yu, understood the importance of the issue. Indeed, Mr. Yu is recorded as having described the discrepancy in the figures between the two audit reports as being "huge"[6].

[6] In an interview with the SFC on 15 June 2010, Mr. Yu twice used the word "huge" to describe the discrepancy in figures between the two reports, saying that he asked about the discrepancy in light of the recent change to the GEM Listing Rules. In short, he understood the context and therefore its importance.

81. Within a couple of days, on 11 February 2009, Mr. Choy put the issue to the new accountants, CCIF, in the course of a teleconference. It appears that, at that time, the representatives of the accounting firm were not prepared to attempt to explain (or assist in exploring) how it was that the RMB7.007 million in RSM's report had been increased to RMB12.952 million in their draft. The 'Auditor's Due Diligence Interview Summary' (prepared by SHKI to record "*other important information*" that had arisen during the course of the teleconference) states: "It is inconvenient for us to express an opinion on this."

82. During the course of the hearing, there was some debate as to the true meaning of the word 'inconvenient' in the above context. As an SHKI document, the summary was of course no more than an interpretation in brief form of what the SHKI team members understood to be CCIF's position. In light of that, we have taken it as a form of shorthand to mean that the representatives of CCIF did not consider it proper to criticise the work of another firm of accountants or to engage in some form of speculation as to that work.

83. We are informed that there was a further teleconference with CCIF on 18 February 2009 when various financial/accounting matters were discussed. However, it does not appear that there was any further mention of the 2007 cash flow discrepancy issue. It appears therefore, within days, to have disappeared from the agenda as an important issue which, by way of the exercise of reasonable due diligence, needed to be clarified.

84. It was Sino-Life of course which had supplied figures to both firms of accountants. It had its own finance department. Sino-Life

must surely have been in a position to provide some sort of insight into the changing cash flow figures. Mr. Choy approached Sino-Life to discuss the issue. Mr. Choy was informed that, as there was no longer any professional relationship with the old accountants, RSM, that firm should not be approached.

85. In an interview with the SFC on 2 June 2010, Mr. Choy's explanation, although somewhat vague, gives an indication of his thinking:

> "CCIF believed that the relevant item was - 12 million odd… and that's that, and it would make no further comments… [whereas] according to the company's view [that is, Sino-Life], since RSM already published a professional [indistinct] in the end of October '08, neither would it answer any of our questions , huh. Hence, it was impossible - impossible for us - to obtain the… to find out the actual difference between the two figures at that time."

86. With respect, this appears to ignore the most obvious route to an explanation. Sino-Life had supplied the necessary accounting figures to both firms of accountants and would have answered any queries raised during the course of the auditing processes. Sino-Life itself was in a position to provide answers, if not in full then at least of sufficient substance to enable CCIF to give a professional explanation[7].

87. With respect, it also escapes us why it was not possible to revert to RSM for its explanation on any particular point that required clarification. The fact that RSM was no longer employed did not mean

[7] As it happened, after the successful listing and during the course of enquiries made by the SFC, SHKI did ask Sino-Life for some explanation as to the difference in the cash flow figures. We are told that Sino-Life's financial controller, Mr. Leo Mok, was able to provide some form of reconciliation within a couple of days. According to Mr. Jat, for the SFC, the reconciliation raised a number of problems. As he put it: "The reconciliation purports that some RMB40 million of costs could be treated as additional revenue. This is difficult to understand and begs more questions that ought to have been asked [at the time]"

that it was prohibited from explaining or answering queries as to work already done and (presumably) paid for. In such circumstances, Sino-Life's direction that there should be no contact with RSM gives the appearance of being tactical, the aim being the avoidance of any debate that may give rise to questioning CCIF's qualifying cash flow figures.

88. We would add that it is difficult to believe that Mr. Choy and his junior colleagues in the deal team did not appreciate that there were any number of ways in which, without great difficulty or cost, a rational form of explanation to explain the differences in the 2007 cash flow figures could be obtained.

89. Mr. Choy explained, when interviewed by the SFC, that he discussed the issue with the senior member of the deal team, Mr. Eric Shum. Mr. Shum, however, supported the Sino-Life approach, namely, that the matter need not be investigated further. CCIF had supplied the necessary audit report and that was good enough. There should be no reversion to RSM. Nor, so it must be implied, should Sino-life itself be asked to address the issue and give some explanation.

90. In summary, the issue was dropped. During the course of his submissions, Mr. Westbrook said that it is not the role of a sponsor to 'chase every rabbit down every hole'. We agree. The exercise of due diligence means the exercise of *reasonable* due diligence. We also accept that Mr. Shum, as the leader of the team, had the responsibility to determine what issues should be pursued by way of due diligence and what issues should not.

91. In our judgment, however, subject to our consideration of Mr. Westbrook's submissions, it seems to us that abandonment of any enquiry at all (or even a decision to reserve an enquiry pending CCIF's final audit report) gives the impression that Sino-Life did not wish to open the discrepancy to the light of day. It further suggests that the deal team at SHKI, instead of adopting an attitude of professional scepticism, being alert to the possible ramifications of the discrepancy, chose instead to follow the path of least resistance by supporting Sino-Life's instructions that the matter should not be further explored. In summary, absent a persuasive explanation, which we have not received, the only reasonable inference to be drawn, in our opinion, is that the decision was made to 'let sleeping dogs lie' by refraining from further investigation, the consequence being an unspoken decision to go with the interests of the client at the potential expense of the integrity of the market.

92. On 25 February 2009, SHKI filed Sino-Life's application for listing with the Stock Exchange. No mention was made in the application papers about the RSM draft audit report and the fact that its figures as to the 2007 positive cash flow were at odds with the figures supplied by the new accountants, CCIF.

93. In the application papers, SHKI was asked for details of any additional information considered appropriate for the consideration of the Stock Exchange[8]. It replied:

> "Based on the information provided to the sponsor by the issuer and so far as we are aware, there is no additional information considered necessary/appropriate for the Exchange's consideration."

[8] Appendix 5, Form A (Forms Relating To Listing), the answer to question 15 on page 5.

94. Later, in the same application documents, the following joint declaration was made by Sino-Life and SHKI:

> "… we have each satisfied ourselves, to the best of our respective knowledge and belief, having each made due and careful enquiries, that:
>
> …
>
> (b) The information supplied in this form and in the documents submitted together with this form is accurate and complete in all respects and not misleading (save in respect of matters that cannot be ascertained as at the date of this form)
>
> …
>
> (f) There are no other facts bearing on the issuer's application for listing of and permission to deal in such securities which should be disclosed to the Exchange."

95. In a further formal answer, SHKI responded to a question asking for confirmation that there were no other material issues which could detrimentally affect the suitability of Sino-Life's listing by stating[9]:

> "Save as disclosed in the prospectus, this checklist I.F or otherwise disclosed to the Stock Exchange, the sponsor, after conducting legal, business and financial due diligence on the group and based on the information provided by the company and other relevant parties, is not currently aware of any material issues which could detrimentally affect the suitability of listing of the company."

96. In considering the application, the Stock Exchange sought certain assurances concerning the work performed by RSM. In this regard, in a letter dated 19 March 2009, it raised a number of questions about the change of accountants. In particular, SHKI was asked to state whether there was any circumstance which needed to be brought to the attention of the exchange concerning the resignation of RSM.

97. In its response, SHKI explained that RSM had proposed fees of $2,660,000 while CCIF had proposed a sum of $2,450,000, a

[9] "Checklist I.F – Additional Information to be Submitted."

difference of $210,000: at first blush, not such a huge difference considering that RSM had already completed a draft audit report. As to the work performed by RSM, having earlier (when seeking a waiver) spoken of the major work carried out by RSM, Sino-Life, speaking through SHKI, now said:

> "The Directors confirmed that RSM only reviewed the *draft* consolidated accounts for the Group's subsidiaries. Neither the accountant's report nor the audited reports are issued by RSM as stated in the clearance issued by RSM." [Our emphasis]

This was followed by the following statement:

> "As at the date of this submission, the sponsor is not aware of any matter which needs to be brought to the attention of the Stock Exchange in relation to the resignation of RSM."

98. As Mr. Jat, for the SFC, submitted, the true point is not whether these answers, viewed in isolation, may be 'literally and technically accurate', the point is that, in light of what was known to SHKI, these answers were clearly designed to withhold more than they told. It was a successful tactic, he said, as the Stock Exchange remained ignorant of the differing cash flow figures for 2007.

99. It was against this factual background that the SFC, in its Decision Notice[10] came to the following determination, namely, that SHKI's failure to conduct proper financial due diligence was twofold –

> "Firstly, it had failed to follow up on a material discrepancy between draft reports compiled by different auditors. Secondly, SHKI did not provide sufficient disclosure to the Stock Exchange to enable it to properly assess whether Sino-Life was eligible to be listed on the GEM Board."

[10] Paragraph 49 of the Notice.

100. In commenting on these two grounds, Mr. Jat said, in respect of the first, that SHKI had itself raised this as an important issue which needed clarification but had dropped the matter without obtaining any 'sensible explanation' when Sino-Life showed resistance to enquiry. In respect of the second, he said that SHKI had compounded its failure of disclosure by positively assuring the Stock Exchange that it was not aware of any information about RSM and/or the cash flow figures that should be disclosed. This, said Mr. Jat, had been intentionally misleading.

101. We turn now to the submissions made on behalf of SHKI.

102. On behalf of SHKI, Mr. Westbrook took issue with the fact that there was in reality any discrepancy between RSM's cash flow figures for 2007 and those of CCIF for the same year. He said that a reconciliation had been provided to the SFC in October 2009 which the SFC had never sought to challenge[11]. In this regard, we would simply observe that the reconciliation was prepared *after* the successful application and at the request of the SFC which was investigating the professional propriety of SHKI's conduct as sponsor.

103. Mr. Westbrook submitted that there was only one legitimate question for consideration by us, namely, whether - after it had noticed that CCIF's first draft accounts differed in certain respects from RSM's earlier draft accounts – SHKI's steps by way of due diligence were, in the circumstances, adequate.

104. Mr. Westbrook's first submission was based on the fact that RSM's report and the draft report submitted by CCIF were both drafts

[11] See footnote 8 above.

which were prepared a year apart by independent accounting firms. The RSM draft, he said, was based on information provided by SHKI that was itself in draft and had not therefore been finalised. The CCIF draft was the first of 10 drafts.

105. In our judgment, there is no weight in this submission. The fact is that SHKI's deal team recognised a very large discrepancy - described by one as 'huge' - at an early stage when they were able to compare one draft with another. There is no suggestion that a decision was made to wait and see how CCIF's drafts resolved themselves and whether, in the end result, any discrepancy remained. To the contrary, the evidence indicates that at *that* early stage, when CCIF's report was itself only in its first draft, the decision was made to place all reliance on the report of CCIF ignoring even any enquiry into the difference between it and the earlier RSM report concerning the 2007 cash flow figures. As we have indicated earlier, in the absence of evidence to the contrary, and none was placed before us, this smacks of a tactical decision to pin Sino-Life's colours to CCIF's favourable first draft report ignoring the fact that, on its face, it was at odds in a material respect - one going to eligibility for listing - with an earlier report.

106. Notwithstanding the detail of Mr. Westbrook's submissions and the skill with which they were advanced, we are unanimously of the view that, taking into account the history of the application, some form of due diligence enquiry on the part of SHKI was required and, depending on the outcome of that enquiry, some explanation advanced to the Stock Exchange. A company can only be listed if it is able to demonstrate the necessary on-going business ability and financial strength as required by the listing rules. SHKI knew that integral to its earlier application for a

waiver had been a report from the then accountants (albeit in draft) that the cash flow figures for 2007, read with 2006, did *not* reach the required aggregate minimum. Now, however, with new accountants at the helm[12], the cash flow figure for 2007 had been materially - indeed it may be said, dramatically – increased and that increase was integral to meeting the required aggregate minimum.

107. There had to be some reason for an increase of that dimension. That reason, obvious or not, simple or complex, needed to be given. It needed to be given so that the Stock Exchange could consider the differences in result between the RSM and the CCIF reports and the reason given to explain it. This is not to imply that one report was wrong and one right. What it does imply is that the financial architecture of a business enterprise, that is, the manner in which its figures have been built, may be, and often is, a crucial consideration for investors.

108. A 'midstream' change in reporting accountants is therefore viewed with concern by the Stock Exchange – the gatekeeper to the market - for sound practical reasons. It is not simply a case that one set of accountants may - no doubt in very rare cases - be more compliant than another, more willing to mould matters to the wishes of an applicant company. When there is a 'midstream' change and that change results in a material change in figures, especially figures going to the fundamental issue of listing qualification, then the Stock Exchange is entitled to know the reasons for the change so that it can assess whether, in its view, the

[12] At least one senior member of SHKI's team was aware of the sensitivity of the manner in which RSM had been replaced by CCIF. In an interview with the SFC on 2 June 2010, Edmond Choy, an associate director of SHKI, said the following: "…at that time, in fact, we already…already… already felt that their [Sino-Life's] change of accountant would..er… cause the Stock Exchange or the colleagues of your Corporate Finance Division to be suspicious."

new figures, when compared with the old, are a true reflection of the financial well-being of the applicant company or whether perhaps, even if the application is granted, the market should be advised.

109. In the present case what could not be avoided was that, on its face at least, there was a material conflict between two professional assessments of operating cash flow in the year 2007. The RSM was a draft report but that went to the weight of the report only and did not disqualify it from consideration. In addition, of course, the decision not to proceed with any enquiry appears to have been finalised at a time when the CCIF report was itself only a draft report.

110. In our judgment, as we have indicated earlier, the SHKI team must have appreciated that the material difference in their 2007 cash flow figures must have been based on material supplied to RSM and CCIF by Sino-Life, material therefore that should be readily available from Sino-Life. If the material difference in the 2007 cash flow figures arose from some change in the accountancy approach adopted by CCIF, surely that would have been known to Sino-Life too. Sino-Life therefore was clearly the fountainhead. Yet, on the evidence before us, it appears that no approach was made to obtain relevant information from Sino-Life. Why not? Absent a clear and convincing explanation, and in our view there was none, the probabilities clearly suggest the single motivation that we have spoken of earlier, one supported by Sino-Life's resistance to any enquiry that may undermine CCIF's draft. Sino-Life now had figures that met the increased cash flow requirement. The success of the application rested on those figures. They had been professionally prepared. They should be adopted and any doubt thrown up by the earlier RSM draft report should remain a matter of history.

111. Mr. Westbrook's second submission was founded on the assertion that SHKI was entitled to rely on the draft report (and subsequent reports) of CCIF. He expressed his argument in the following terms.

112. The difference in the draft reports was identified by the deal team and enquiries were made. The matter was raised with Sino-Life, that company being of the view that RSM's role was historic and that CCIF was now responsible for auditing the accounts. CCIF was not prepared to comment on work previously done by an independent firm of accountants. Its mandate was to prepare an audit report based on the accounting information provided to it. SHKI knew that information had been provided to CCIF which had not earlier been provided to RSM; put another way, that CCIF had prepared its draft report on updated (and therefore different) information. In the circumstances, it was entitled to rely on the work and professional expertise of CCIF.

113. Again, we find no weight in this submission. The fact is that, having several months earlier put the application for listing 'on ice' because of the unfavourable draft audit report submitted by RSM, SHKI was now presented with a draft report from new accountants which very substantially increased Sino-Life's 2007 cash flow stream, that increase being integral to meeting the requirements for listing. The obvious question, and the one which Mr. Choy and his colleagues, clearly asked themselves was: how did this come about? They knew that, absent some explanation which rendered the discrepancy entirely irrelevant, they needed a rational explanation. At the first sign of resistance, however, they pulled back.

114. We have earlier cited paragraph 2 of Practice Note 2 of the GEM Listing Rules which in our view is directly applicable in the present circumstances. It provides that, in undertaking its role, a sponsor should examine with "professional scepticism" the accuracy and completeness of material placed before it. This means making a critical assessment with a questioning mind and being alert to information, including information from experts, which brings into question the reliability of such material. As we have said, at that stage SHKI had before it two draft audit reports which appeared to be materially at odds. Clearly, a form of enquiry was required. But, when viewed in the round, there was no such enquiry. Tactically, the CCIF report went towards ensuring the success of the application. The RSM report raised the spectre of doubt or at least the possibility of prolonged further enquiries. The RSM report was therefore to be ignored. That did not constitute reasonable due enquiry. That constituted a tactical decision to abandon due enquiry.

115. In this regard, we agree with the observation of Mr. Jat that, if CCIF felt constrained (for ethical reasons) not to comment on the figures in the report of a previous auditor, it made it all the more important for SHKI itself to follow up. As sponsor, SHKI could not turn a blind eye to a known issue. Yet it did so. At that early stage, how could it have been said without some form of reasonably detailed enquiry that there was no validity in the earlier draft report of RSM? Yet there was no enquiry.

116. During the course of his submissions, Mr. Westbrook laid particular emphasis on the fact that it is not for a sponsor to question the merits of an audit report prepared by an independent expert. It was

entitled to rely on the correctness of the draft report prepared by CCIF and it did so.

117. We do not suggest that SHKI should have embarked on a dissection of the two draft reports in order to compare their merits. That is not the point. Both reports no doubt, being compiled by independent experts on the basis of material provided to them by Sino-Life, were correct. Yet they provided markedly different results in respect of the 2007 cash flow. As we have said earlier, the issue is not whether one report was right and the other wrong. The probabilities must have indicated at that time that they had been compiled on the basis of different data supplied and/or in accordance with differing accountancy principles. Those were matters which could readily have been investigated without any challenge being made to the professional expertise of either of the two firms of accountants. However, there was no such investigation, not even (on the evidence before us) the beginnings of one.

118. Insofar as we understood the extent of Mr. Westbrook's submission, we accept that a sponsor is entitled to rely on the correctness of an audit report prepared by an independent expert. But the application of such a principle must always be considered in context. A simple example suffices. If, in respect of a listing application, one fully reasoned legal advice states that it is contrary to law to undertake a certain commercial act while a second states that it is in accordance with law to do so, a sponsor must surely seek some way of resolving the issue so that there is certainty as to the legal position. Enquiries are required. Are the two advices based on different facts and may the issue be resolved that way? If not, is there perhaps the need for a third defining advice from a known expert? In such circumstances, it cannot suffice simply to choose

the advice most advantageous to the listing and ignore the other. We see no difference in principle in the present case. Two expert audit reports, both in first draft, were at odds. Some form of enquiry to reach a rational explanation for the difference, an explanation that could be put before the Stock Exchange, was required. However, as we have said, for all practical purposes there was no enquiry, simply the making of a tactically advantageous decision, and there was certainly no explanation made to the Stock Exchange.

119. Mr. Westbrook's third principal submission related to the finding by the SFC that there had been deliberate non-disclosure to the Stock Exchange by SHKI.

120. In this regard, Mr. Westbrook submitted that the SFC relied principally on two responses made to the Stock Exchange's letter of 19 March 2009. He emphasised the fact that the letter sought numerous responses in respect of a variety of matters and that the responses which have been criticised were just two out of many. We accept that this is the case. But we do not see this as unusual. It is one of the reasons why companies licensed to provide corporate finance advice, when taking on the role of sponsor, invariably allocate a team of professionals.

121. Mr. Westbrook submitted that the two responses were both accurate. Insofar as it goes, we do not dispute the accuracy of that submission. In our judgment, however, the true issue goes not to the accuracy of what was said but to the materiality of what was not said.

122. Rule 6A.04 of the Stock Exchange Listing Rules directs as follows:

> "Each sponsor must undertake to… (2) use reasonable endeavours to ensure that all information provided to the Exchange during the listing application process is true in all material respects *and does not omit any material information* and, to the extent that the sponsor subsequently becomes aware of information that casts doubt on the truth, accuracy or completeness of information provided to the Exchange, it will promptly informed the Exchange of such information…" [Our emphasis].

123. This Rule may not have direct applicability but we are satisfied that in substance the same directive is to be found in the various rules and principles of conduct binding sponsors in GEM listing applications.

124. As Mr. Jat observed, SHKI must have known that cash flow figures were of critical importance, more especially as the first figures supplied by RSM would, without material amendment, have derailed Sino-Life's application. Moreover, the figures were not a matter only for the auditors. SHKI, as sponsor, was required to confirm that all the basic qualifications for listing had been met. The importance of the issue, said Mr. Jat, was underscored by the fact that the very first matter raised in the letter of enquiry from the Stock Exchange dated 19 March 2009 related to the minimum cash flow requirement contained in the GEM Listing Rules. This was followed later by a number of questions concerning the change of reporting accountants.

125. In our view, in such circumstances, SHKI must at the very least have had their attention drawn back to the issue of the difference in the 2007 cash flow figures. A number of enquiries, while they did not go directly to the issue, focused on the work carried out by RSM and the circumstances of its resignation.

126. We agree with Mr. Jat's observation that, in giving its replies, SHKI said as little as possible. We also agree with his submission that, from a study of what was and was not told to the Stock Exchange, the single compelling inference to be drawn is that SHKI wished to avoid revealing the difference in the 2007 cash flow figures between RSM's draft report and CCIF's report.

127. It may be said that it is a prudent rule only to answer questions asked. In the present instance, however, SHKI was bound by a structure of rules and principles of conduct that obliged it not simply to represent the interests of Sino-Life but also the interests of the integrity of the market. That in turn required it to give a complete picture of all material matters to the Stock Exchange.

128. For the reasons given, we are fully satisfied that the difference in the 2007 cash flow figures contained in the draft audit report of RSM and the report of CCIF constituted a material matter. As we have said, the financial architecture of a business enterprise, that is, the manner in which its figures have been built, may be, and often is, a crucial consideration for investors. As the gatekeeper to the market, it is also a crucial consideration for the Stock Exchange. We are equally satisfied that SHKI was at all material times aware of the importance of the issue. The failure to raise it in the substantive application and the studied avoidance of revealing it when answering enquiries from the Stock Exchange was, we are satisfied, intentional. As such, in the circumstances, on an objective assessment, it had to constitute an intention to mislead the Stock Exchange.

Failure to exercise due diligence, the second issue – 'the encumbrances on the Taiwan columbarium'

129. In its prospectus, Sino-Life informed potential investors that it intended to advance its business interests in Taiwan by undertaking the refurbishment of a columbarium in Miaoli County. It was estimated that the cost of the refurbishment would be about HK$13.1 million, those funds to be drawn from the anticipated proceeds of the GEM Board listing.

130. As it was, the listing of Sino-Life secured funds of approximately HK$124 million, greater than expected. The columbarium project was planned to utilise more than 10% of this sum. In his submissions, Mr. Westbrook, on behalf of SHKI, said that the columbarium project was "simply a future business prospect". If the comment was meant to imply that the project was therefore of little or no consequence, we would disagree. Sino-Life's expansion plans were important, especially on the GEM Board which was intended to house emerging business enterprises; as Mr. Jat put it, "growth enterprises with less track record seeking to attract investors on the basis of their future prospects". It is also to be observed that, when dealing with future plans, the prospectus laid emphasis on this project. Potential investors were therefore entitled to be given accurate information not only as to general risks but, importantly, as to any specific risks that may undermine the commercial viability of the project.

131. Sino-Life's operations in Taiwan were conducted through a wholly-owned subsidiary, Bau Shan Life Science Technology Company Limited ('Bau Shan'). As the SFC expressed it in its Decision Notice of 2

April 2013, the Taiwan operations conducted by Bau Shan consisted principally of the following:

a. sales of funeral service deeds, accounted by Sino-Life as receipt of funds in advance, and

b. provision of funeral arrangement services to both deed holders and deceased persons who had not purchased deeds, accounted as revenue.

132. Neither Sino-Life nor Bau Shan owned the columbarium. Nor did they have any secured rights in it, that is, rights in the structure itself that would hold good against all parties. The beneficial owner of the columbarium was a Taiwanese company, Zhen Yuan Sheng Ming Huan Huai Technology ('Zhen Yuan') which had contracted out the authority to manage the columbarium to another company, Jin Yu Cheng Development ('Jin Yu Cheng').

133. In February 2008, Jin Yu Cheng, holding the contractual right to manage the columbarium, entered into an agency agreement with Bau Shan in terms of which Bau Shan had the right to sell niches and other forms of storage space for funerary urns in the columbarium on a commission basis. The agreement was to run from March 2008 until the end of January 2013. Several months later, a complementary agreement was entered into in terms of which, once refurbishment work on the columbarium commenced, Bau Shan would be given exclusive agency rights.

134. The commercial rationale of the columbarium project appears to have been as follows. The refurbishment would make the columbarium a more fitting place for the repose of cremated remains which would in turn increase sales and thereby boost commissions due to Bau Shan. In this regard, the prospectus said:

> "An amount of up to approximately HK$13.1 million (approximately RMB11.56 million) will be used to develop business in columbarium in Taiwan through entering into an agency agreement for a columbarium which structural construction is completed and the whole amount will be utilised to refurbish the columbarium from bringing it into saleable condition…"

135. Two warnings were given in the prospectus. Both were of a general nature. First, that the intended refurbishment may not in fact increase sales and, second, that there was no guarantee that, by the time the agency agreement had expired, the full costs of refurbishment would have been recovered. As Mr. Westbrook emphasised, no profit forecast was contained in the prospectus. This was because SHKI felt there were too many imponderables in respect of its businesses generally.

136. As it was, by the date of listing (9 September 2009), no sales of niches, urns and other forms of storage for cremated remains had been concluded by Bau Shan, this despite the fact that the agency agreement had permitted sales from 1 March 2008. How it was that a period of some 19 months had elapsed without sales being concluded is uncertain. On its face, it would appear perhaps to be a combination of reasons; the fact that refurbishment work had not started, the fact that extra sales staff had not been hired, the fact that the columbarium had not yet been listed as an authorised columbarium by the relevant authorities and that no approval to operate had as yet been granted, these last two facts not being disclosed in the prospectus.

137. As to the post-listing success of the columbarium project, it was fundamental that it could not be assured unless Zhen Yuan, the company which owned the columbarium, remained secure in its title. Put simply, if for any reason (for example, indebtedness to creditors) Zhen Yuan lost its title, it could in turn undermine Bau Shan's business. If ownership passed to a third party by way of a forced sale, the degree to which that new owner of the columbarium would be bound by the contractual arrangements between Zhen Yuan, Jin Yu Cheng and Bau Shan would (at best) be problematic.

138. As it was, in late June 2009 Mr. Weber Yu of SHKI conducted an Internet search and discovered that in 2007 a judgment had been entered against Zhen Yuan, the beneficial owner of the columbarium, in the Miaoli District Court. The judgment had been followed by foreclosure proceedings which in turn had led to proceedings for the sale by auction of the columbarium itself, the sale being set for November 2007. Mr. Yu discovered that the auction had been cancelled. Using commercial common sense, the natural conclusion to be drawn was that Zhen Yuan had either paid the judgment debt in full or entered into some kind of arrangement with the judgment creditor.

139. Whether in fact Zhen Yuan had paid the debt in full or whether payments of any form were still outstanding was clearly a significant issue, more especially if any agreement to make repayment was subject to the auction of the columbarium taking place in the event of default.

140. Equally, of course, a collateral question arose. Was this piece of litigation an isolated matter or did it indicate a more general financial frailty on the part of Zhen Yuan?

141. Mr. Yu reported the matter to his superior, Mr. Choy, who immediately sent an email to Sino-Life to the following effect:

> "Please find enclosed our search results relating to Zhen Yuan which shows that, as at 31 October 2007, Zhen Yuan is under foreclosure as a result of outstanding debt. Please clarify and provide the following:
>
> 1. relevant court judgment;
> 2. the outstanding debt owed by Zhen Yuan leading to the foreclosure;
> 3. the relevant outstanding debt owed by Zhen Yuan as at 31 December 2008 and as at 31 May 2009; and,
> 4. as the directors claim that, as there is no public sale of Zhen Yuan, there is no reference of open market price of the columbaria at Zhen Yuan, please clarify whether it was the result of foreclosure that led to no open market sale of Zhen Yuan with the support of Taiwan legal advice."

142. When it received the email, Sino-Life instructed its lawyers in Taiwan, Qunji United Law Firm, to respond. The response from the lawyers was as follows:

> "As to the foreclosure of the real estate under Zhen Yuan for compulsory auction by the court on 17 October 2007, the procedures of the court's compulsory auction have been terminated on 31 October 2007 due to the creditor's withdrawal of execution. Usually, for cases in which the creditors apply for auction withdrawal, they would do so only if a consensus, subject to certain conditions, has been reached between the debtor and creditor.
>
> As to the foreclosure of real estate for auction, Miaoli Court of Taiwan on 31st of October 2007 announced that (the procedures) have been terminated, indicating that the creditor had withdrawn the foreclosure, and hence the interest of Zhen Yuan Company would not be affected.

> As to the up to date debt situation of Zhen Yuan Company, Bau Shan Company, being merely a sales agent, has no power to ask about it.
>
> As to the matter that none of the columbarium niches have been put up for public sale by Zhen Yuan Company, it was principally the decision of Zhen Yuan Company, and foreclosure was not necessarily the reason behind. Besides, after the foreclosure was withdrawn on 31 October 2007, Zhen Yuan Company could sell (the columbarium niches) to the public."

143. We shall look to the substance of this legal advice shortly. At this juncture, it suffices to say that Mr. Yu of SHKI did not believe that the advice met the concerns expressed in the email to Sino-Life. In the result, he sent an email immediately to Mr. Mok Yu Ting, the financial controller and company secretary of Sino-Life. In that email he expressed the view that Sino-Life, working through its subsidiary, Bau Shan, did have the right to be informed of matters related to the indebtedness of Zhen Yuan. He made it clear that, if there was any risk that the columbarium may be put up for auction by way of court action, that risk should be disclosed in the prospectus as it threatened to undermine the viability of the project. Mr. Yu sought confirmation that the debt had been settled.

144. The response was received from Sino-Life that it had known of the 2007 foreclosure proceedings before its subsidiary, Bau Shan, had entered into the sole agency agreement. It said that the columbarium had not been subject to any legal problems in the past 20 months or so and echoed the advice of its lawyers that it was in any event not entitled to demand from Zhen Yuan details of its finances. It was said that SHKI should have trust in the experience and ability of Sino-Life's senior management.

145. As an indication of the importance which SHKI gave to this issue, Mr. Choy then sent a lengthy email in which he said that the directors of Sino-Life should provide information in the prospectus concerning any foreclosure risk. This he said was "to fulfil the statutory duties of the directors under the regime of Hong Kong laws and the GEM Listing Rules". He concluded his email by saying: "Therefore, we are looking forward to the directors taking [the] correct course in this issue. Thank you!"

146. The matter, however, appears to have been taken no further. Certainly, there was no mention in the prospectus of Zhen Yuan's financial position and/or risks related to the forced sale of the columbarium. Put bluntly, the 'correct course' urged by Mr. Choy had not been followed.

147. Significantly also, there is no evidence that SHKI itself, as sponsor, made any further independent enquiries. If it had done so, it would have learnt that the single legal action which it had discovered was just one of a number of actions for recovery of debt that had been instituted against Zhen Yuan in the Maioli District Court. Shortly after the listing, among several other legal actions, the following was discovered.

148. First, that in May 2009 the company that had constructed the columbarium had petitioned for its sale to recover more than New Taiwan Dollar ('NTD') 9.3 million, an encumbrance being placed on the columbarium itself. Zhen Yuan hoped to repay the debt before the end of 2009 and thereby release the columbarium from the encumbrance, this being *after* the date of listing.

149. Second, that the Tax Bureau had petitioned for the foreclosure of the columbarium in or about May 2009 in respect of a debt in excess of NTD 1 million. In this matter also, Zhen Yuan apparently hoped to repay the debt before the end of 2009.

150. It was in this context that the SFC concluded that there had been a failure on the part of SHKI to conduct due diligence in respect of Zhen Yuan's financial frailty exhibited by the various encumbrances placed on the columbarium.

151. Integral to the overall finding of the SFC was the specific conclusion that SHKI had failed in its duties as sponsor by not pressing for fuller and better details of both historic and current claims for the recovery of debt made against the beneficial owner of the columbarium and/or still being litigated.

152. In seeking to convince us that the findings of the SFC were wrong, Mr. Westbrook referred us to advice received from the Taiwanese lawyers after Sino-Life's listing. In that advice, the lawyers set out a far more detailed exposition of the financial difficulties faced by Zhen Yuan, confirming much of what the SFC itself had found. In the advice it was said that the persons who purchased repositories for ashes in the columbarium, even if for any reason they did not obtain full rights of ownership, would nevertheless have full rights of usage, for all practical purposes that being the same thing. In short, so the advice said, purchasers of repositories would not be at risk.

153. Consequent upon this, Mr. Westbrook said that there is no common international practice in property law and procedure. It is notoriously idiosyncratic and local. There are strong reasons therefore to obtain local legal advice and equally strong reasons to accept and rely upon the advice that is provided.

154. Mr. Westbrook added that there was no basis upon which the "core competence" of the Taiwanese lawyers could be challenged. He amplified this by saying that the SFC had not itself obtained independent legal advice from experts in Taiwanese property law.

155. In our judgment, however, the issue of whether or not SHKI conducted due diligence does not turn on the correctness of the advice supplied by the Taiwanese lawyers prior to the listing. It is not a question of looking to the merits of that advice. It is rather a question of looking to the *extent* of that advice. Did it answer the questions that had been asked? Was it of any benefit in the due diligence process?

156. What needs to be emphasised is that the rules and principles of conduct which at the time governed the manner in which sponsors were obliged to discharge their duties did not in any way suggest that, when it came to considering legal and/or accountancy advice from independent experts, sponsors were entitled to abandon all nimbleness of mind, being entitled to assume that such advice could be accepted at face value as providing a full answer to all issues raised. As it was said during a brief exchange in the course of the hearing, if that was the case it would place a premium on incompetent and/or tactically limited advice being received.

157. Both Mr. Yu and Mr. Choy of SHKI appreciated from the outset that the legal advice did not answer the questions posed. Their emails sent to Sino-Life make that plain. Indeed, in the absence of a full disclosure of Zhen Yuan's financial situation, Mr. Choy informed his client, Sino-Life, in the most direct of terms what the correct course must be.

158. What SHKI was seeking was plain enough. Had the judgment it had discovered been paid in full? If not, how much remained outstanding? If there was an amount outstanding, did it disclose a continuing risk of foreclosure? Were other debts due? If so, what was the nature and extent of this indebtedness?

159. When commenting on the assertion that SHKI was entitled to accept the advice of the Taiwanese lawyers, Mr. Jat said: "This begs the question of whether the concerns arising from the discovery of the [Miaoli District Court] notice were only legal in nature… The real core concern was Zhen Yuan's financial position. If it could not pay a creditor for so long that the creditor was able to obtain a court judgment and take enforcement steps all the way to scheduling a foreclosure auction, the obvious questions must be whether Zhen Yuan had other creditors and was in financial difficulties".

160. What then of the extent of the legal advice?

161. As to the actual foreclosure proceedings found on the Internet by SHKI, the lawyers confirmed what SHKI already knew, namely, that the auction had been cancelled. The lawyers then went on to make an equally obvious point, one which was more an observation of

the commercial world then advice as to a specific point of law, namely that "usually" , if a judicial auction was cancelled, it was because some arrangement had been reached between debtor and creditor. That advice took the matter no further at all, a fact which must have been obvious to Mr. Yu and Mr. Choy.

162. With respect, it was also a statement of the obvious to say that, because the creditor had withdrawn its foreclosure proceedings, the interests of Zhen Yuan were not affected. The information that was sought, and which clearly SHKI would have wanted canvassed, was whether, if some arrangement for repayment had been reached, in the event of a default of that repayment there remained the risk of foreclosure.

163. In respect of Zhen Yuan's current debt situation, the advice received was that Sino-Life (acting through its subsidiary, Bau Shan) as a mere sales agent had no power to "ask about it". Strictly speaking that may have been correct, but of course it did not stop enquiries being made nor answers being given. Self-interest dictated that for both Sino-Life and Zhen Yuan there was good reason to supply information. Zhen Yuan after all was seeking to have a HK$13 million renovation undertaken to its columbarium at no cost to itself. It appears, however, that Zhen Yuan was not even approached to see if it would be willing to co-operate.

164. With respect, the advice received from the Taiwanese lawyers was blinkered; indeed a cynic may say that it was designed more to keep information at bay rather than divulge it. In that regard the cynic would be able to point to the fact that Zhen Yuan's financial malaise was far greater than SHKI at the time appreciated. Post the listing, the Taiwanese lawyers were able to give substantial detail concerning this

malaise. It begs the question: why were they not able to do so prior to the listing?

165. In our opinion, the probabilities suggest that Mr. Yu and Mr. Choy knew they were being 'stonewalled' by their own client. Regrettably, whatever their private misgivings, there is no evidence that they made it clear that, as sponsor, it was their duty to ensure that all material risks were set out in the prospectus. As we have emphasised before, their duty was not simply to their client, it was equally to the integrity of the market. The SFC's own investigations make it clear that it would not have been difficult for SHKI to find out considerably more about Zhen Yuan financial difficulties. But this was not done. Despite Mr. Choy's unequivocal advice to Sino-Life as to the correct course to take, no specific warning appeared in the prospectus.

166. In our view, the need to fully investigate Zhen Yuan's true financial history and to spell out the risk that would have been known if such an investigation had taken place is obvious. We reiterate that Mr. Yu and Mr. Choy knew it was obvious. Despite that, however, there was no investigation beyond the initial and limited discovery of the one court action. In all the circumstances, we are satisfied that this amounted to a significant failure of due diligence on the part of SHKI.

167. We have reached this view in the knowledge of the fact that further advice was received from the Taiwanese lawyers *after* the listing, such advice stating that, despite Zhen Yuan's financial difficulties, purchasers of repositories at a columbarium would not be at risk because they would have right of use in perpetuity even if not right of ownership. Whether potential buyers of the repositories would have been assured by

this advice, requiring, as it did, an understanding of the different concepts of ownership and use and whether deprivation of ownership affects rights of use, is another matter. We suspect it would have afforded cold comfort to potential buyers. The point, however, in our view, is that due diligence is to be exercised prior to an application being made. It is an anticipatory exercise and little is to be gained from saying after the event, "well, as it turned out, little or no damage was done".

168. By way of a postscript, two matters should be mentioned. First, in an announcement made by Sino-Life in January 2011 it was said that earlier, on 13 September 2010, Zhen Yuan had been "deleted" as owner of the columbarium. For whatever reason, therefore, in just over a year from the date of listing Zhen Yuan was no longer the beneficial owner of the columbarium. Second, although in the prospectus Sino-Life had placed a degree of emphasis on the fact that it was to commence renovation works on the columbarium - and indeed informed the Stock Exchange that such work would commence immediately after listing - in fact no such work was undertaken. Nor was evidence placed before us of the sale of any repositories for ashes or memorials at any time after listing. The only reasonable inference to be drawn, in our opinion, is that by the date of listing or shortly thereafter Sino-Life had second thoughts concerning the project. Why that was so was not explained to us.

Failure to exercise due diligence, the third issue – "the viability of the columbarium business"

169. Because of what it said were the imponderables related to the funeral business, Sino-Life did not include a profit forecast in the

prospectus. However, as to its intended business ventures, more particularly the columbarium in Miaoli County, the Stock Exchange required to be satisfied of their essential viability.

170. In this regard, in June, July and August 2009 there were communications between the Stock Exchange and SHKI concerning the columbarium in which the Stock Exchange sought details supporting its essential viability as a business plan.

171. Early in the process, accompanying a letter from the Stock Exchange dated 4 June 2009, SHKI were asked to –

> "(a) provide detailed reasons for the Group's [Sino-Life's] inability to conclude any sales of the cubicles although the agency agreement was signed in February 2008[13];
>
> (b) explain meaningfully why the Group would plan to employ 3 to 5 extra sales staff to sell cubicles and earmark a substantial portion of its IPO proceeds in the amount of HK$13.1 million to upgrade and refurbish the columbaria not owned by it given that the Group has not generated any revenue from this new line of business. In this connection, the Sponsor should advise its due diligence taken to ensure that the information disclosed in relation to this business arrangement is made by the Directors after due and careful enquiry;
>
> (c) elaborate on whether and how the Group expects the expenditure of HK$13.1 million to be paid back including the relevant commission fees to be generated and the timeframe involved."

172. In its response of 12 June 2009, SHKI declared that it had reviewed the business proposal concerning the columbarium project and

[13] In terms of its agency agreement entered into on 1 February 2008 with Jin Yu Cheng, the company which held the management rights of the columbarium, Bau Shan was contractually entitled to begin selling repositories and memorials at the columbarium from 1 March 2008 until the conclusion of the contract on 31 January 2013. On 30 June 2009, a supplemental agreement was entered into in terms of which it was agreed that, when Bau Shan commenced its renovation works, it would be entitled to sole agency. However, no steps to commence renovation work was undertaken. Accordingly, by the time of the exchanges in June and July and August 2009, a period in excess of 15 months had passed without a sale.

had in addition conducted Internet searches in respect of similar existing businesses. It provided a cash flow timeline. That timeline estimated that the columbarium business would generate commission income of HK$7,247,000 in the remainder of 2009 and HK$25,428,000 in 2010. The business proposal indicated that the full cost of the renovation of the columbarium would be recovered by, or before, the end of 2010.

173. The Stock Exchange sought further details. Under cover of a letter dated 25 June 2009, the following was requested (paragraph 13 (c) of the Principal Comments):

> "It is submitted that the Directors estimate that the invested amount on the refurbishment of the columbaria will be paid back during 2010. In this connection, please –
>
> i. provide a breakdown of the total commission income expected to be generated from the sales of columbaria for each of 2009 and 2010 and a breakdown of the net cash inflow expected to be generated from the sales of columbaria for each of 2009 and 2010;
>
> ii. provide a confirmation from the Sponsor that a cash flow forecast, together with the underlying assumptions, have been arrived at by the Directors after due and careful enquiry; and
>
> iii. disclose, where appropriate, in the Risk Factors section the risks associated with the investment in the refurbishment of the columbaria given that the Group has yet to conclude any sales of the cubicles although the agency agreement was signed in February 2008."

174. In the breakdown that was supplied, it was indicated that by the end of 2009 a total of 560 repositories for ashes would be sold[14]. This would bring in the anticipated income of HK$7,247,000. Concerning

[14] This was made up of 300 individual repositories, 128 designed for couples, 24 designed for families, 80 being memorials only and 28 being for urn storage.

2010, it was estimated that a total of 1,956 repositories and memorials would be sold, the anticipated income being HK$25,428,000.

175. There was of course an accounting relationship between the two years: 2009 and 2010. In this regard, concerning 2010, the breakdown said the following: "Total units sold is expected to increase by 16% on average as the establishment of the sales channel of the columbarium by the Group." The 2010 breakdown, however, showed a total of 1,956 repositories and memorials of different kinds of being sold. The Stock Exchange pointed out that an increase of approximately 16% should result in total sales in 2010 of no more than 650 repositories and memorials. The estimated increase contained in the breakdown represented an increase of some 250%.

176. In a response dated 16 July 2009, SHKI explained that the 560 units expected to be sold by the end of 2009 referred only to the units expected to be sold between 1 September and 31 December 2009, this being because it was only intended to start selling repositories and memorials from 1 September 2009 and not before. The following was then said: "Given the estimated annualised figure of sale of 1,680 units for the year ending 31 December 2009 and the estimated growth rate of approximately 16% for the sale of units, the total number of units that is estimated to be sold for the year ending 31 December 2010 will be approximately 1,956."

177. Later, under cover of a letter dated 28 August 2009, SHKI submitted a 'board memorandum' on profit and cash flow forecasts for 2009 and 2010 signed by the Chairman of Sino-Life. This memorandum was to be read in conjunction with the prospectus. The memorandum

stated that the columbarium would start to generate income after the listing of Sino-Life on the GEM Board in September 2009.

178. In the draft (and final) prospectus, having stated that no repositories for ashes and/or memorials had yet been sold at the columbarium, two warnings of a general nature were given. First, that the renovations to the columbarium may not increase sales and, second, that there was no guarantee that, by the time the agency agreement had expired in early 2013, the full costs of renovation would have been recovered. That being said, it was evident that Sino-Life remained optimistic as to the financial success of the project. In this regard, the following was said in the prospectus:

> "The Group considers that the amount of HK$13.1 million is well spent in consideration of its estimation that the business of selling the Products and the prices of the Products will increase steadily giving the Group a steady and increasing return from such business."

179. In its Decision Notice, the SFC concluded that the various financial projections and breakdowns concerning the financial viability of the columbarium project were materially problematic. It further concluded that the failure to recognise this and to ensure rectification in an acceptable form cast serious doubts on the quality of the relevant due diligence conducted by SHKI. Specifically, the SFC referred to the following problematic areas:

> "i. the doubtful validity of the assumption that commission would be generated from 1 September 2009 ;
>
> ii. the apparent lack of support for the assumption that there would be an annual sales growth of 16%;
>
> iii. the projected sales figures for the final four months of 2009 of 560 repositories and/or memorials appeared to be arbitrary;

iv. representations on the supply of urn spaces and cubicles appeared to be "false and misleading".

180. Before looking to the specific areas identified by the SFC, consideration must be given to a general response argued before us by Mr. Westbrook for SHKI.

181. Mr. Westbrook emphasised that the directors of Sino-Life had, after due consideration and on the advice of SHKI, not included a profit forecast in respect of its general business activities in the prospectus. This was because the directors of Sino-Life were of the view that it was difficult to predict with certainty the turnover and profit derived from its principal business activities, namely, the provision of funeral services[15].

182. In the result, said Mr. Westbrook, taking into account the various matters contained in the prospectus and the decision not to put a profit forecast into the documents, neither the Stock Exchange nor potential investors were left in any doubt as to the commercial uncertainties associated with the columbarium business.

183. In this regard, Mr. Westbrook placed particular emphasis on the following entry in the prospectus which, he noted, had been inserted at the specific request of the Stock Exchange and which indicated that the

[15] The Listing Division of the Stock Exchange was informed of this decision in a letter dated 25 February 2009, the final paragraph of which reads: "The directors are of the view that it is difficult to predict with certainty the turnover and profit derived from its principal business activities, inter alia, the provision of funeral services. Accordingly, the directors are of the opinion that it is difficult to assess and project the group's turnover and profitability for the financial year ending 31 December 2009 with such level of accuracy and reasonableness as would be required for a profit forecast to be disclosed in the prospectus. Therefore, the directors have not included in the prospectus a profit forecast of the group for the financial year ending 31 December 2009."

Exchange itself was not misled as to any uncertainty associated with recouping the columbarium investment:

> "The Group has not concluded any sales of the cubicles and urn spaces since the date of the agency agreement. There is no assurance that such sales will increase after the upgrading and refurbishment work. In the event that the sales of cubicles and urn space do not increase after the upgrading and refurbishment work, the Group's financial results may be materially affected. In addition, there is no assurance that upon the expiration or the termination of the agency agreement, the Group's receipts from the sale of cubicles and spaces for storage in the columbarium will cover the investment of HK$13.1 million of the placing proceeds in upgrading and refurbishing the columbarium. In the event that the Group's receipt falls short of the amount of investment in upgrading and refurbishing the columbarium upon the expiration or the termination of the agency agreement, it may have an adverse impact on the business of the Group."

184. It was Mr. Westbrook's submission that the particular difficulties involved in assessing future profit and cash flow in respect of the columbarium project were therefore made abundantly clear to the Stock Exchange (and to potential investors) and that a balanced assessment of the adequacy of the forecast and figures should have been considered in that context. The SFC, he submitted, had failed to do this. Its assessment had therefore unbalanced.

185. It followed, of course, that he urged us, sitting to consider matters afresh and on their merits, to place emphasis on the very real difficulties involved in assessing the columbarium project's future profit and cash flow.

186. In response, Mr. Jat accepted that sometimes profit forecasts and allied cash flow figures may be difficult to bring together. If such was the case in respect of the columbarium project, he said, the correct course of action was to advise the Stock Exchange that it was not possible in the circumstances to provide such accounts. To the contrary, in early

June 2008 a draft board memorandum was prepared and thereafter refined. It is a weak submission, said Mr. Jat, to suggest that the Stock Exchange, in discharging its obligation to investigate whether the columbarium project was a viable one, should not have regard to the memorandum and other supporting projections submitted by SHKI for the very purpose of convincing it that it was viable.

187. Having regard to the general uncertainties concerning the columbarium project and the fact that, aside from concluding agency agreements, little, if anything, had been done to advance the business, it does seem to us to be arguable that a profit forecast should not have been submitted to the Stock Exchange. We recognise the inherent difficulties of making a forecast. That being said, Sino-Life, on the advice of SHKI, decided that detailed figures should be submitted. In providing those figures, SHKI had an obligation to conduct proper due diligence, assessing the profit forecasts and cash flow figures "with a questioning mind and being alert to information, including information from experts, that contradicts or brings into question"[16] their reliability. We further take into account that forecasts of this kind are commonly undertaken, the norm being that forecasts as to the current year should be fairly achievable.

(i) That commission would be generated from 1 September 2009

188. In the board memorandum, it was confirmed that sales of repositories for ashes and memorials would commence in September 2009, the directors of Sino-Life forecasting that about 560 repositories and memorials would be sold in the four-month period up to the end of

[16] See paragraph 2 of Practice Note 2 of the GEM Listing Rules.

the year. This was based on an estimate of mortality rates in surrounding areas, the estimate coming to 16,566 of which Sino-Life expected to have a market share of 10% from the outset: the exact figure produced on that percentage being 552 units which was then rounded up to 560.

189. It is evident that Mr. Weber Yu of SHKI was sceptical from the beginning of these initial projections. He advised the applicant company that, when reporting to the regulators, generally a more conservative approach was adopted in respect of profit forecasts and cash flow estimates. This advice was contained in an email dated 26 June 2009 at which time it was estimated that Sino-Life would be listed in or about mid-August 2009. In the result, as we have said, it was not listed until nearly a month later on 9 September 2009.

190. In the email, Mr. Yu said that on his reckoning the mortality rate for the sales target area of the columbarium was materially less than the estimate of 16,566. He put the estimate around 11,000. He also pointed out that there were a number of competing locations for the placing of cremated remains and for memorials to the deceased. He referred to some four by name and made mention of a larger number of public columbarium structures.

191. It should be added that in the email he was doubtful whether the columbarium would be able almost immediately to gain 10% market share. He further pointed out that, as Miaoli County was relatively remote, this would have to be taken into account in setting prices.

192. As to the issue in question, that is, that commissions would be generated from the date of listing, he said the following:

> "In the present situation, the optimistic estimation is that your company could be listed in mid-August the earliest, and after that it would take a month to decorate and prepare, which means that there would be only three and a half months left in 2009 for selling."

193. In respect of this last issue, Mr. Yu was informed by Sino-Life that: "Our company will commence sales immediately after listing in sync with the decoration works."

194. In principle, this was sensible enough, similar to a property developer selling off plan while in the course of building. However, while we do not suggest it is a matter of great materiality, the fact is that this suggested approach was at odds with the prospectus which stated that funds were needed for renovation work before selling commenced, the reason being that the repositories for ashes and memorials at the columbarium needed to be brought into a saleable condition. Sino-Life's decision therefore to sell concurrently with renovations smacks of a quick tactical decision. SHKI, as sponsor, had an obligation to set out what was intended: were sales to be promoted during the course of renovation works or were they to be held over until completion (or near completion) of such works? If the former was the case then the prospectus needed to be amended.

195. What also needs to be taken into account, we believe, is that, if meaningful sales were to be generated, Sino-Life recognised that it was necessary to employ additional sales staff. However, in the prospectus (page 134) it was said that –

> "As at the latest practicable date, Bau Shan had *not* employed any extra employees in connection with the business of the agency agreement. The Group plans to employ 3 to 5 additional sales staff … to sell

> cubicles and spaces for urn storage in the columbarium." [Our emphasis]

196. On the last practicable date, therefore, Sino-Life did not have a sales team ready nor was it actively in the process of engaging a sales team; it merely had "plans" to employ sales staff. This would appear to fit in with what was said elsewhere in the prospectus, namely, that renovation was necessary before the commencement of any sales campaign.

197. In such circumstances, we agree that the information available to the Stock Exchange as to the intention – and ability – of Sino-Life to commence sales in early September immediately upon listing was, at best, ambiguous. A more severe judgment may say it was contradictory. Bearing in mind that, on the figures presented, Sino-Life estimated that it would be able to bring in an amount of approximately HK$7,247,000 by the end of 2009, unambiguous information as to when it would be able to commence generating sales to earn this sum was a matter of some moment.

(ii) Lack of support for a sales growth of 16%

198. In a set of figures supplied to the Stock Exchange (identified as JYC Op Plan 3) Sino-Life estimated its 2009 income (calculated in NTD) in the figure of NTD30,636,000. This included a management fee of NTD1,300 for all the repositories, 470 in number, but excluding the memorials: a total of NTD611,000.

199. In the same set of figures - assuming a sales growth rate of 20% and the cost of repositories and memorials rising in accordance with

inflation by 2.5% - Sino-Life estimated its 2010 income to be NTD107,523,900 including a management fee of NTD2,160,600 in respect of 1,662 repositories.

200. In respect of these figures, SHKI queried the reason for the insertion of management fees given that Bau Shan was a sales agent only and had no management responsibilities. Sino-Life responded that it would no longer collect management fees and that the necessary amendments would be made to the figures.

201. In its Decision Notice, the SFC commented[17] that, although Sino-Life "seemed ready to abandon the collection of management fees, it was not quite prepared to forego the corresponding income."

202. The revised figures for 2009 (JYC Op Plans 4 and 5) showed an income of NTD30,400,000, just NTD236,000 less than the previous figures although in the previous figures management fees had been estimated at NTD611,000. Similarly, the revised figures for 2010 showed an income of NTD107,517,600, just NTD6,300 less than the previous figures although in the previous figures management fees had been estimated at NTD2,160,600.

203. How had this apparent discrepancy come about? The SFC found that the number of units as well as the selling prices of units had been adjusted so that the figures for agency income excluding management fees nevertheless remained roughly on par with the first set of figures supplied to the Stock Exchange which included agency income.

[17] See paragraph 171 of the Notice.

For example, the original set of figures had estimated a sale of 1,938 units in 2010 while the revised figures estimated a sale of 1,956 units.

204. To arrive at its revised figures, Sino-Life's forecasted increase in sales was amended to 16%, down from 20%. Even though the increase had been revised downwards, it appears that sales increased. More than that, in mathematical terms, the new figures did not reconcile fully with the projected sales growth rate. This was a matter noticed by Mr. Yu of SHKI who queried the discrepancies. For example, Mr. Yu calculated that, if the selling price of an individual repository in 2009 had been NTD100,000, increased by the rate of inflation (2.5%) that should have resulted in the selling price in 2010 of NTD102,500 and not the figure contained in the revised estimates of NTD103,000.

205. The individual differences were not necessarily great but cumulatively they were of significance.

206. In this regard, we were informed that, although Mr. Yu had raised his queries, they were not answered. Accordingly, no reasons were given to explain the changes and/or apparent mathematical discrepancies.

207. On behalf of SHKI, Mr. Westbrook condemned the finding of the SFC that SHKI was culpable of a lack of due diligence in respect of these profit forecasts and estimates as "nonsensical". The discrepancies, he said, were essentially immaterial, more especially as they constituted estimates of future revenue, hardly an exact science.

208. We do not accept this criticism. The fact is that, having excluded management fees from its estimates, Sino-Life's revised figures

resulted in a total income that was approximately the same. The estimated sales growth rate had been reduced from 20% to 16% but its forecast for sales had increased. These matters needed to be explained but were not. The impression given, therefore, whether rightly or wrongly, was that Sino-Life wished to maintain its profit forecasts even if that was at the expense of the inherent integrity of its figures.

209. In our view, there is therefore substance in Mr. Jat's observation that, having regard to the revisions and/or apparent discrepancies, SHKI should at least have satisfied itself that the management of Sino-Life had indeed made the revised forecasts after due and careful enquiry. This, he said, SHKI failed to do.

(iii) Apparent arbitrariness of projected sales figures for 2009

210. Sino-Life's profit forecasts for the columbarium were premised on the assumption that from about the time it commenced sales in September 2009 it would enjoy a 10% share of the market, that 10% share remaining until the end of the year. Thereafter it was hoped that the columbarium business would enjoy an increasing market share.

211. The decision to adopt an opening 10% share of the market was always going to be open to debate. As Mr. Westbrook said to us, such estimations are not an exact science and in the end must be left to the knowledge and experience of the directors of the applicant company.

212. SHKI did give advice as to what it considered to be the correct approach. In his email of 26 June 2009 (to which we have earlier made reference) Mr. Yu said that "generally, people tend to be more

conservative when preparing earnings and cash flow forecasts for submission to the regulatory authorities". He then gave a number of reasons why he believed it was doubtful, certainly in respect of the memorial garden, that the columbarium would be able to commence business with a 10% market share. Mr. Yu estimated that "the market capacity" for the columbarium's catchment area would be about 11,000 people. They or their families would have a choice of four other private columbarium facilities and some 11 public facilities. In addition, he said, a number of burials (rather than cremations) still took place, especially in the more rural (and less developed) Miaoli County.

213. Sino-Life responded by saying that, on the basis of its calculations, it considered a 10% market share not to be beyond its reach but, to the contrary, to be conservative. In this regard, its reply was as follows:

> "The population of Miaoli County is 560,000, and the average death toll is 7,600 per year. Based on the supply of about 57,502 columbarium urn spaces by industry participants and the average death toll of 7,600 per year, in 7.5 years' time the columbarium urn spaces will be in short supply and unable to satisfy future demand. According to the age of the current population, about 210,000 people in Hsinchu County, Miaoli County and Hsinchu City are at the age of 59 or above, and all of them are the usage market for the next 10 years.
>
> Moreover, as people become more open-minded and like to invest and plan beforehand, columbarium urn spaces are no longer just designed for the deceased but are also for living people who want to prepare for their future resting place. Therefore, the target of the memorial garden is not only the 7,600 deceased persons in Miaoli County but also the population of 1.4 million people in Miaoli County and Hsinchu County. Basing on just the population of 210,000 people aged 59 or above in Hsinchu County, Miaoli County and Hsinchu City, our company considers it to be conservative for our company to strive for only a 0.26% target market share in 2009."

214. Sino-Life then went on to observe that the Taiwanese Government was introducing a rotational burial system to solve the

shortage of cemetery land, advocating bone retrieval after 7 to 10 years in the grave with the storage of bones themselves in an ossuary or bones reduced to ashes in a columbarium space. Accordingly, so it was implied, the rotational burial system would add to the demand for columbarium spaces. In light of the assertion that more people in the area were looking to secure their final resting place, it followed that many would look not only to their burial but also to the fact that there remains would be disinterred after a period of time and placed in a columbarium.

215. Sino-Life also rejected any suggestion made by Mr. Yu that positioning the columbarium in the relatively rural aspects of Miaoli County would have a dampening effect on its marketability. The opposite, it said, was the case. The further from the urban area the more expensive it would become and therefore, by implication at least, the more desirable to those with the money to afford a private columbarium. It was emphasised that the surrounding environment, presumably ideally an area of rural tranquillity, and the facilities afforded by the columbarium, for example, the ability to have urn spaces at eye level, would be materially determinative of a columbarium's attraction to the market. In this regard, the implication was that, the Miaoli County columbarium being new and designed with attractive features as well as being given a rural setting, should be able to secure a 10% share of the market.

216. We accept that a number of these assertions are subject to question. A number also appear to be more relevant to the long-term market share of the columbarium rather than its immediate share. But that being said, Sino-Life put forward a number of factors which in its opinion supported its estimate of an opening 10% share of the market and which,

as we see it, cannot be dismissed as having no force. They may be summarised as follows.

217. First, there was an increasing demand by persons to book a space at a columbarium while they were still well and healthy, as a form of funeral assurance therefore. This increased the potential market for the sale of repositories and memorials.

218. Second, the fact that there was a system of burial rotation being introduced by the Government meant that even those seeking burial would have to look to the longer term and the fact that their mortal remains would be disinterred.

219. Third, the Miaoli County columbarium was new, built with attractive features and freshly renovated, all of these factors making it especially attractive to the market.

220. Fourth, it was (so it would appear) built in a rural setting, thus adding to its attraction to the market.

221. Fifth, many of the existing columbarium facilities were ageing. This meant, first, that many of them were either completely full or nearly so and, second, that invariably the choicest resting places for urns and other repositories had already been taken.

222. We accept that SHKI had an obligation to satisfy itself that these assumptions were reasonable and that the calculations based upon them, although they could not be determined with mathematical certainty, were themselves reasonable. In our view, however, the five matters set

out above, when read with information supplied by Sino-Life were not only inherently credible but, when taken together, were capable of allowing for a rational estimate of an almost immediate market share for the columbarium of 10%.

223. The SFC was critical of SHKI for a lack of follow-up action on its part even after it had identified weaknesses in the assumptions made by Sino-Life. But the fact remains that concerns expressed by SHKI were answered by Sino-Life and, as we have indicated, a number of the answers were not only inherently credible but, as the basis for an estimate of market share, were (on their face) reasonably convincing.

224. We have looked to the detailed analysis contained in the Decision Notice. In our judgment, however, when matters are viewed as a whole, looking to the balance of probabilities, there is no clear evidence that SHKI failed in its duty of due diligence in accepting Sino-Life's estimate of a 10% market share. Nor, in our judgment, is there evidence of sufficient clarity that SHKI was culpable in accepting that the directors had arrived at the 10% figure after due and careful enquiry.

(iv) Misleading representations on other columbarium facilities

225. In about June 2009, Sino-Life informed SHKI that there were just two private columbarium buildings and one public columbarium building in its target area.

226. In an email dated 26 June 2009, Mr. Yu took issue with that statement. He said that, according to his research, there were a greater number of columbarium facilities in the target area. He spoke of 11 public facilities and named four private facilities. Taking into account his

understanding that a number of traditional burials were still taking place, he expressed the view that it was doubtful that the memorial garden at the Miaoli County columbarium would be able to gain a 10% market share from the outset.

227. In responding to the question of the number of columbarium facilities, Sino-Life said: "The aforesaid columbaria are small, and they are no match for the capacity of 176,705 columbarium urn spaces in Jin Yu Cheng, the largest columbarium in Miaoli County."

228. In a set of estimates (a JYC Op Plan) revised in July 2009, the following statement was made by Sino-Life:

> "According to the Government website, there are seven public and private columbaria in Miaoli County. These columbaria had establishment dates between 1954 and 2001, but until now JYC is the only operative columbarium in the area. Therefore the company considers that market supply is limited and demand is significant."

229. However, in its signed board memorandum of 28 August 2009, provided to the Stock Exchange Sino-Life returned to its original statement concerning the number of columbarium facilities. It emphasised the shortage of columbarium facilities in its target area saying and went on to say that there were two private columbarium buildings and one public columbarium building inside what it defined as its business circle[18]. However, all space in the public columbarium had been sold out. This

[18] The following is the statement: "The management have conducted a business research before entering the agency contract with the developer of the columbarium. The columbarium is located nearby intersection point in Toufen Township of Miaoli County, Miaoli City and County and the north of Fongyuan City of Taichung County. There are two private columbarium buildings and one public columbarium building inside the business circle. All the columbarium in the public one is sold out and the columbarium of the other two private-run buildings are still available for sale and their selling price for the individual size of a columbarium is approximately NTD100,000 on average."

was used as the basis for the estimate that the Miaoli County columbarium would from the outset attract a 10% market share, the memorandum stating:

> "As there is a limited competitor in the business circle, based on our management judgment, we assume at least 10% of market share in the area."

230. Against this background, looking strictly to the issue of the number of columbarium buildings, the assertion in the board memorandum that there are only two private columbarium buildings and one public columbarium building in the business circle appears to be at odds with the research conducted by Mr. Yu and Sino-Life's own earlier estimate that there were seven such facilities. We say that it "appears" to be at odds because the exact size of the target areas or business circles referred to in the various communications have not been shown to be the same.

231. In its Decision Notice, the SFC said that disclosure on the supply of repositories for ashes and memorials was misleading, coming to the finding that there appeared to have been an effort to create an illusion of shortage by manipulating supply figures.

232. Mr. Westbrook submitted that there were a number of reasons why the analysis by the SFC was not sound. Supply was a measure of unsold space, he said, the implication being that it was not to be judged by recitation of a simple number of columbarium facilities. As he put it, the more established a columbarium is, the less space it is likely to have. What mattered, he suggested, was not the number of

columbarium facilities but the critical issue of supply; in short, the level of competition.

233. That may well be the case but again it seems to us that there was a failure to put the picture in clear terms before the Stock Exchange. The statement in the board memorandum only makes reference to three columbarium facilities and only says that one of them is full.

234. On behalf of the SFC, Mr. Jat said that even at the date of the hearing before us counsel for SHKI was unable to say why it was that Sino-Life had said in the board memorandum that there were only two private columbarium facilities and one public one in the target area. If it was explicable by reference to earlier estimates in which Sino-Life indicated that it was excluding small-scale columbarium facilities and ones that were no longer operative then why was that qualification not stated in the memorandum?

235. Bearing in mind that the issue of the number of columbarium facilities and their capacity was an early point of discussion between Mr. Yu of SHKI and Sino-Life it is puzzling why a more accurate statement was not put forward. If there were other columbarium facilities in the target area, as on all the evidence appears to be the case - even if they were of insignificant size or full - this should have been mentioned in order to give an accurate picture. We do not dispute the fact that there may have been a high demand for columbarium facilities in Miaoli County, that is not the issue. In our judgment, the issue is that SHKI had an obligation, when dealing with the important issue of competition, to put a clearer and more accurate picture before the Stock Exchange. This it failed to do.

Failure to keep a proper record

236. The rules and principles of conduct within which sponsors work demand that they maintain records that are sufficiently exact and detailed to enable them, upon request by the SFC, to provide a 'proper trail of work done'. Such a trail must include documentation of due diligence planning which itself demands a demonstration that sponsors have turned their minds to what enquiries are necessary by way of reasonable due diligence in the context and circumstances of an application. Importantly, sponsors are required to document the conclusions they reach regarding an applicant's compliance with the listing rules.

237. The applicable regulatory structure consists of three provisions contained in the CFA Code, the GEM Listing Rules and the Sponsor Guidelines.

238. Paragraph 2.3 of the CFA Code directs that:

> "A Corporate Finance Adviser should maintain proper books and records and *be able to provide a proper trail of work done* upon request by the SFC." [Our emphasis]

239. Rule 4 of Practice Note 2 of the GEM Listing Rules directs that:

> "The Exchange expects Sponsors to document their due diligence planning and significant deviation from their plans. This includes demonstrating that they have turned their minds to the question of what enquiries are necessary and reasonably practicable in the context and circumstances of the case. The Exchange also expects Sponsors to document the conclusions they reach on the new applicant's compliance with all the conditions in Chapter 11 of the GEM Listing Rules…"

240. Paragraph 1.5.2 of the Sponsor Guidelines requires that –

> "A sponsor should keep a complete and up-to-date list of all the sponsor work that has been and is being undertaken. The list should include the names of the companies being advised, the composition of the teams designated for the sponsor work (including any variations thereto) and the title role of each team member from start to finish. Such information should be made available to the SFC upon request."

241. Accordingly, a 'bare bones' outline setting out only broad and entirely expected areas of due diligence is insufficient. The SFC must be able to understand the manner in which each area of investigation was pursued, the nature of the material decisions made in pursuit of that investigation and understand the reasons for, and nature of, conclusions reached. Self-evidently, there is a special need for details in respect of vexing issues, that is, issues which are contentious.

242. In summary, the SFC must be able, by a study of the sponsor's records, to see *how* that sponsor has discharged its duties, especially when faced, as we have said, with issues that are, or are likely to be, contentious. As Mr. Jat expressed it: "For our regulatory regime to work, the SFC must be able to see, after the fact, whether a sponsor has or has not conducted proper due diligence." We would stress that the keeping of proper records is not merely an aid to investigation by the SFC, it is equally a protection for sponsors.

243. In its Decision Notice, the SFC concluded that in a number of material respects SHKI had either failed entirely to maintain records or

had maintained records that, in the circumstances, were inadequate[19]. The SFC listed three instances in particular which it considered were evidence of material failure.

244. First, although Mr. Shum, head of corporate finance at SHKI, said that, in addition to multi-party meetings and/or teleconferences, the sponsorship team usually held weekly meetings to discuss on-going matters of due diligence while he usually attended a meeting every second week to report progress to senior management, there was no record of any such meetings in the five-month period from 16 April 2009 to the date of listing. In this regard, the SFC commented: "Given the scope and complexity of sponsor work, it is difficult to conceive that no regular internal meetings were held at all, and no similar multi-party meetings or teleconferences were held between mid-April and September 2009."

245. Second, there was no documentation found of internal discussions concerning the reasonableness and reliability of the legal advice given by the Taiwanese lawyers in respect of the encumbrances registered against the columbarium and the general indebtedness of Zhen Yuan, its beneficial owner.

246. In our view, having regard to the strong views concerning the legal advice of Mr. Choy and Mr. Yu, it is equally difficult to conceive of there being no internal discussions, more especially

[19] See paragraph 208 of the Decision Notice which reads: "Notwithstanding the obligation to maintain proper books and records, it appears from the evidence on hand that there is either a lack of or inadequate records of matters detailed below."

discussions which in one way or the other would have led to the decision not to include any mention of the matters in the prospectus.

247. Third, in respect of the due diligence work generally concerning the columbarium project and the prospects of the agency business in the sale of repositories of different kinds, the SFC commented that the records of the chain of correspondence were scanty and incomplete. It commented: "On many occasions, Sino-Life's replies to SHKI's handwritten queries were not documented at all."

248. For his part, Mr. Jat made mention of the lack of relevant records concerning the difference in the 2007 cash flow figures in the draft audit reports of RSM and CCIF. In an interview, he said, both Mr. Shum and Mr. Choy said that SHKI considered asking RSM for its comments. Mr. Shum even thought that Mr. Choy had contacted RSM directly. This was clarified by Mr. Choy in his interview when he said that he did not do so because Mr. Shum told him to drop the issue. However, as Mr. Jat observed, none of these matters were documented. Mr. Jat made the further observation with which we agree: "The fact that there is not a shred of paper on how SHKI came to drop the issue is conspicuous as well as far short of the required standard."

249. On behalf of SHKI, Mr. Westbrook emphasised that the SFC had identified just three matters, these forming the sole basis for the conclusion that it had failed to maintain proper books and records. Mr. Westbrook further emphasised that none of the SHKI team were questioned on the topic of record-keeping, an indication, he suggested, that the issue was either entirely peripheral or arose as an afterthought.

250. The issue, said Mr. Westbrook, had to be considered in context. SHKI had maintained extensive records. Its record of due diligence planning was comprehensive and well organised. Mr. Westbrook submitted that the record of work done is not only contained in formal due diligence files but also in contemporaneous documents such as successive drafts of the prospectus. These edited drafts and emails related to them, he said, provided a record also of the due diligence work performed. "It is frankly unrealistic," he said, "especially in a GEM listing, to expect every act and thought of the team to be recorded in writing, just in case the SFC later want to review it."

251. Outside of the three narrow issues, said Mr. Westbrook the SFC had given no consideration to the overall adequacy of SHKI's documentation. As he put it: "if the SFC's approach was correct, every corporate finance adviser would be liable to sanction on every transaction because a regulator could inevitably identify a particular document or documents that might ideally have been included, without having regard for the overall adequacy of the record taken as a whole."

252. We take no issue with Mr. Westbrook's submission that a sponsorship team cannot be expected to make a record of every act, suggestion and matter of discussion. However, in managing a listing application there will invariably be matters which, on any objective consideration, especially by a professional in the field of corporate finance advice, will be recognised as being matters that may be contentious or material in some way. Common sense dictates that such matters be recorded. We would go so far as to say that a failure to record such matters may in the eyes of the reasonable observer suggest an intention to disguise. For example, the issue of the difference in the 2007

cash flow figures in the draft audit reports of RSM and CCIF and the actions taken to resolve the matter would, in our view, on any objective evaluation, invite scrupulous records, if only to show that the matter was given serious consideration at the time, was properly investigated and, whether contentious or not, was made the subject of a rational decision as to the best way forward.

253. Concerning the finding of the SFC that there was no record of any form of meeting in the five-month period leading up to the listing, Mr. Westbrook observed that there is no specific requirement imposed on sponsors to hold regular meetings or indeed to keep written records of them. That is the case. However, in our view, the SFC was entitled to take into account the fact that there were no records of meetings in the crucial months leading up to the listing when Mr. Shum, the head of the team, had spoken of such meetings taking place regularly.

254. In summary, we are satisfied of the following. First, the need to keep proper records is not simply an arid bureaucratic imposition. It is a rational requirement based on the need for transparency. A failure to keep proper records is therefore a material omission on the part of a sponsor. Second, while obviously the adequacy of the record-keeping generally is an important consideration, an abundance of information in respect of the obviously mundane is not to be taken as excusing a lack of information in respect of matters of particular importance or contention.

255. For the reasons given, viewing the matter *de novo* and on its merits, we too are satisfied that there was a failure by SHKI to maintain proper records.

Our conclusions on liability

256. For the reasons given, looking at all the issues *de novo*, we are satisfied - with the one exception - that there is clear evidence that SHKI failed to exercise due diligence in the manner asserted by the SFC. We are further satisfied that there is clear evidence of a failure on the part of SHKI to maintain proper records.

The issue of the penalties

257. In its Notice of Proposed Disciplinary Action issued on 13 February 2012, the SFC was minded to impose the following penalties, namely, a public reprimand, a fine of $18,500,000 and the revocation of HKI's licence to practice Type 6 regulated activities, that is, advising on corporate finance. Having considered representations submitted on behalf of SHKI, the SFC accepted that there was doubt as to certain of its provisional findings (more especially in respect of a company called Bau Kong Life Planning Company Limited). In order to reflect this, in its Decision Notice it reduced the intended fine by $3,000,000 and substituted the revocation of SHKI's Type 6 licence with a suspension of one year. In the result, the following penalties were imposed:

a. that SHKI be publicly reprimanded, the terms of the reprimand being contained in a draft press release;

b. that SHKI be fined $15,500,000; and

c. that SHKI's licence for Type 6 regulated activities (that is, advising on corporate finance) be suspended for one year.

258. For the reasons set out in this judgment, having made a full merits review of the SFC findings as to culpability, exercising our independent judgment, we have concluded that the SFC was correct in all of its findings with the exception of one.

259. The single finding which, in our judgment, has not been demonstrated was a component of a broader finding by the SFC. That broader finding was related to the submission to the Stock Exchange of various financial projections and breakdowns concerning the financial viability of the intended commercial exploitation of the columbarium in Miaoli County, Taiwan. The SFC found that the financial projections and breakdowns were materially problematic. It further found that the failure to recognise this and to ensure rectification in an acceptable form was due to a failure to exercise due diligence on the part of SHKI. In particular, the SFC identified four problematic areas in respect of which there had been a failure of due diligence. We have found that there was a failure of due diligence on the part of SHKI in respect of three of those four areas. In our view, while of course this has reduced the measure of SHKI's culpability in respect of the supply of financial projections and breakdowns related to the intended columbarium business, it has only done so to a limited extent. We are satisfied that, taken together, the three remaining failings still prove SHKI's overall culpability.

260. At the beginning of this judgment[20], we cited from a consultation paper published in June 2005 in which the SFC emphasised the central importance of the function of a sponsor in listing applications in Hong Kong. It was said that, Hong Kong being one of the leading

[20] See paragraph 8 of this judgment.

fund-raising centres in the world with a significant number of companies seeking listing not only being incorporated overseas but having their assets and business operations outside of Hong Kong too, it meant that sponsors, acting as corporate finance advisers, played a pivotal role in providing the regulatory authorities and potential investors with information about these companies.

261. In an earlier consultation paper, also cited in this judgment[21], the SFC stated why it considered the work of due diligence carried out by sponsors to be of such pivotal importance. In part, it said:

> "The Exchange does not have the resources or mandate to gain the detailed knowledge of an issuer's business which the sponsor is expected to have accumulated through its preparation of the applicant for listing. Consequently, the Exchange and the market are entitled to rely on the competence and integrity of the sponsor in assisting the issuer to prepare and present the listing application and listing documents."

262. We ourselves emphasised the importance of the exercise of due diligence by a sponsor[22]. In this regard, we think it is appropriate to cite again some of what we said:

> "In an orderly and transparent market [which the Hong Kong regulatory authorities strive to ensure] investors must be able to place trust, first, in the fact that the listing of a company has been founded on a consideration of full and accurate information and, second, that the information contained in the prospectus is equally 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. All investment involves risk. The point is that investors must be able to

[21] See paragraph 43 of this judgment.

[22] See in particular paragraph 44 of this judgment.

> assess the risk by relying on accurate and relevant information. If they are unable to do that then trust in the market is undermined."

263. In summary, it is accurate to say, we think, that without an assurance of the exercise of due diligence by the sponsor in each and every application, whether to the Main Board or to the GEM Board, the integrity of the market is threatened.

264. It is further accurate to say, we think, that a failure to exercise due diligence in respect of an application for listing, whether intended or occasioned by negligence, is more often than not proved by evidence of limited evasions and/or oversights and small inaccuracies, the accumulation of these matters constituting a material distortion.

265. It is unsurprising, therefore, that a failure to exercise due diligence on the part of sponsors has been viewed by the regulatory authorities as a matter of considerable seriousness. The exercise of due diligence is fundamental to the proper working of the listing system.

266. The present case does not constitute an isolated incident. In recent years there has been concern on the part of our regulatory authorities as to the maintenance of professional standards by sponsors. In the consultation paper published in June 2005 to which we have made reference in this judgment[23], the SFC said that, as a result of various corporate scandals related to initial public offerings and in particular the failure of sponsors to carry out proper due diligence in respect of them, there had been a call for more effective measures to raise the overall standard of professionalism in the market and to take action against

[23] See paragraph 9 of this judgment.

culpable sponsors. In summary, at all times material to this judgment, the threat has been recognised together with the need to deter it.

267. Undoubtedly, one of the most potent deterrents is the revocation or suspension of the relevant licence and this measure has been chosen on a number of occasions in recent history. It prevents a company found culpable - many of which in the finance industry have deep pockets - from simply paying its way out. During the course of submissions, a number of authorities were brought to our attention. It suffices to cite a few.

268. It appears that the proceedings with the gravest consequences related to Mega Capital (Asia) Limited which acted as a sponsor for the Main Board listing of a company called Hontex International Holdings Limited. The shares of Hontex were suspended and its entire listing proceeds of $997,400,000 were injuncted shortly after listing on the basis of alleged fraud and the supply of materially false and misleading information in the prospectus including a substantial overstatement of turnover. In April 2012, Mega Capital's licence was revoked and it was fined $42,000,000 on the basis of a serious abandonment of the duties of a sponsor to exercise due diligence[24].

269. Proceedings against CSC Asia Limited for a lack of due diligence in respect of two lapsed listing applications resulted in a

[24] In a table of authorities submitted by Mr. Westbrook, it is said that the findings against Mega Capital included, first, the fact that it had conducted a number of interviews with suppliers and customers over the telephone in haste on the very day that Hontex filed its application for listing; second, that all interviews with suppliers, customers and franchisees were arranged by Hontex and conducted in the presence of Hontex representatives; third, that a number of suppliers and customers had refused to have face-to-face interviews with Mega Capital and that the sponsor had acceded to this and, fourth, that there had been inadequate supervision of junior staff.

settlement in terms of which in March 2006 its licence was suspended for 13 months.[25]

270. In December 2004, Oriental Patron Asia Limited had its licence suspended for six months on the basis that, in respect of an application for listing in which it acted as sponsor, it had withheld relevant information from the Stock Exchange. The relevant information related to a change of reporting accountants. The company, as sponsor, represented to the Stock Exchange that the change had been occasioned by a change in senior management when in fact the professional clearance letter (which the Stock Exchange requested to see) stated that the initial accountants had resigned because of unresolved differences between them and the applicant for listing over certain sales transactions that represented some 17.5% of the listing applicant's turnover. The application for listing was rejected in part because the sponsor had not satisfactorily addressed the issue of those sales transactions.

271. In respect of the penalties imposed in the present case, Mr. Westbrook submitted that they are "excessive, unprincipled, unjustified and unreasonable".

272. He submitted that the suspension of a licence can only be justified in a case involving serious institutional or systemic failure and that neither occurred in the present case. SHKI, he said, had a clean

[25] Mr. Westbrook's table states that the findings against CSC Asia Limited included a failure to pay sufficient attention to recommendations from professional advisers and to perform adequate due diligence on various important issues including, first, major suppliers and customers; second, the existence of a connected relationship between the applicant companies seeking listing and its major customers. The SFC further identified major internal control deficiencies including the absence of due diligence plan, and inadequate audit trial and the insufficient involvement of principles in the due diligence work.

disciplinary record. The findings in the present case related to a limited number of people who were members of the team put together to manage the sponsorship, all of whom had now left SHKI. The SFC had not interviewed anybody outside that small team, in particular not a single member of group management. The sting of a suspension in the circumstances would be visited upon persons who had had no involvement in the due diligence failings, a number of whom would certainly lose their jobs.[26]

273. Mr. Westbrook further argued that a suspension of one year, in itself unjustified, amounted in practice to a longer period. This arose out of the fact, he said, that a number of employees had already left SHKI in knowledge of the risk of a revocation and/or suspension of its licence and that, if a suspension was ordered, after the period of suspension it would take a considerable period of time for SHKI to re-establish itself in the market.

274. We do not accept that suspension is a sanction which can only be justified in cases involving serious institutional or systemic failure. Each case must be determined according to its own circumstances.

275. As to the assertion that only a limited number of persons had been responsible for the failings of due diligence, all of whom had now left the company, what must be borne in mind is that the sanction of revocation and/or suspension applies to the company itself, not to

[26] Although we make no findings as to the matter, and certainly do not indulge in speculation, we note that during the hearing before us we received no indication that any of the licensed persons employed by SHKI had been made the subject of regulatory action. The regulatory action appears to have been taken against the company only.

individual directors and/or employees. The 'deal team' was an integral part of the management structure of the company. It had an internal hierarchy, being headed by Mr. Eric Shum, head of corporate finance at SHKI who accepted that he was obliged to report regularly to group management. Working with Mr. Shum were two associate directors, Mr. Choy and Mr. Lai. They were in turn assisted by Mr. Yu who held the post of manager and by two further executives. This was not therefore some small team tucked away in a back office charged with some entirely peripheral endeavour. To the contrary, it was an important part of the overall management structure and, as such, should have been subject to effective scrutiny by group management.

276. Nor can it be said that the failures that we have identified were the failures of one rogue individual. On the evidence, it is clear that matters were discussed by the team, a number of the decisions being made by the head of the team, Mr. Shum, sometimes against the advice of his subordinates.

277. As to the assertion that, if a suspension is found to be appropriate, its length will inevitably be extended by the loss of staff prior to it coming into effect and by the time taken after its completion for the company to re-establish itself in the market, this, it seems to us, is an inevitable consequence of all suspensions. By analogy, a person sentenced to a period of imprisonment for the commission of a criminal offence will require a period of time to re-establish himself or herself in society and to find employment. However, absent special or particular circumstances, we do not see that such a factor should of itself reduce the length of a term of imprisonment which in all other respects is found to be appropriate.

278. More significant circumstances, we believe, are to be found in the fact that the company has a clean disciplinary record and that, in order to try and ensure that it is not subject to such failings in the future, it has taken professional advice.

279. Mr. Westbrook argued that, whatever the failings of due diligence, there is no evidence that it had any prejudicial effect on the market. We accept that it may not have had any dramatic or major prejudicial effect – although the share price after listing was subject to a marked decline. However, in our view, what must be taken into account is that, if there had been full and accurate disclosure of the matters which we are satisfied were tactically withheld from the Stock Exchange, the success of the listing itself may well have been open to some doubt.

280. As we have indicated at various times in our judgment, we are satisfied that there was a reluctance on the part of the members of the 'deal team' to oppose the wishes of Sino-Life even when they must have been aware that their reluctance compromised their duties of due diligence. One example arises in the context of the patently relevant (indeed important) matter of differing 2007 cash flow figures in the draft reports of the two firms of accountants, RSM and CCIF. In this regard, see in particular paragraphs 91 and 110 of our judgment, in particular the following:

> "It further suggests that the deal team at SHKI, instead of adopting an attitude of professional scepticism, being alert to the possible ramifications of the discrepancy, chose instead to follow the path of least resistance by supporting Sino-Life's instructions that the matter should not be further explored. In summary… the only reasonable inference to be drawn, in our opinion, is that the decision was made to 'let sleeping dogs lie' by refraining from further investigation, the

> consequence being an unspoken decision to go with the interests of the client at the potential expense of the integrity of the market."

281. Interwoven in Mr. Westbrook's submissions was the assertion that SHKI's culpability was in all respects essentially one of negligence. We do not agree. Negligence implies a lack of actual intent. In respect of the issue to which we have just made reference, we are satisfied that the members of the 'deal team' (who dealt with the matter) were well aware that they were compromising their obligations of due diligence.

282. In its Decision Notice, the SFC found that there had been undue (and by necessary implication, artificial) reliance on third-party expert reports, for example, reliance on the CCIF audit reports at the expense of the RSM draft report and also the purported reliance on the report of the Taiwanese lawyers concerning the discovery that the beneficial owner of the Miaoli County columbarium may, as a result of financial difficulties, not be able to ensure the viability of the columbarium project. In both instances, the evidence makes clear that members of the 'deal team' knew that the reports, considered in context, were very much open to question. They also knew that the reports related to important matters. As we said in respect of the columbarium project (paragraph 166 of this judgment):

> "… the need to fully investigate Zhen Yuan's true financial history and to spell out the risk that would have been known if such an investigation had taken place is obvious. We reiterate that Mr. Yu and Mr. Choy knew it was obvious. Despite that, however, there was no investigation beyond the initial and limited discovery of the one court action."

283. Both of the issues to which we have just referred illustrate the fact that SHKI, in an attempt to assist its client, that is, to ensure the success of the listing, was prepared to take action to divert the receipt of information that may tell against the success of the listing. That itself indicates that SHKI understood that the success of the listing was not a sure thing.

284. We would add that, in our view, this knowing willingness to compromise its duties as a sponsor by giving preference to the interests of the client over the interests of the integrity of the market is perhaps the most serious aspect of SHKI's failure of due diligence.

285. In our judgment, having regard to the totality of SHKI's culpability – that culpability including a puzzling failure to maintain proper records – we are satisfied that the period of suspension is inevitable. This is especially so bearing in mind our finding that the identified culpability was not solely one of oversight or negligence but contained a disturbing measure of tactical decision-making.

286. During the course of submissions, Mr. Westbrook said that it was open to us to order a suspension only of SHKI's licensed sponsorship activities. We have considered that. In our view, however, the failings that we have identified were not so specific in nature that they related solely to sponsorship activities but indicated a state of mind that went more generally to the due and proper discharge of SHKI's licensed activities. We are not therefore prepared to limit the suspension to the single activity of sponsorship.

287. In our view, a suspension of one year is entirely appropriate.

288. As to the issue of a fine, this, we are satisfied, must be determined in accordance with the SFC Disciplinary Fining Guidelines and of course having regard to the impact of the other sanctions.

289. The Guidelines state that "a fine should deter non-compliance with regulatory requirements so as to protect the public".

290. The Guidelines further state that conduct that is intentional or reckless, as we have found it to be in the present case, it is to be regarded as being more serious. Also to be regarded as more serious is conduct that damages the integrity of the market. In our view, the failings of due diligence which we have identified did cause damage to the integrity of the market in that it did not enable the Stock Exchange to determine the application for listing (which, as we have said, was not a sure thing) in possession of all relevant information.

291. We accept that conduct which produces little or no benefit to accompany is to be considered as being less serious. In this regard, Mr. Westbrook pointed to the fact that SHKI only charged a sponsorship fee of $1,500,000. That, in our view, is too simplistic an approach. As we have noted at the beginning of this judgment, SHKI also took on the role of joint book runner, assisting in underwriting the initial public offering.

292. In assessing an appropriate fine, we take into account the fact that we have come to a different conclusion to the SFC in respect of one instance of a failure of due diligence. We further take into account that the suspension of one year will undoubtedly have material financial ramifications.

293. In the circumstances, we have been drawn to the conclusion that a fine of $12,000,000 is appropriate.

294. In summary, we would impose the following sanctions:

a. that SHKI be publicly reprimanded in accordance with the draft press release prepared by the SFC, that release to be amended to accord with the terms of this judgement. The terms of the amended public reprimand are to be agreed between the parties. Failing such agreement, the matter is to be referred to us to settle the terms;

b. that SHKI be fined $12,000,000;

c. that SHKI's licence for Type 6 regulated activities (advising on corporate finance) be suspended for one year; and

d. that there will be an order *nisi* awarding costs of this application to the SFC, the order to be made final on Monday, 17 February 2014 unless, prior to that date, an application has been made for a different order as to costs.

295. By way of a postscript, we would add that we have not broken down the fine so that it accords with each and every breach identified in the Decision Notice and which we have found does constitute such a breach. In our view, the totality approach in the circumstances of this case is the more equitable approach. For example, as Mr. Westbrook pointed out, although in the Decision Notice the breach

of the sponsor's formal undertakings attracted its own fine, that breach is entirely consequential on the substantive breaches identified by us in the body of this judgment. By necessity, therefore, the apportionment of the overall fine to specific breaches takes on a certain artificiality. That being said, should the applicant or the SFC require a breakdown, we are prepared to consider doing so upon an application being made supported with reasons.

296. An application to amend our order *nisi* in respect of costs and/or an application seeking a breakdown of the fine may be made in writing without the need for oral argument unless, having considered the written submissions, we determine that oral argument is necessary to ensure the ends of justice.

(The Hon Mr. Justice Hartmann, NPJ)
Chairman, Securities and Futures Appeals Tribunal

(Professor Eric Chang Chieh)
Member

(Mr. Frederick Tsang Sui-cheong)
Member

Mr. Simon Westbrook SC, instructed by Davis Polk & Wardwell Solicitors, for the Applicant

Mr. Jat Sew-Tong SC, leading Mr. Laurence Li, instructed by the SFC, for the Respondent