

HCMP 314/2020
[2021] HKCFI 1975

**IN THE HIGH COURT OF THE
HONG KONG SPECIAL ADMINISTRATIVE REGION
COURT OF FIRST INSTANCE**
MISCELLANEOUS PROCEEDINGS NO 314 OF 2020

IN THE MATTER OF ANXIN-
CHINA HOLDINGS LIMITED

and

IN THE MATTER of section 214 of
the Securities and Futures Ordinance,
Cap 571

BETWEEN

SECURITIES AND FUTURES COMMISSION Petitioner

and

LIU ZHONGKUI	1 st Respondent
YANG MA	2 nd Respondent
LIN SUPENG	3 rd Respondent
YANG SHUYAN	4 th Respondent
CHEUNG CHUEN	5 th Respondent

Before: Deputy High Court Judge William Wong SC in Court

Date of Hearing: 24 June, 2021

Date of Judgment: 24 June, 2021

Date of Reasons for Judgment: 8 July, 2021

REASONS FOR JUDGMENT

INTRODUCTION

1. On 18 March 2020, the Securities and Futures Commission (the “SFC”) presented the petition herein (the “Petition”) against, amongst others, the 3rd Respondent, who was an executive director of Anxin-China Holdings Ltd (the “Company”). The SFC and the 3rd Respondent have agreed to dispose of these proceedings under the *Carecraft* procedure.

2. The parties have agreed to and executed a Schedule containing the SFC’s case against the Company and the 3rd Respondent, the agreed facts and the agreed proposed orders: *see* Schedule for Carecraft procedure in respect of the 3rd Respondent dated 18 January 2021 (the “Schedule”).

3. The parties have agreed that a disqualification order be made against the 3rd Respondent on the basis of sections 214(1)(b), (c) and (d) of the Securities and Futures Ordinance, Cap 571 (the “SFO”) and that the proper period of disqualification is 8 years: *see* Schedule at §80.

4. Further, it was agreed that there should be an order that the 3rd Respondent do pay the costs of the SFC in these proceedings, or such portion thereof as the Court thinks appropriate, to be taxed if not agreed with certificate for counsel: *see* Schedule at §81.

LEGAL PRINCIPLES

Proceedings under Section 214 of the SFO

5. Section 214(1) of the SFO covers a wide range of business or affairs of a listed corporation. The terms used in section 214(1) of the SFO was recently considered by Coleman J in *SFC v Wong Kam Leong* [2021] HKCFI 624 at §§37 to 39:-

“37. The phrase “or other misconduct” in sub-section (b) is something of a belt and braces exercise, intended to cover the widest range of possible misconduct. So, for example, the failure of a director to exercise the requisite degree of skill and care in the management of the company as may reasonably be expected of a person of his knowledge and experience and holding his office and functions within that company was enough to establish misconduct under the paragraph. Further, “other misconduct” has also been held to embrace things such as “culpable neglect of duties”.

38. As to sub-section (c), it can be complimentary to the other sub-sections, but it is not easy to think of examples where the affairs of the company have been conducted with no suggestion of impropriety on the part of its directors and with no suggestion of unfair prejudice to the shareholders, yet where it can confidently be said shareholders have been deprived of information which they might reasonably be expected to be given. So it may be unhelpful to hypothesise other than to say such circumstances may arise and will be evident when they do.

39. As to sub-section (d), conduct which is unfairly prejudicial is conduct which results in harm to the members of the company or part of the membership in their capacity as members of the company. The harm is harm which could either have been avoided or ameliorated without harming the legitimate interests of others who were parties to the particular transaction. It covers a range of conduct. At one end of the scale is fraud. At the other end of the scale the conduct can take the form of neglect or inaction on the part of those to whom the affairs of a company are

entrusted. The question to be asked in such circumstances is whether the conduct concerned is that which can be expected from the managers of the company to whom those affairs have been entrusted. The directors, of course, cannot leave their duties to be performed by others.'

Carecraft Procedure

6. The *Carecraft* procedure is the summary procedure sanctioned in the case of *Re Carecraft Construction Co Ltd* [1994] 1 WLR 172. It has been adopted by the Hong Kong courts in various proceedings under section 214 of the SFO.

7. Under the *Carecraft* procedure, the Court is not entitled to make findings upon materials other than the agreed facts. It must be satisfied, based on the agreed facts, that the business or affairs of the company have in fact been conducted in a manner that contravened one of the limbs in section 214(1) of the SFO and if so, determine the order to be made: *see SFC v Shandong Molong Petroleum Machinery Co Ltd* [2021] HKCFI 497 at §§9 and 18, per Linda Chan J.

8. Further, whilst the agreed facts and orders reached between the parties do not oblige the Court to make the orders sought, the Court is likely to be guided by the agreement that the SFC, as a responsible regulator, has reached as to the appropriate sanction to be imposed: *see Wong Kam Leong* at §5, per Coleman J.

Disqualification Orders

9. The principles relating to disqualification orders were summarised by Coleman J in *Wong Kam Leong* at §40. In essence:-

- (1) The power to determine the appropriate period of disqualification is a discretionary power. It is necessary for the Court to be satisfied that the director's involvement in the relevant matter involves a sufficiently serious failure to satisfy his duties that some period of disqualification is justified and fair.
- (2) The purpose of imposing a qualification order is twofold. The first, and primary, purpose is that of the protection of the public. The second is the purpose of general deterrence.
- (3) In determining the period of disqualification, the Court will adopt a broad-brush approach, where earlier decided cases will be of limited assistance to the exercise of the Court's discretion.
- (4) The period of disqualification must reflect the gravity of the offence. A starting point of assessment may be fixed by reference to the gravity of the conduct, with a discount given for any mitigating factors.
- (5) Previous authorities have identified starting points within brackets, which provide guidelines not tramlines. Those brackets are:-
- (a) Disqualification of over 10 years for particularly serious cases;
- (b) Disqualification of below 5 years for relatively less serious cases; and

(c) Disqualification of between 6 and 10 years for cases in between.

(6) The Court will have regard to a wide range of considerations including the age, state of health and character of the offender, the nature of the breaches, the honesty and competence of the offender, the length of time he has been in jeopardy, whether he appreciates and/or admits the breaches, his general conduct before and after the offence, the periods of disqualification of his co-directors that may have been ordered by other courts, and the interests of shareholders, creditors and employees.

MISCONDUCT UNDER SECTION 214(1) OF THE SFO

10. The pertinent facts pleaded in the Petition, insofar as they relate to the 3rd Respondent, have been agreed and are set out in the Schedule and summarised below.

The Company and the 3rd Respondent

11. The Company was, until 20 December 2018, listed on the Main Board of the Hong Kong Stock Exchange (stock code: 1149). The Company through its direct and indirect subsidiaries (collectively the “Group”) provided specialised intelligent monitoring systems and products for industrial and public safety surveillance: *see* Schedule at §§12 and 18.

12. The Company acted as an investment holding company and carried on business through, *inter alia*, Shenzhen Anxin Digital

Development Co Ltd, Shenzhen Xinye Intelligence Technology Co Ltd, Jilin Province Yingke Information Technology Co Ltd, and Jilin Anxing Information Technology Co Ltd: *see* Schedule at §16.

13. The 3rd Respondent joined the Group in May 2009. He was an executive director of the Company from 3 February 2010 to 16 February 2016: *see* Schedule at §§19 and 21.

Discrepancies discovered during the 2014 Audit

14. During the Company's audit for the year ended 31 December 2014 (the "2014 Audit"), the Company's then auditors, BDO Limited ("BDO") discovered certain discrepancies regarding the banking records and the management accounts of the Group: *see* Schedule at §23.

15. Whilst the Company had ostensibly formed an internal special investigation team (the "Special Team") to investigate the discrepancies identified by BDO and had purportedly attempted to answer the questions raised, the Company failed to fully address BDO's queries: *see* Schedule at §§24-28.

16. By letter dated 5 May 2015, BDO asked the Company to engage an independent forensic investigator to *inter alia* examine the cash and bank balances and fund movement of all the companies in the Group. BDO also stated that unless the said forensic investigator has thoroughly investigated the matter, it would not be able to complete the 2014 Audit: *see* Schedule at §§29-30.

17. The Company refused to engage an independent forensic investigator and stated that it was satisfied with the purported findings of the Special Team. As a result, BDO tendered its resignation as the auditor of the Company with immediate effect by letter dated 11 May 2015: *see* Schedule at §§31-34.

Appointment and resignation of the independent forensic investigator

18. By reason of the discrepancies identified by BDO during the 2014 Audit, the publication of the Company's annual results for the year ended 31 December 2014 had to be delayed: *see* Schedule at §35.

19. The trading of the Company's shares was suspended on 1 April 2015. The Hong Kong Stock Exchange imposed conditions for the resumption of trading, which included *inter alia* an appropriate investigation be conducted on the discrepancies identified by BDO and the disclosure of the finding of such investigation: *see* Schedule at §36.

20. On 29 June 2015, RSM Nelson Wheeler Corporate Advisory Limited ("RSM") was engaged to conduct an independent forensic accounting investigation into the discrepancies between the banking records and the management accounts of the Group as identified by BDO: *see* Schedule at §37.

21. On 23 September 2015, RSM emailed the 4th Respondent to seek an explanation on certain unusual features in relation to the bank statements which were provided by the Company to RSM for the purposes of the forensic accounting investigation. However, there was no response to

the request and the 4th Respondent resigned on the same day: *see* Schedule at §§38-40.

22. Thereafter, by letter dated 25 September 2015, RSM informed the Company that the independent forensic review would not be able to proceed any further and tendered its resignation with immediate effect: *see* Schedule at §41.

The investigations of the provisional liquidators

23. On 29 September 2015, a winding up petition was presented against the Company. Shortly thereafter, on 2 October 2015, Osman Mohammed Arab, Wong Kwok Keung and Lai Wing Lun of RSM were appointed as the provisional liquidators of the Company (“PLs”): *see* Schedule at §§43-44.

24. The PLs discovered that there was a shortfall of around RMB 1.6 billion in respect of the bank balances of the accounts when compared to the management accounts of the Company and 13 subsidiaries as at 31 August 2015. The PLs filed a report dated 27 November 2015 and an affirmation dated 4 August 2016 setting out its investigations: *see* Schedule at §§44-46.

Overstatement of the Group's cash position

25. According to the audited consolidated financial statements of the Group for the years ended 31 December 2012 and 31 December 2013, which were approved in board meetings of the Company attended by, amongst others, the 3rd Respondent, the Group had a high level of cash and cash equivalents: *see* Schedule at §§49-54. The salient details are as follows:-

Year	Cash and cash equivalents (HK\$ million)
2011	1,077.8
2012	1,580.7
2013	2,249.0

26. According to the PLs' investigation, the Group's records show that the Company's PRC subsidiaries held the following balances in their accounts between 2011 and 2015: *see* Schedule at §55.

Year	Amount (HK\$ million)
31.12.2011	783
31.12.2012	1,409
31.12.2013	2,135
31.12.2014	2,035
31.08.2015	1,936

27. According to the PLs' investigation, there were material differences in the bank balances between the Group's records and the bank statements of the Company's PRC subsidiaries obtained by the PLs directly

from the banks in the PRC. The discrepancies were mainly found in 6 PRC bank accounts where there were shortfalls for each year from 2011 to 2015: *see* Schedule at §56(3) and Annex I. The shortfall is summarised as follows:-

Year	Shortfall (HK\$ million)
31.12.2011	515
31.12.2012	1,263
31.12.2013	1,732
31.12.2014	2,019
31.08.2015	1,931

28. Therefore, it is clear that the Company has grossly overstated the Group's position in "*cash and cash equivalents*" in the audited consolidated financial statements of the Group: *see* Schedule at §58.

29. Further:-

(1) False confirmations which overstated the total sum in 4 bank accounts of two PRC subsidiaries of the Company for the years ended 31 December 2012 and 31 December 2013 were provided to BDO during BDO's audit of the Company Accounts in respect of those two financial years: *see* Schedule at §§59-65. Specifically:-

(a) According to the false confirmations, the purported total amount in the said accounts were approximately RMB 1,024.8 million and RMB 1,451.7 million for the years

ended 31 December 2012 and 31 December 2013: *see* Schedule at §62.

(b) However, the bank statements obtained by the PLs and by the China Securities Regulatory Commission show that the total sums in the said accounts were only approximately RMB 34.26 million and RMB 160.5 million for the years ended 31 December 2012 and 31 December 2013 respectively: *see* Schedule at §63.

(2) The Company communicated the purported findings of the Special Team (which was formed by the Company ostensibly to investigate the discrepancies identified by BDO during the 2014 Audit) to BDO by way of two letters signed by the 3rd Respondent on behalf of the Board of the Company dated 9 March 2015 and 29 April 2015. However, the findings of the Special Team and the information provided to BDO and announced to the public were actually false: *see* Schedule at §§66-70. Specifically:-

(a) According to the Special Team's purported investigations, the discrepancies identified by BDO during the 2014 Audit were caused by two accounting staff of a subsidiary who had allegedly altered some bank statements in order to conceal their misappropriation of RMB9.15 million from the relevant subsidiaries. However, the said RMB9.15 million which was purportedly deposited into two bank accounts of two

purported recipients had already been returned to the Group: *see* Schedule at §67.

(b) The SFC obtained the bank statements of the bank accounts of the two purported recipients from the China Securities Regulatory Commission. The said bank statements show that the two recipient accounts did not actually receive any funds from the Group at the relevant time. Accordingly, the purported findings of the Special Team provided by the Company to BDO and announced to the public must have been based on false information: *see* Schedule at §§69-70.

(3) False bank statements were provided to RSM when they were carrying out an independent forensic investigation of the Company's accounts to impede RSM's investigations: *see* Schedule at §§71-73.

30. Based on the matters mentioned in paragraphs 25 to 29 above, the 3rd Respondent accepted and agreed that:-

(1) The Company grossly overstated the Group's positions in "cash and cash equivalents" in the audited consolidated financial statements of the Group for the years ended 31 December 2012 and 31 December 2013: *see* Schedule at §58.

(2) False confirmations, which grossly overstated the amounts in 4 bank accounts held by two PRC subsidiaries of the Company

for the financial years 2012 to 2013, were provided to BDO:
see Schedule at §64.

(3) The purported findings of the Special Team provided by the Company to BDO and announced to the public was false: *see* Schedule at §70.

(4) False bank statements were provided to RSM when they were carrying out an independent forensic investigation of the Company's accounts to impede RSM's investigations: *see* Schedule at §73.

31. By reason of the matters aforesaid, the 3rd Respondent accepted and agreed that:-

(1) He failed to discharge his duties with due and reasonable care, skill and diligence reasonably expected of a person of his knowledge, experience and holding his office and functions in failing to take reasonable steps which would have enabled him to realise that the Group's cash position had been overstated between 2011 and 2015: *see* Schedule at §§76-77.

(2) He failed to carry out his duties to the requisite standards in ascertaining the financial position of the Group and was simply going through the motions in the approval of the draft audited financial statements without properly engaging with the tasks and responsibilities required of him: *see* Schedule at §78.

32. On the basis of the above agreed facts, I agree that:-

(1) The overstatement of key financial information of the Group plainly falls within the business and affairs of the Company within the meaning of section 214(1) of the SFO: *see e.g. SFC v. Fung Chiu* [2009] 6 HKC 423 at §18.

(2) The business or affairs of the Company were conducted by the 3rd Respondent in a manner within the meaning of section 214(1)(b), (c) and (d) of the SFO, in that:-

(a) The 3rd Respondent's conduct, which involved a marked failure to exercise the requisite degree of skill and care in ensuring the truthfulness of accounts, constituted "misconduct" under section 214(1)(b).

(b) Members or any part of the members of the Company ("Members") were plainly not given all the information with respect to the Company's business or affairs that they might reasonably expect, namely its true cash position. Thus, section 214(1)(c) is engaged.

(c) Such overstatements or negligence in uncovering the same was conduct that was harmful to Members because they were provided with false accounting information and were unfairly denied access to the Company's true financial position. Such conduct was therefore unfairly

prejudicial to the Members, as described in section 214(1)(d).

Analysis and Relief against the 3rd Respondent

33. In view of the foregoing, I have little difficulty in coming to the view that the business and affairs of the Company for which the 3rd Respondent was partly responsible, were conducted in the manner described under limb (1)(b), (1)(c), and (1)(d) of section 214 of the SFO.

34. In the present case, the type of relief (i.e. a disqualification order) and the duration of the proposed disqualification order (i.e. 8 years) have been agreed between the parties. While the Court is not bound by such agreement, the Court is likely to be guided by the regulator's agreement on the appropriate sanction to be imposed: *see Wong Kam Leong* at §5, per Coleman J.

35. I am of the view that the agreed duration of the disqualification order of 8 years, which falls within the middle bracket, is appropriate and justified having regard to the following matters:-

(1) The cash shortfall occurred repeatedly from 2011 to 2015. The cash shortfall for each year was significant, ranging from HK\$515 million (as at 31 December 2011) to HK\$1,931 million (as at 31 August 2015): *see* Schedule at §56. Further:-

(a) The overstated amount of HK\$1,263 million accounted for around 79.9% of the "cash and cash equivalents" of

HK\$1,581 million as recorded in the audited consolidated financial statements of the Group for the year ended 31 December 2012: *see* Schedule at §57(1).

(b) The overstated amount of HK\$1,732 million accounted for around 77% of the “cash and cash equivalents” of HK\$2,249 million as recorded in the audited consolidated financial statements of the Group for the year ended 31 December 2013: *see* Schedule at §57(2).

(2) Whilst the 3rd Respondent did not personally benefit from the misfeasance or misconduct, this is a case of high degree of incompetence and irresponsible attitude. As executive director the 3rd Respondent occupied a senior position in the Group and public shareholders legitimately expected him to satisfactorily discharge his duties and responsibilities to manage and/or supervise the affairs of the Company. However, the 3rd Respondent displayed a marked indifference to his responsibilities as an executive director of a listed company and failed to properly scrutinise and review the financial statements of the Company. In particular:-

(a) The 3rd Respondent showed up at board meetings and signed attendance records but did not properly perform the tasks or discharge the responsibilities required of him. He simply went through the motions of approving the draft audited financial statements. He failed in his duties in exercising reasonable care and diligence in the

management of the Company: see Schedule at §77(3) and (4).

(b) The 3rd Respondent admitted that there was a lack of transparency with regard to the accounts of the Group and the level of profits made by the Company's subsidiaries. However, the 3rd Respondent did not take any steps to voice out these problems nor draw this to the attention of the Board or the shareholders: see Schedule at §77(1) and (2).

(c) R3 also admitted that he did not take meaningful measures to verify or ascertain that the cash reserves held by the Company's PRC subsidiaries were *bona fide*: see Schedule at §77(5).

(3) I note that the SFC accepts that the 3rd Respondent is cooperative in the present proceedings and is willing to bear the costs of the SFC. These mitigating factors have been taken into account in the agreed duration of disqualification.

36. For all the reasons above, this Court finds it proper to make a disqualification order against the 3rd Respondent for a period of 8 years and to order the 3rd Respondent to pay the costs of the Petition in these proceedings. The 3rd Respondent has no objection to the same. I will make an order in those terms accordingly.

37. The only issue of dispute between the SFC and the 3rd Respondent is the quantum of the costs. Mr Mak for the 3rd Respondent submitted that this Court should not adopt a mechanical approach of apportioning the costs equally amongst the 5 respondents. Mr Mak for the 3rd Respondent submitted that the 3rd Respondent should be responsible for about 10% of the costs. Ms Lam SC for the SFC submitted that whilst there are no fixed rules, the 3rd Respondent did not just play a marginal role.

38. I will take a broad brush approach in gross sum assessment and I am of the view that a fair amount should be HK\$285,000.00. Accordingly, the 3rd Respondent is ordered to pay the sum of HK\$285,000 to the SFC forthwith.

39. Finally, it remains for me to thank Ms Lam SC and Mr Tai for the SFC and Mr Mak for the 3rd Respondent for their assistance, in particular, their written submissions which are very comprehensive and helpful.

(William Wong, SC)
Deputy High Court Judge

Miss Rachel Lam SC, leading Mr Terrance Tai, instructed by Securities and Futures Commission, for the Petitioner

Mr Bernard Mak, instructed by Squire Patton Boggs, for the 3rd Respondent

