

Corporate & Commercial

Sponsors' Risk Exposure under the SFC's Latest Position on Prospectus Liabilities

Background

In May 2012, the Securities and Futures Commission (the “SFC”) conducted consultations and made proposals for enhancing the standard of sponsors' work in conducting due diligence and other parts of the IPO process. After the consultation conclusions, the Listing Rules (Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited) were amended and took effect in October 2013 to clarify sponsors' duties in the IPO process including due diligence, disclosure and communications with the regulators. However, the other proposals that deal with sponsors' liabilities for misstatements in prospectuses remain unimplemented. Recently, the SFC finally responded to these proposals in its “Supplemental Consultation Conclusions on the Regulation of IPO Sponsors – Prospectus Liability” (the “**Consultation Conclusions**”).

The current law on prospectus liabilities

The liabilities in respect of misstatements in prospectuses are mainly provided for in sections 40, 40A and 342(1) of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (“**C(WUMP)O**”). S. 40 C(WUMP)O specifies certain persons to be subject to civil liabilities to pay compensation to subscribers of new shares or debentures for their loss or damage caused by any untrue statement in a prospectus. Such persons include:

1. every director of the company at the time of the issue of the prospectus;
2. a promoter of the company; and
3. any person who has authorised the issue of the prospectus.

Persons in category 3 above are further subject to criminal liabilities under s. 40A(1) C(WUMP)O.

Sponsors' liabilities

It has been argued that sponsors are caught under the above provisions for untrue statements in prospectuses on the following grounds:

1. sponsors are persons who have “authorised the issue of the prospectus” in category 3 above; and

2. sponsors might fall in category 2 above, whereas a promoter is a party who is involved in the preparation of the prospectus but not including any person by reason of his acting in a professional capacity for persons engaged in procuring the formation of the company.

The SFC's position

The above arguments however remain untested by case law. To enhance legal certainty, the SFC proposed legislative amendments to clearly identify sponsors as being liable for untrue statements in prospectuses in December 2012. In the Consultation Conclusions, the SFC responded to this proposal and concluded that no legislative amendments are required. In re-examining the scope and applicability of the existing provisions to sponsors, the SFC considered that s. 40(1)(d), 40A(1) and 342(1) C(WUMP)O already cover sponsors under the category of persons who have “authorised the issue of the prospectus”. One of the factual bases stated by the SFC is that sponsors are required to, among other things, provide declarations to the Stock Exchange of Hong Kong Limited in respect of the truth, accuracy and completeness of the information in the prospectuses, which are necessary for prospectuses to be issued and authorised for registration under the C(WUMP)O. Therefore, sponsors are obviously persons who have “authorised the issue of the prospectus”.

Implications

Sponsors should be cautious of the overall result of the SFC's serial initiatives to enhance regulations on sponsors' prospectus liabilities. First, there have been revised Listing Rules to clarify or extend the rules on sponsors' duties in respect of matters including due diligence, disclosure and communications with the regulators. Second, the SFC has interpreted the C(WUMP)O in a way that subjects sponsors to criminal liabilities for untrue material statements in prospectuses. Even though there is no case law for applying C(WUMP)O to impose criminal prospectus liabilities on sponsors at the moment, the SFC stated clearly in the Consultation Conclusions that it will have no hesitation in relying on the existing criminal liability provisions in appropriate cases. By authorising the issue of a prospectus with any untrue material statement, sponsors can be liable for 3 years' imprisonment (12 months by summary conviction) and a fine of up to HK\$700,000 on indictment (HK\$150,000 by summary conviction). It is noteworthy that the Consultation Conclusions have not dealt with the issue of individuals' criminal prospectus liabilities. Therefore, it remains uncertain whether individuals in a sponsor firm are subject to criminal prospectus liabilities in the future.

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Important: The law and procedure on this subject are very specialised and complicated. This article is just a very general outline for reference and cannot be relied upon as legal advice in any individual case. If any advice or assistance is needed, please contact our solicitors.

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