

香港聯合交易所有限公司

(香港交易及結算所有限公司全資附屬公司)

THE STOCK EXCHANGE OF HONG KONG LIMITED

(A wholly-owned subsidiary of Hong Kong Exchanges and Clearing Limited)

**This case involves a public statement that the retention of office by one of the relevant directors would have been prejudicial to the interests of investors.**

**The conduct in this case relates to breaches of Chapters 13 and 14 of the Exchange Listing Rules and a lack of implementing and maintaining effective internal controls.**

**Directors must ensure that listed issuers implement and maintain an effective internal control system for procuring Exchange Listing Rule compliance. Failure to do so may amount to breach of director's duties under the Exchange Listing Rules.**

**The Listing Committee of The Stock Exchange of Hong Kong Limited (the "Listing Committee")**

#### **CENSURES:**

- (1) **Zhongtian International Limited** (the "**Company**") (Stock Code: 2379), and together with its subsidiaries, the "**Group**") for breaching Rules 13.13, 14.34, 14.38A and 14.40 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "**Exchange Listing Rules**") for failing to comply with the announcement, circular and shareholders' approval requirements for an advance to an entity and a major transaction identified below;

#### **AND FURTHER CENSURES:**

- (2) **Mr Chen De Zhao** ("**Mr Chen DZ**"), former executive director ("**ED**") and the Chairman of the Company;
- (3) **Mr Chen Jun** ("**Mr Chen J**"), ED of the Company;
- (4) **Mr Zhao Yun** ("**Mr Zhao**"), former ED of the Company;
- (5) **Mr Liu Jin Lu** ("**Mr Liu**"), independent non-executive director ("**INED**") of the Company and a member of the audit committee (the "**AC**") of the Company;
- (6) **Mr Chen Wen Ping** ("**Mr Chen WP**"), former INED and AC Chairman of the Company,

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for breaching their directors' duties under Rule 3.08, and for failing to comply with the Exchange Listing Rules to the best of their ability and use their best endeavours to procure the Company's Listing Rule compliance, breaching their obligations under the Declarations and Undertakings with regard to Directors given to the Exchange in the form set out in Appendix 5B to the Exchange Listing Rules (the "**Undertakings**").

(The directors identified at (2) to (6) above are collectively referred to as the "**Relevant Directors**".)

### **The Listing Committee further**

**STATES** that, in the Exchange's opinion, had Mr Chen DZ remained on the board of directors (the "**Board**") of the Company, his retention of office would have been prejudicial to the interests of investors.

For the avoidance of doubt, the Exchange confirms that the sanctions and directions in this news release apply only to the Company and the Relevant Directors, and not to any other past or present members of the Board of the Company.

### **HEARING**

On 17 June 2020, the Listing Committee conducted a hearing into the conduct of the Company and the Relevant Directors in relation to their obligations under the Exchange Listing Rules and the Undertakings.

### **FACTS**

On 1 June 2017, a subsidiary of the Company (the "**Subsidiary**") entered into a framework agreement (the "**Framework Agreement**") with Qingdao Ruiding Energy Co., Ltd ("**Ruiding**"). Under the Framework Agreement, Ruiding appointed the Subsidiary as the exclusive supplier of construction materials and equipment under an energy project (the "**Project**"). The Subsidiary would procure the construction materials and equipment from a specific supplier (the "**Supplier**") which would deliver direct to Ruiding.

On 26 June 2017, the Subsidiary obtained a loan of RMB600 million (the "**Loan**") from a trust scheme. The Subsidiary pledged a piece of land (maximum valued RMB1 billion) to the trust scheme as security.

On 17 July 2017, the Subsidiary entered into an agreement (the "**Agreement**") with Ruiding and the Supplier under which the Subsidiary would provide RMB600 million (the "**Payment**") to the Supplier; in return, the Supplier would supply construction materials and equipment to Ruiding for the Project. Ruiding would repay the Payment with interest to the Subsidiary.

The Agreement was approved by Mr Chen DZ and executed by his son, Mr Chen J for and on behalf of the Subsidiary.

The Company did not announce the Agreement until 25 March 2018 (over eight months after entering into the Agreement) after its auditors were aware of the Agreement. On 17 April 2018, the Company published a supplemental announcement disclosing further information about the Agreement. It did not issue a circular and/or obtain shareholder approval in respect of the Agreement.

## **EXCHANGE LISTING RULE REQUIREMENTS**

The Agreement was subject to the Exchange Listing Rules:

- (a) Rule 13.13 requires issuers to announce as soon as reasonably practicable details of any advance to an entity which exceeds 8 per cent under the assets ratio. Rule 13.11(2)(c) defines “advance to an entity” as the aggregated amount due from and all guarantees given on behalf of an entity and the entity’s subsidiaries.
- (b) Rules 14.34, 14.38A and 14.40 require issuers to announce, issue a circular and obtain shareholders’ approval for major transactions. A “transaction” is defined under Rule 14.04(1)(e) to include, among others, providing financial assistance by an issuer unless they fall within any of the exemptions thereunder.

The Relevant Directors were obliged to, under their respective Undertakings, comply with the Exchange Listing Rules to the best of their ability (the “**Best Ability Undertaking**”), and use their best endeavours to procure the Company’s compliance with the Exchange Listing Rules (the “**Best Endeavours Undertaking**”).

## **LISTING COMMITTEE’S FINDINGS OF BREACH**

The Listing Committee considered the written and/or oral submissions of the Listing Division, the Company and the Relevant Directors, and concluded as follows:

### **Company’s breach**

The Listing Committee found that the Payment constituted an advance to an entity under Rule 13.13, and financial assistance and a major transaction under Chapter 14. The Company breached Rules 13.13, 14.34, 14.38A and 14.40 and admitted those breaches.

### **Internal control deficiencies**

The Listing Committee also found that the Company did not have adequate internal controls with respect to compliance with Rule 13.13 and Chapter 14 of the Exchange Listing Rules which contributed to the Company’s breaches set out above:

- (a) There was no clear and well established system in place to:
  - (i) govern the types and size of transaction which would require the Board's approval under the Company's then practice;
  - (ii) monitor and identify transactions including advance and financial assistance which may be subject to the requirements under Rule 13.13 and Chapter 14 of the Exchange Listing Rules; and
  - (iii) determine if the transactions gave rise to any Exchange Listing Rule implications and, if necessary, escalate to the Board for consideration and approval.
- (b) One individual director (the Chairman) had complete control without a clear check-and-balance framework over (i) the decision-making process as to whether a given transaction should be escalated to the Board for approval, and (ii) the payment approval process.
- (c) There was no evidence of any review of its internal control system, and no training to the Chairman and the other directors on Exchange Listing Rule compliance or directors' duties, since 1 January 2015.
- (d) The Company's directors (except Mr Chen DZ and Mr Chen J) were unable to monitor and assess the Group's financial position on an informed basis and, therefore, discharge their duties under Rules 3.08 and 13.13 and Chapter 14 of the Rules due to the Company's failure to provide regular management accounts of the Subsidiary or the Group to them. Had such monthly management accounts been circulated to the Company's directors as part of the Company's internal control procedures, the INEDs would have been aware of the Agreement and the related transactions.

#### **Relevant Directors' breaches**

The Listing Committee concluded that the Relevant Directors failed to discharge their duties under Rule 3.08 and failed to comply with the Best Ability Undertaking and the Best Endeavours Undertaking.

#### **Mr Chen DZ – Chairman and ED**

Since early 2017, Mr Chen DZ:

- (a) had discussed the transactions contemplated under the Agreement with his son, Mr Chen J as the sole director, general manager and legal representative of the Subsidiary; and
- (b) had received progress updates and report from Mr Chen J in respect of the negotiation, execution and performance of the Framework Agreement followed by the Agreement.

In deciding whether Mr Chen DZ had discharged his duties under Rule 3.08, the Listing Committee considered the following background:

- (a) All the relevant transactions including the Loan from the Trust Scheme and the Agreement were handled by Mr Chen DZ and his son Mr Chen J, to the exclusion of the entire remaining Board. No other directors were aware of them until they were discovered by the auditors in January 2018. The Company's assertion that Mr Zhao was also aware of the transactions was a bare assertion without any supporting evidence, and had been denied by Mr Zhao.
- (b) Mr Chen J was involved in the management of both the Subsidiary (as the sole director, general manager and legal representative) and Ruiding (as the sole director and legal representative since February 2017). Mr Chen DZ must have known (or at least should have reasonably known) Mr Chen J's conflicting roles based on the official public record of SAIC in respect of Ruiding, and the reporting line from, and his familial tie with, Mr Chen J.
- (c) Although the Company submitted that Mr Chen J tendered his resignation to Ruiding on 26 May 2017 (which was just six days before he executed the Framework Agreement), the filing of the resignation was only made with the SAIC on 8 August 2017. Hence, Mr Chen J remained as Ruiding's director and legal representative on the public records until 8 August 2017 (ie almost a month after he signed the Agreement). (The Company obtained a written legal advice stating that, in the given circumstances, Mr Chen J's date of resignation from Ruiding was effective on 26 May 2017 rather than the date of filing with the SAIC.)
- (d) Ruiding appointed the Subsidiary to obtain the Loan from the Trust Scheme (of which Ruiding was one of the investors) to fund the Project because Ruiding was unable to satisfy the scheme's requirements.
- (e) Instead of making a back-to-back loan to Ruiding which would constitute a plain advance to an entity and financial assistance under Chapters 13 and 14, the transactions were structured in such a way that Ruiding received the benefit of the Loan indirectly through the Supplier supplying construction materials and equipment direct to it after the Subsidiary made the Payment (i.e. the Loan proceeds) to the Supplier. It was the first time the Group entered into a transaction of such nature.
- (f) As Chairman and an ED of the Company who had access to the Company's financial information, and had discussions with and received progress reports from Mr Chen J in respect of the transactions, Mr Chen DZ knew or should reasonably have known that the financial exposure and risk undertaken by the Group under the Loan and the Agreement was significantly high and that the Company's interest would be seriously jeopardised in the event of Ruiding's default of repayment:
  - (i) the size of the Loan (RMB600 million) (ie the Payment to the Supplier for Ruiding) was very significant to the Group as the Company's market capitalisation at the material time was approximately \$512.8 million;
  - (ii) the Subsidiary's obligation to repay the Loan to the Trust Scheme was independent from Ruiding's obligation to repay the Subsidiary;

- (iii) the Subsidiary pledged a piece of land (minimum estimated value: RMB 229 million; maximum estimated value: RMB1 billion) in favour of the Trust Scheme as security for the Loan;
- (iv) the only security held by the Subsidiary for Ruiding's repayment was a pledge by Ruiding's shareholders of the entire shareholding in Ruiding (which was set up in 2014 with a registered share capital of RMB26 million); and
- (v) the Supplier was set up only three days before the Agreement was executed with no track record of its financial and business performance and therefore no certainty as to performance of its obligations under the Agreement.

The Listing Committee concluded that Mr Chen DZ breached his duties under Rule 3.08(a) to (d) and (f) by reason of the following:

- (a) Mr Chen DZ failed to procure the Company to conduct adequate due diligence in respect of Ruiding and the Supplier. The only due diligence work which had been carried out was visiting Ruiding several times and receiving a feasibility report in respect of the Project. However, no details regarding the visits had been provided. The feasibility report merely focused on the Project's financial feasibility and profitability. There was no evidence showing that he had taken any steps to protect the Group's interest based on the visits and the feasibility report. No records or documents recording consideration, review, analysis, discussion and comments of the results of the visits or the feasibility report had been provided.
- (b) He failed to at least evaluate the financial and technical capabilities of Ruiding and the Supplier for the Project, and assess and address the risks to the Group in the event of default by Ruiding and/or the Supplier.
- (c) He failed to avoid his conflict of interest in the matter by failing to raise the conflict issue with the other directors and declaring his interest therein. He simply approved the Agreement without the knowledge of any of the other directors.
- (d) He failed to keep the other directors informed of the Agreement and the related transactions, which were material in nature as the Agreement constituted a major transaction and led to significant financial exposure and risks to the Group.
- (e) This was the first time the Company entered into a transaction of this nature. Mr Chen DZ failed to procure the Company to obtain professional advice on the Exchange Listing Rule implications, in particular, in the light of the financial significance of the Agreement and the related transactions, and to discuss the nature and structure of the Agreement with the other directors, in particular the INEDs who were expected to provide the Board with the benefit of their skills, knowledge and judgement.
- (f) He failed to raise the Exchange Listing Rule implications of the Agreement and the related transactions for the other directors' consideration and discussion to procure the Company's Rule compliance.
- (g) He failed to procure the Company and/or the Subsidiary to obtain adequate security from Ruiding for repayment.

In the light of the circumstances set out above, the Listing Committee concluded that Mr Chen DZ wilfully failed to discharge his duties under Rules 3.08(a) to (d) and (f).

Mr Chen DZ resigned as a director and all other positions in the Company on 20 December 2019.

## Mr Chen J – ED

In considering Mr Chen J's discharge of his duties under Rule 3.08, the Listing Committee has taken into account the following background:

- (a) Although Mr Chen J had been the Company's director and CEO from 6 March 2007 to 29 May 2015, he ceased to be so thereafter (but remains part of the senior management within the Group). He was therefore not a director of the Company when he executed the Agreement for and on behalf of the Subsidiary.
- (b) Mr Chen J was appointed as the sole director and legal representative of Ruiding on 13 February 2017. He was in a conflicting position due to his capacity as the Company's controlling shareholder (57.92 per cent) and/or roles in both the Group and Ruiding when he discussed with Mr Chen DZ about the transactions contemplated under the Agreement since February to May 2017. According to the Company, he tendered his resignation to Ruiding on 26 May 2017, and executed the Framework Agreement six days thereafter on behalf of the Subsidiary.
- (c) He was aware of his father's view that the Agreement was an ordinary trading activity rather than an advance to an entity and/or financial assistance during the preparatory stage for the Agreement but he did not suggest to his father to raise the matter with the full Board and in particular the INEDs, and procure the Company to seek professional advice on the Rule implications of the Agreement.
- (d) He executed the Agreement, the land pledge and approved the Payment to the Supplier. It was the first time the Group entered into a transaction of such nature.
- (e) The financial exposure and risk undertaken by the Group was significantly high.
- (f) He was aware of the terms of the Agreement and approved the subsequent Payment of the total sum of RMB600 million to the Supplier in tranches between August and December 2017.

After Mr Chen J was re-appointed to the Board as an ED and the CEO on 2 November 2017, he continued to approve the release of the remaining Payment to the Supplier until December 2017 without exercising his skill, care and diligence to proactively procure the Company to take at least the following steps within a reasonable time after his appointment:

- (a) table the Agreement, its Rule implications with reference to Mr Chen DZ's decision that it was an ordinary trading activity, and the Company's financial exposure and risk under the Loan and the Agreement, for the information, consideration and discussion by the Board;

- (b) seek professional advice on the Rule implications of the Agreement; and
- (c) procure the Company to comply with the relevant Rules.

The Listing Committee therefore concluded that Mr Chen J breached his duties under Rules 3.08(a), (c) and (f) and the Best Ability Undertaking.

#### All Relevant Directors

The Listing Committee referred to the materiality of the Group's internal control deficiencies identified above, and the unavailability of information on, or evidence of, any internal control review or steps taken by any of the Relevant Directors to maintain an effective internal control system in the Company. The Listing Committee therefore concluded that, by failing to ensure that the Group implemented an effective internal control system on compliance with Rule 13.13 and Chapter 14 of the Rules, which contributed to the Company's Rule breaches, the Relevant Directors breached their directors' duties under Rule 3.08(f) and their Best Ability Undertakings and Best Endeavours Undertakings in respect of the Agreement.

### **REGULATORY CONCERN**

The Listing Committee regards the breaches in this matter as serious:

- (1) The failure by Mr Chen DZ to discharge his responsibilities under the Rules was wilful as analysed above.
- (2) The Agreement was a major transaction which required announcement and shareholder approval. The financial exposure and risk undertaken by the Group under the Agreement and the related transactions (including the Loan) was significantly high. The negotiations, approval and execution of the Agreement were solely in the hands of Mr Chen DZ and/or Mr Chen J, to the exclusion of all the other directors who had no knowledge of the transactions until 25 March 2018.
- (3) There were material deficiencies in the Company's internal controls for procuring the Company's compliance with Rule 13.13 and Chapter 14, which contributed to the Company's breaches. There was no evidence of any review of the effectiveness of the Company's internal controls conducted at least annually since 2015.
- (4) The interest of the Company's shareholders had been prejudiced in terms of their right to timely receipt of information concerning the Agreement, and vote on it before it was carried out.
- (5) Directors of listed issuers have an obligation to ensure that issuers notify the shareholders (and obtain their approval if required) and the market of transactions falling within the scope of Rule 13.13 and Chapter 14 in a timely manner. Failure to do so destroys transparency, trust and confidence in the market.



## SANCTIONS

Having made the findings of breaches stated above, the Listing Committee decided to:

- (1) Censure the Company for its breaches of Rules 13.13, 14.34, 14.38A and 14.40 of the Exchange Listing Rules;
- (2) Censure the Relevant Directors for breach of Rule 3.08 of the Exchange Listing Rules and their Undertakings; and
- (3) Make a statement that, in the Exchange's opinion, had Mr Chen DZ remained on the board of directors of the Company, his retention of office would have been prejudicial to the interests of investors.

The Listing Committee further directed:

### Internal control review

- (4) The Company to retain an independent professional adviser satisfactory to the Listing Division (the "**Adviser**") to conduct a thorough review of and make recommendations to improve the Company's internal controls to ensure compliance with the Exchange Listing Rules, within two weeks from the date of publication of this news release; and provide the Listing Division with the written report of the Adviser containing such recommendations within two months from the publication of this news release. The Company is to submit the proposed scope of retainer to the Listing Division for comment before appointment of the Adviser.
- (5) The Company to furnish the Listing Division with the Adviser's written report on the Company's full implementation of the Adviser's recommendations within a further period of two months.

### Compliance Adviser appointment

- (6) The Company to appoint an independent Compliance Adviser (as defined in Rule 3A.01 namely, any corporation or authorised financial institution licensed or registered under the Securities and Futures Ordinance for Type 6 regulated activity and permitted under its licence or certificate of registration to undertake work as a sponsor and, as applicable, which is appointed under Rule 3A.19 or Rule 3A.20 to undertake work as a Compliance Adviser) satisfactory to the Listing Division on an ongoing basis for consultation on Exchange Listing Rule compliance for two years within four weeks from the publication of this news release. The Company is to submit the proposed scope of retainer to the Listing Division for comment before appointment of the Compliance Adviser. The Compliance Adviser shall be accountable to the AC of the Company.

Director training

- (7) The Relevant Directors (except Mr Chen DZ, Mr Zhao and Mr Chen WP) to each (a) attend 24 hours of training on Exchange Listing Rule compliance and director's duties, including at least 4 hours of training on the requirements under the Exchange Listing Rules in respect of director's duties and 4 hours on notifiable transactions under Chapter 14 (the "**Training**"), to be provided by institutions such as the Hong Kong Institute of Chartered Secretaries, the Hong Kong Institute of Directors or other course providers approved by the Listing Division. The Training is to be completed within 90 days from the publication of this news release; and (b) provide the Listing Division with the training provider's written certification of full compliance within two weeks after Training completion.
- (8) As a pre-requisite of any future appointment as a director of any company listed on the Exchange, Mr Zhao and Mr Chen WP, who are not currently a director of any other company listed on the Exchange, (a) to attend the Training as a pre-requisite of any future appointment as a director of any company listed on the Exchange. The Training is to be completed before the effective date of any such appointment; and (b) to provide the Listing Division with the training provider's written certification of full compliance.
- (9) The Company is to publish an announcement to confirm that each of the directions in paragraphs (4) to (7) above have been fully complied with within two weeks after the fulfillment of each direction. The last announcement required to be published under this requirement is to include a confirmation that all directions in paragraphs (4) to (7) above have been complied with.
- (10) The Company is to submit the draft announcements referred to in (9) above for the Listing Division's comment and may only publish the announcements after the Listing Division has confirmed it has no further comment on each of them.
- (11) Following the publication of this news release, any changes necessary and any administrative matters which may emerge in the management and operation of any of the directions set out in paragraphs (4) to (10) above are to be directed to the Listing Division for consideration and approval. The Listing Division should refer any matters of concern to the Listing Committee for determination.

Hong Kong, 11 August 2020