REPORT OF THE MARKET MISCONDUCT TRIBUNAL OF HONG KONG

on whether any market misconduct has taken place

in relation to the listed securities of

Tianhe Chemicals Group Limited

in and between December 2013 and June 2014

and other related questions

The Report of the Market Misconduct Tribunal into dealings
in the shares of Tianhe Chemicals Group Limited
in and between December 2013 and June 2014

A report pursuant to section 252(3)(a) and (b) of the Securities and Futures Ordinance, Cap 571

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CHAPTER 1

INTRODUCTION

The Tianhe listing

1. Tianhe Chemicals Group Limited ('Tianhe' or the 'Tianhe Group'), was incorporated in the British Virgin Islands in 2007 and at all times material to this report operated as an investment holding company. Its subsidiaries included intermediate holding and service companies incorporated in various jurisdictions and also, as the generators of revenue, operating subsidiaries established in the People's Republic of China ('the PRC').

2. Wei Xuan was an Executive Director and the Chief Executive Officer ('the CEO') of Tianhe and was in addition a substantial indirect shareholder.

3. Wei Xuan's brother, Wei Qi, was also an Executive Director of Tianhe and held the position of Chairman.

4. The main operating subsidiary of the Tianhe Group was a PRC corporation called Jinzhou DPF-TH Chemicals Co. Ltd ('Jinzhou') which manufactured and sold lubricant additives and speciality fluorochemicals. Wei Xuan was a director of Jinzhou. To give an indication of its importance as an operating entity in the Tianhe Group, for the years 2011, 2012 and 2013 Jinzhou was said to have contributed over 90% of the revenue of the Tianhe Group[1].

[1] The figures placed before the Tribunal showed that in 2011, 2012 and 2013 Jinzhou contributed (in round figures) 93%, 97% and 96% of the revenues of the Tianhe Group.

5. Something should briefly be said of the early days of Jinzhou. It was established in 2007 by a group of financial investors and by a PRC company called Liaoning Tianhe Fine Chemicals Co. Ltd ('Liaoning Tianhe') which was wholly owned by the Wei family. In about early 2010, the Wei family assumed full ownership of Jinzhou which, as its major operations entity, was incorporated into the Tianhe Group.

6. As for Liaoning Tianhe, although it continued business in the manufacture and distribution of lubricant additives, it was never incorporated into the Tianhe Group; it remained at all material times a private company owned by the Wei family.

7. It is relevant to note that in or about 2011 Tianhe, under the leadership of Wei Xuan, attempted to list on the London Stock Exchange. The listing was not successful.

8. In 2014, Tianhe sought a listing on the Main Board of the Hong Kong Stock Exchange.

9. As an indication of the purported size of the listing, there were three joint sponsors: Morgan Stanley Asia Limited ('Morgan Stanley'), UBS Securities Hong Kong Limited ('UBS') and Merrill Lynch Far East Limited ('Merrill Lynch'). The auditors and reporting accountants were Deloitte Touche Tohmatsu ('Deloitte'). In addition, Clifford Chance were appointed as legal advisors to Tianhe in respect of matters governed by Hong Kong and US law while Simpson, Thacher & Bartlett were appointed to advise the joint sponsors and the underwriters in respect of matters governed by the same laws. There was, therefore, no lack of professional assistance available to Wei Xuan and the senior management of the Tianhe Group to ensure due compliance with the listing requirements of the Hong Kong Exchange.

10. In its prospectus, Tianhe represented that it was the largest producer of lubricant additives and speciality fluorochemicals in the PRC and, in terms of revenue, the sixth largest producer in the world. Revenues earned from the sale of these products were, therefore, a fundamentally important part of the business of the Tianhe Group, both as to the nature and size of the corporations which purchased its additives and fluorochemicals and, of course, the level of those purchases.

11. Wei Xuan, in addition to holding the position of CEO of Tianhe, was a member of the listing committee formed for the purpose of guiding Tianhe's listing. Wei Qi, his brother, described Wei Xuan as being mainly responsible for the necessary preparations in that regard.

12. In the prospectus, published for the purposes of the listing, it was said that Tianhe had a 'proven track record of growth and profitability' based on its revenue earned during the previous three years: the 'track record period'. Importantly, it was held out that a substantial volume of the corporation's sales were to its top customers which included 'blue chip' companies as well as state-owned enterprises and their subsidiaries. The Group's profits earned in the three-year track record period were published in the prospectus. By way of a summary, Tianhe's purported sales revenues for the three 'track record years' (in RMB '000) were as follows[2] –

Year	Sales Revenue	Gross Profit	Profit before tax	Net Profit
2011	3,359,368	1,489,914	1,164,220	948,111
2012	4,192,553	2,541,253	2,553,656	2,189,964
2013	5,033,795	3,046,990	3,100,407	2,626,229

13. In addition, it was stated in the prospectus that the Tianhe Group held significant competitive advantages in its production and sale of additives and

[2] The table is to be found in paragraph 10 of the SFC Synopsis.

fluorochemicals and was well positioned to capitalise on the expected growth of relevant industries in the PRC.

14. Importantly, it was a fundamental assertion in the prospectus that the growth in revenues over the track record years was evidence that Tianhe was enjoying robust growth. In this regard, it was said that sales revenue over that three-year period had grown from RMB3.359 billion in 2011 to RMB4.192 billion in 2012 and then to RMB5.03 billion in 2013 – an increase over that three-year period exceeding RMB1.6 billion.

15. The Tianhe prospectus was published on 9 June 2014. The publication was authorized by the directors, including Wei Xuan, pursuant to board resolutions.

16. Tianhe was successfully listed on 20 June 2014 (under stock code 1619). As a result of the listing, more than two billion new shares were issued by Tianhe to the subscribing public at HK$1.80 per share. The listing proceeds were in excess of HK$3.5 billion.

17. A substantial portion of the proceeds – some 45% – were used to repay loans granted to Tianhe by its largest shareholder, a company called Driven Goal Limited ('Driven Goal'). Driven Goal held 72.36% of Tianhe's total issued share capital before the listing and 64.58% immediately after it. Driven Goal was wholly owned by the Wei family, including Wei Xuan.

18. From the date of listing in June 2014 through until the beginning of September of that year, the share price of Tianhe steadily increased, reaching a high of HK$2.54. It appeared at that early stage to be a successful listing.

The challenge to the accuracy of the prospectus figures

19. On 2 September 2014, however, less than three months after the listing, a private stock research organization by the name of Anonymous Analytics ('AA') published what proved to be a highly damaging report as to the accuracy (and integrity) of the Tianhe prospectus.

20. It was asserted by AA that Tianhe's sales revenues had been massively inflated and that its true revenues were some 85% less than represented.

21. Trading in Tianhe shares was suspended that same day.

22. In the weeks that followed, Tianhe sought to refute the allegations made by AA. On 29 September 2014, with share trading still suspended, Tianhe published its interim results for the six-month period ended 30 June 2014. These results sought to defy the AA assertions, purporting to show continued strong growth in revenue and a healthy profit attributable to shareholders. AA, however, persisted in its criticisms.

23. Trading in Tianhe shares on the Main Board was resumed on 9 October 2014. The resumption, however, was far from auspicious. Winnie Pao, an expert witness engaged by the Securities and Futures Commission ('the SFC'), reported that on that first day of resumed trading the stock dropped by 39.8% from the previous close of HK$2.31. Winnie Pao reported that the trading volume was extraordinarily heavy that day with over one billion shares changing hands.

24. The extraordinary level of trading on the resumption day and the massive drop in value of the stock that day by nearly 40% is compelling evidence that the market was greatly concerned as to the true level of Tianhe's trading revenues.

25. Some five months later, on 26 March 2015, Tianhe announced that the publication of the annual results for the year ended 31 December 2014 would be delayed. This led – the following day – to a further indefinite suspension of trading pending publication of those results. Less than six months later, Deloitte resigned as Tianhe's auditors.

26. With effect from 25 May 2017, the Stock Exchange formally suspended all dealings in Tianhe's shares[3] and three years later, on 11 June 2020, it formally cancelled the listing of Tianhe.

Institution of present proceedings

27. On 19 June 2020, a few days after the cancellation of listing, the SFC instituted the proceedings which are the subject of this report. The SFC's Notice listed Tianhe and Wei Xuan as the two Specified Persons, that is, the two persons suspected to have perpetrated market misconduct within the meaning of section 277(1) of Part XIII of the Securities and Futures Ordinance ('the Ordinance'). Copies of the SFC Notice and the SFC Synopsis are attached to this report as Annexures "A" and "B".

28. The market misconduct proceedings were founded on the assertion that Tianhe's purported sales revenues to three leading customers had been massively overstated in the prospectus: the SFC asserting that in the result the total revenue earned during the track record period had been inflated in the prospectus by some RMB3.245 billion. The three customers said to be, or to be among, Tianhe's top customers, were CITIC International Company Limited ('CITIC'); PetroChina

[3] The suspension of dealings was made pursuant to the provisions of s.8(1) of the Securities and Futures (Stock Market Listing) Rules.

Company Limited ('PetroChina') and Shanghai High-Lube Additives Company limited ('Shanghai High-Lube').

29. The Tribunal's mandate has been to consider matters in respect of these three companies.

30. It was the SFC assertion that, in respect of each of these three companies, the true sales revenue figures were as summarized below[4] –

CITIC

FY	True sales revenue (RMB '000)	Sales revenue adopted in the Prospectus (RMB '000)
2011	12,881	828,999
2012	6,181	953,140
2013	3,421	1,485,449
Total	22,483	3,267,588

31. In respect of CITIC, among other matters, the SFC put forward the following matters of concern –

(a) That a total of 11 sales contracts said to have been entered into between CITIC and Jinzhou during the track record period were not in fact entered into by CITIC.

(b) That the joint sponsors had not been given an unencumbered opportunity to interview management of CITIC. As a result of persuasion on the part of Wei Xuan, they had only interviewed a man by the name of Li Bin who had been vouched for by Wei Xuan and who held himself out as being a management level employee of CITIC. Li Bin, however,

[4] See paragraph 12 of the SFC Synopsis.

on the balance of the evidence, appears to have been an imposter – never an employee of CITIC – who had walked out of the interview when he was asked to produce identification.

PetroChina

FY	True sales revenue (RMB '000)	Sales revenue adopted in the Prospectus (RMB '000)
2011	19,173	1,080, 791
2012	20,576	1,046,298
2013	11,535	1,065,054
Total	51,284	3,192,143

32. In respect of PetroChina, among other matters, the SFC put forward the following matters of concern –

(a) That, out of a total of eight PetroChina factories which, according to Tianhe, had made purchases from Jinzhou during the track record period, a total of four sales contracts emanating from those factories had proved to be fictitious.

(b) That representatives of factories interviewed by the joint sponsors during the due diligence process were not staff of those factories nor were they related to any staff members.

(c) That three corporate entities which purported to have a relationship with PetroChina and contributed to sales to PetroChina in fact had no relationship at all [5].

[5] The three corporate entities were Gansu Xinxing Ruidi Petrochemical; Dalian Qixing Lubricant Technological Development Co. and Lanzhou Hongye Fine Chemicals (Sanye) Company.

Shanghai High-Lube

FY	True sales revenue (RMB '000)	Sales revenue adopted in the Prospectus (RMB '000)
2011	0	143,714
2012	0	105,545
2013	0	115,639
Total	0	364,898

33. In respect of Shanghai High-Lube, the SFC put forward the following matters of concern –

(a) That this corporation had had no business transactions with Jinzhou during the track record period and had not entered into any of the contracts that were given to the joint sponsors during due diligence: hence the zero sales revenues.

(b) That during the track record period, however, the company had had business dealings with Liaoning Tianhe, the private company – independent of the Tianhe Group - controlled by the Wei family.

34. In light of those figures, it was the SFC assertion that there had been a gross inflation of the Tianhe Group's sales revenue earned over the three-year track record period in respect of CITIC, PetroChina and Shanghai High-Lube. As to the extent of that inflation, the SFC set out the following table[6] which, in the sixth column, sets out the percentage of revenues said to be overstated: averaged over the three years, and expressed in broad figures, they showed that some 50% of revenues stated in the prospectus were inflated –

[6] See paragraph 13 of the SFC Synopsis.

FY	Amount of sales overstated in relation to CITIC (RMB ’000)	Amount of sales overstated in relation to PetroChina (RMB ’000)	Amount of sales overstated in relation to Shanghai High-Lube (RMB ’000)	Total sales of the Group reported in the Prospectus (RMB ’000)	Percentage of sales revenue overstated
2011	816,118	1,061,618	143,714	3,359,368	60.2%
2012	946,959	1,025,722	105,545	4,192,553	49.6%
2013	1,482,028	1,053,519	115,639	5,033,795	52.7%

The core matters falling for resolution by the Tribunal

35. In respect of sales revenue figures published in the prospectus, and if it can be shown that they were likely to influence the market, the Tribunal has been required, pursuant to the provisions of section 277(1) of the Ordinance, to come to the following determinations –

(a) Whether, on the evidence, it has been demonstrated that the sales revenue figures contained in the prospectus and said to have been earned from the three companies were, by reason of their exaggeration, materially false or misleading.

(b) Whether, on the evidence, it has been demonstrated that Wei Xuan was reckless or negligent in failing to prevent publication of that false or misleading material.

(c) Whether, on the evidence, Tianhe, the corporation, acting through the directing mind of Wei Xuan, was reckless or negligent in the same respect.

The hearing of the inquiry

36. The substantive hearing of the inquiry took place before the Tribunal (consisting of the Chairman and two Members) on 12 May 2021.

37. Tianhe, the corporation, was not represented at the hearing nor were any written submissions filed on its behalf. Earlier, however, through its then solicitors, it had informed the Tribunal that it did not intend to oppose the proceedings.

38. Wei Xuan himself was absent from the hearing. Nor was he legally represented at the hearing. At no time during the proceedings had the Tribunal received any form of communication from him.

39. Section 252(6) of the Ordinance directs that the Tribunal shall not identify a person as having engaged in market misconduct "without first giving the person a reasonable opportunity of being heard". The first issue that has fallen to be determined by the Tribunal, therefore, is whether the two Specified Persons – even though neither chose to participate in the proceedings in any way – had nevertheless been given a reasonable opportunity to do so.

CHAPTER 2

WERE THE TWO SPECIFIED PERSONS GIVEN A REASONABLE OPPORTUNITY OF BEING HEARD?

40. In determining proceedings instituted by the SFC pursuant to s.252(2) and Schedule 9 of the Ordinance, the Tribunal does not discharge a criminal jurisdiction but rather a civil jurisdiction, one that is regulatory in nature, its essential purpose being the protection of the integrity of the securities and futures market. As such, pursuant to the provisions of section 252 (6) of the Ordinance, the Tribunal has the discretion to inquire into the conduct of an individual even though that individual, having been given a reasonable opportunity to make representations to the Tribunal, has chosen not to do so.

41. Whether a person has been given a reasonable opportunity of being heard within the meaning of section 252 (6) of the Ordinance is to be determined in accordance with the circumstances of each and every case. Any discretion to proceed in the absence of representations made by a specified person is, of course, one that must be exercised with caution, the overriding concern being to ensure that the hearing of the inquiry is in the circumstances as fair as circumstances permit and leads to a just outcome.

Was Tianhe given a reasonable opportunity of being heard?

42. There can be no dispute that Tianhe, the corporation, was duly served with the SFC Notice and accompanying papers.

43. Aside from the positive evidence of service supplied by the SFC to the Tribunal, in a letter dated 15 September 2020, Howse Williams, Tianhe's Hong Kong solicitors (with no complaint that there had been any deficiency in the

service of papers) wrote to the Tribunal requesting an adjournment of the preliminary conference. It did so on the single basis that Tianhe's CEO, Wei Xuan – himself, the second Specified Person – was recovering in hospital from pneumonia and that instructions could not therefore be obtained from him at that time on behalf of Tianhe. It is important to recognise that an indefinite adjournment was not sought. An adjournment of one month only was sought to "allow time for Mr Wei to recover from his illness."

44. As it was, just a day or so before the preliminary conference, which was set for 18 September 2020, Howse Williams informed the Tribunal in writing that it had no instructions to attend that conference.

45. Some four months later, in a letter dated 13 January 2021, Howse Williams informed the Tribunal that it had now received instructions from its client, Tianhe. The instructions were that Tianhe "no longer intends to contest the proceedings" and, as such, would not attend the second preliminary conference.

46. Thereafter, Howse Williams made no further contact with the Tribunal. Nor was any contact made by any other legal representative or anybody acting with purported authority to represent Tianhe.

47. It is open to any party subject to inquiry to inform the Tribunal that it does not wish to be heard in opposition and will leave the matter to the Tribunal. That was the decision made by Tianhe. Of course, that does not permit the Tribunal, on that basis, to imply culpability.

Was Wei Xuan given a reasonable opportunity of being heard?

48. Howse Williams, Tianhe's solicitors, were explicit in their communications with the Tribunal that, although they represented Tianhe and

required the instructions of Wei Xuan as to the corporation's intentions, they had not received instructions from Wei Xuan himself to represent his own interests in the inquiry.

49. However, that the solicitors had to obtain instructions from Wei Xuan as to the affairs of the corporation is evident from the fact that they sought an adjournment of proceedings for a period of a month because Wei Xuan was in hospital and unable to give them instructions until the expiration of that period. Thereafter, at a later stage, they received instructions that the corporation would no longer oppose the proceedings.

50. On any common sense approach, against that background, it would appear inevitable that Wei Xuan himself would have come to know that he too was subject to the SFC inquiry. How would the solicitors have come to know that they were not representing both Tianhe *and* Wei Xuan unless that issue had been discussed with Wei Xuan or unless Wei Xuan had given them specific instructions? And why would Wei Xuan have given such instructions – namely, that they were not to represent his personal interests – unless he knew that he too was an involved party?

51. The SFC, of course, in advancing its case that there had been due service, did not rely solely on this inferential evidence, no matter how persuasive. It relied on the fact that numerous attempts were made to serve papers on Wei Xuan in the PRC.

52. Viewing that evidence in the round, the Tribunal is satisfied that a compelling inference can be drawn that Wei Xuan, knowing full well that he was an implicated party, did his best to avoid being physically served with the SFC papers.

53. The evidence reveals that the SFC attempted to serve papers on Wei Xuan at nine different addresses in respect of each of which he had been known (during the history of the listing and subsequent investigations) to have substantial connections. Of particular relevance are the following attempts at service or of service itself –

(a) In June 2020, an attempt was made – via DHL, an international delivery service – to effect delivery at an office in Beijing. This office had earlier, during the course of listing, been identified as being an office of Tianhe and/or its associated companies. When service was attempted, DHL were informed that they could not enter the building without the permission of Wei Xuan himself. Clearly, therefore, Wei Xuan was known at the office and exercised authority there. An attempt was made through the office number and also through a personal (mobile telephone) number that Wei had himself given to the SFC during an earlier interview. Wei, however, could not be contacted by DHL in order to obtain his permission to make delivery.

(b) An attempt was made – this time by Hong Kong Speed Post – to effect delivery at the same Beijing office in July 2020. Initially, the papers – addressed to Wei Xuan – were accepted and signed for by a third party, all seeming to be in order. However, more than a month later, at the end of August 2020, the papers were returned to the SFC in Hong

Kong with the Chinese characters for "overdue"[7] written on a return sticker.

(c) An attempt was made to serve papers in Jinzhou City in August 2020. DHL telephoned Wei Xuan's personal mobile number. The call was answered by a male. When the male was informed that a parcel from the SFC was to be delivered, the male refused to accept it. Subsequent telephone calls to the same number were not answered. In the judgment of the Tribunal, the probabilities clearly indicate that the male was Wei Xuan; the number was his personal mobile number.

(d) Again, in August 2020, delivery was made by DHL to the offices of Jinzhou in Jinzhou City by Hong Kong Speed Post. The company was one of Wei Xuan's companies. Staff in the mail room accepted delivery.

54. On a consideration of the relevant evidence, the Tribunal is satisfied that the SFC was able to make effective delivery of papers in these proceedings upon Wei Xuan on at least two occasions – these being the instances outlined in sub-paragraphs b) and d) above. On that basis alone, the Tribunal is satisfied that Wei Xuan was given a reasonable opportunity to receive and consider the SFC papers and, if he so chose, to make representations to protect his own interests in the inquiry.

55. The Tribunal is further satisfied, however, on a consideration of the evidence as a whole, that, knowing full well that he was subject to inquiry by the

[7] A strange annotation which, read on its own, makes little sense.

SFC, Wei Xuan did his best to avoid service or simply rejected service in the misguided belief that, if he did not openly accept service, he could avoid inquiry.

56. The Tribunal is satisfied that, in the circumstances of the present case, knowing that the SFC had launched an inquiry into his actions and the actions of Tianhe, and knowing that legitimate attempts had been made to serve papers upon him, it was open to Wei Xuan to take action to accept the papers, to acknowledge his interest in the matter and, if he wished, to make representations. In such circumstances, simply sending the papers back or getting staff simply to refuse to accept those papers did not remove him from the ambit of the inquiry.

57. For the reasons given, the Tribunal is satisfied that both Tianhe, the corporation, and Wei Xuan, the individual, were given a reasonable opportunity to make representations. The fact that both declined to take up that opportunity was entirely a matter for them.

CHAPTER 3

DIRECTIONS AS TO LAW

58. In addition to principles referred to elsewhere in this report, the issues that have fallen for determination by the Tribunal have been determined in accordance with the following principles of law.

Assessment of the evidence

59. Once it was evident that neither of the Specified Persons, although given a reasonable opportunity of making representations to the Tribunal, had any intention of taking up that opportunity and would play no part in the proceedings, the Tribunal directed that all evidence could be presented in written form without the need for supporting oral evidence. The direction was given after the Chairman of the Tribunal had satisfied himself, as a matter of law, that there were no vagaries or internal inconsistencies in the written evidence which demanded an explanation by way of oral evidence. Indeed, the Tribunal records that the evidence, although factually complex – and whether credible or not – was relatively straightforward.

60. The direction that oral evidence need not be given was further subject at all times to the condition that, if the Tribunal was troubled by any of the contents of the written evidence, it could during the substantive hearing call upon counsel for the SFC to present relevant oral evidence. As it turned out, however,

during the presentation of evidence by Jonathan Chang SC, leading counsel for the SFC, the Tribunal found no need to seek such assistance.[8]

61. This direction to dispense with the need for oral evidence was made pursuant to section 253(1) of the Ordinance which permits the Tribunal to receive and consider any evidential material whether it is placed before it in the form of oral evidence, written statements or in some other documentary form. This is the case even if that material would not be admissible in civil or criminal proceedings. The Tribunal also has the power to determine the manner in which any evidential material is received and considered. It is not therefore mandatory for a person to come before the Tribunal to give oral testimony in order to verify the correctness of any written statement previously made. In short, the Tribunal has a wide discretion as to the nature of the evidence that it may consider and the manner in which that evidence may be received.

62. What weight, if any, is to be given to such evidence is of course a separate matter. When determining weight, a judicious approach must be adopted. By way of example, caution is to be exercised in determining the weight to be attached to a statement not made on oath or affirmation and not tested by way of cross-examination. The Tribunal should also have regard to whether or not such material is, or is not, supported by other evidential material which has been received.

63. In considering the evidence, it is open to the Tribunal to reach determinations by way of drawing inferences. That said, any conclusions reached must be plainly established as a matter of inference from the proven facts. The proceedings being civil in nature, it would not be right to say that, if any inference

[8] Mr Chang's written submissions, complemented by his oral explanations and answers to questions from the members of the Tribunal, were of very real assistance in the writing of this report; they were careful, balanced and thorough.

is to be drawn, it must be the only inference that can be drawn. However, before any inference can be drawn, it must be established as a compelling inference.[9]

The standard of proof

64. Section 252(7) of the Ordinance directs that –

> "… the standard of proof required to determine any question or issue before the Tribunal shall be the standard of proof applicable to civil proceedings in a court of law."

65. That standard is the 'balance of probability' standard which has been expressed as follows –

> "The balance of probability standard means that a court is satisfied an event occurred if the court considers that, on the evidence, the occurrence of the event was more likely than not."

Looking to the requirements of section 277(1)

66. The Tribunal was mandated to conduct its inquiry with respect to the provisions of section 277 (1) of the Ordinance which provides as follows –

> "Disclosure of false or misleading information inducing transactions takes place when, in Hong Kong or elsewhere, a person discloses, circulates or disseminates, or authorizes or is concerned in the disclosure, circulation or dissemination of, information that is likely –
>
> (a) to induce another person to subscribe for securities, or deal in futures contracts, in Hong Kong;

[9] See the CITIC Report dated 7 April 2017, paragraph 185.

(b) to induce the sale or purchase in Hong Kong of securities by another person; or

(c) to maintain, increase, reduce or stabilize the price of securities, or the price for dealings in futures contracts, in Hong Kong,

if –

(i) the information is false or misleading as to a material fact, or is false or misleading through the omission of a material fact; and

(ii) the person knows that, or is reckless or negligent as to whether, the information is false or misleading as to a material fact, or is false or misleading through the omission of a material fact."

67. The four elements of market misconduct under section 277(1) may be described as follows[10] –

The element of dissemination

68. It must be demonstrated on the evidence that a person, whether in Hong Kong or elsewhere, has disseminated or has been concerned in the dissemination of information. The information which is the focus of this report is the information (related essentially to sales revenues) contained in the Tianhe prospectus. The publication of a prospectus in order to obtain a listing is one form of dissemination. There is no doubt that the Tianhe prospectus was published on the authority of Wei Xuan as a director of Tianhe and was an essential document in ensuring a successful listing of the company.

[10] These elements were earlier defined in the Greencool Technology Holdings Limited report dated 24 January 2018, see paragraphs 110 and following of the Greencool report.

The element of market effect

69. It must be demonstrated that the information was likely to induce another person to subscribe for, sell or purchase Tianhe's shares, or maintain, increase or stabilise the share price. In the present case, it was the SFC case that the purported figures were likely to induce potential investors to subscribe to and/or purchase Tianhe's shares and/or were likely to maintain or increase the price of those shares.

70. As to the meaning of the word 'likely', if information is likely to induce third parties to undertake a course of action, it is necessary for the Tribunal to conduct an objective test, one in which it will look to the probabilities, determining whether there is a real chance it will have that effect on third parties and not merely a remote chance.

The element of falsity

71. It must be demonstrated that the information is false or misleading as to a material fact or is false or misleading through the omission of a material fact. In the present case, as earlier emphasized, it was the SFC case that the purported sales revenue figures of the three companies – CITIC, PetroChina and Shanghai High-Lube – had been grossly exaggerated. As to the language of this element, the word 'false' is plain enough. It means 'untrue'. The word 'misleading' means to cause an incorrect impression. If information is misleading, it is information that is inconsistent with the true state of affairs. A 'material fact' is a fact that is sufficiently significant to influence a reasonable person to take a course of action, for example, in the present case, to purchase shares in Tianhe.

The mental element

72. Before a Specified Party may be held to be culpable of market misconduct, the Tribunal must be satisfied that the party has acted in a reckless or negligent or reckless manner. As a matter of well-established principle, a corporation may be held to have acted negligently or recklessly in the same manner as an individual who has guided the actions of that corporation.

73. As to negligence – conduct of less serious culpability – the concept has been defined as the failure to exercise that care which circumstances demand. The concept of negligence is an objective one, being judged through the eyes of the reasonable man.

74. In the present case, when considering whether negligence on the part of Wei Xuan and Tianhe itself has been proved, the issue to be determined may be expressed as follows: did Wei Xuan and, through his direction, did Tianhe itself exercise that level of care to avoid the inclusion in the prospectus of false or misleading information as to material facts that would have been required of a reasonably prudent person in their positions?

75. Wei Xuan was a director of Tianhe and its CEO and, as such, especially as one of the members of the listing committee, would have been required to adopt an objective and diligent interest in all relevant company information coming before him, especially in respect of matters of fundamental importance such as financial statements detailing revenue streams. In this regard, the following well-established principles have been enunciated in *ASIC v Healey*[11] –

> "All directors must carefully read and understand financial statements before they form the opinions which are to be expressed [in the present

[11] (2011) 83 ACSR, at 484 and onwards.

> case, in the prospectus]. Such a reading and understanding would require the director to consider whether the financial statements were consistent with his or her own knowledge of the company's financial position. This accumulated knowledge arises from a number of responsibilities a director has in carrying out the role and function of a director."

76. The dicta continues –

> "… A director should maintain familiarity with the financial status of the corporation by a regular review and understanding of financial statements; a director, whilst not an auditor, should still have a questioning mind. "

77. As clearly set out in *ASIC v Healey*, the questioning mind is to be employed not simply in order to correct typographical or grammatical errors or even immaterial errors of arithmetic, it is rather to be used to ensure, as far as possible and reasonable, that the information included in the financial statements is accurate.

78. In the present case, that must give rise to the fundamental question to be considered later in this report; namely, how, having regard to all the circumstances, it could have been possible for Wei Xuan, unless at the very least he acted negligently, for him to accept figures that so grossly and falsely inflated sales revenue from the Tianhe Group's three leading customers?

79. The Tribunal moves now to the concept that points to greater culpability, namely, recklessness. The definition of recklessness was given by the Court of Final Appeal in *HKSAR v Sin Kam Wah*[12] –

> "… it has to be shown that the defendant's state of mind was culpable in that he acted recklessly in respect of a circumstance if he was aware of a

[12] (2005) 8 HKCFAR 192 at paragraph 44.

> risk which did or would exist, or in respect of a result if he was aware of a risk that it would occur, and it was, in the circumstances known to him, unreasonable to take the risk. Conversely, a defendant could not be regarded as culpable so as to be convicted of the offence if, due to his age or personal characteristics, he genuinely did not appreciate or foresee the risks involved in his actions."

80. The concept of 'recklessness' contains both a subjective and objective test. Reduced to its core, it may be said that reckless conduct takes place when a person is aware of a risk and, in the circumstances known to him at the time, it is unreasonable for him to take that risk. Leading counsel for the SFC expressed the test as follows –

(a) First, the Tribunal must ask itself whether the Specified Person was aware of a risk which did or would exist, or, in respect of a result, if the Specified Person was aware of a risk that it would occur.

(b) Second, the Tribunal must assess whether it was, in the circumstances known to the Specified Person, objectively unreasonable for the Specified Person to take that risk.

CHAPTER 4

LOOKING TO THE FIRST TWO ELEMENTS: DISSEMINATION AND MARKET EFFECT

81. As indicated in the previous chapter, proof of market misconduct pursuant to section 277(1) of the Ordinance requires proof of each of the four elements that constitute that misconduct. In this chapter the first two elements are considered.

The element of dissemination

82. There can be no doubt that, on the evidence, Wei Xuan and Tianhe itself were concerned in the dissemination of the information contained in the prospectus. Wei Xuan, the CEO (and a director) of Tianhe, was on the committee responsible for ensuring a successful listing of the company and that required that he played an important role in ensuring the accuracy of the matters set out in the prospectus and then in overseeing the publication of the prospectus[13]. It was, in largest measure, Wei Xuan's mind that directed the actions of Tianhe itself in ensuring the accuracy of materials contained in the prospectus and in the publication of the prospectus. There can be no doubt therefore that both played a material role in the preparation and publication of the prospectus.

The element of market effect

83. Nor can there be any doubt that the information contained in the prospectus, particularly the information related to Tianhe's sales revenues earned

[13] Among other matters, Wei Xuan signed a confirmation and undertaking on 10 March 2014 confirming to the Stock Exchange that the application papers for listing, including the prospectus, were accurate and complete and not misleading or deceptive.

in the three-year track record period, would, at the very least, have been *likely* to influence members of the market to subscribe for shares in Tianhe and/or to maintain their holdings.

84. The Tribunal is satisfied that declarations in the prospectus as to sales revenue obtained from three of the most important customers of Tianhe would invariably have had an influence on a material number of companies and individuals considering the purchase of shares in the new listing. First, that sales revenue data purported to show, by their magnitude, that Tianhe was well established in the PRC. Second, it purported to show that its sales revenues were increasing year-on-year in robust manner. Third, by inference, it purported to show that it was well positioned to take advantage of further expansion in the PRC market.

85. In her expert report to the Tribunal, Winnie Pao pointed out that sales revenues, particularly if they showed robust profitability ratios, were important indicators for informed investors. In the prospectus, she noted, these ratios appeared to be very favourable.

86. Winnie Pao further pointed out that, given the financial figures set out in the prospectus, interested investors would be able to conduct their own analyses to calculate the earnings per share (EPS) and the price/earnings to growth (PEG) ratio. Any such analyses, she said, would show that the corporation's shares were inexpensive: a further attraction to investors.

87. As it was put by leading counsel for the SFC, the key factors which investors would likely take into account in determining whether or not to purchase Tianhe shares were both directly and indirectly related to the purported sales revenue figures contained in the prospectus. As Mr Chang expressed it, the overall picture presented to investors based on the revenue figures was that

Tianhe was an industrial leader in the PRC, operating in markets with a high expectation of growth, a company that had demonstrated a strong rise in its revenues and profits over the track record period. That picture, he said, would clearly influence – or would at least be likely to influence – a large number of potential investors to invest in the corporation.

88. During the hearing, the Tribunal was informed that, at the time of the listing, a number of blue-chip investment companies had subscribed to purchase shares in Tianhe, hardly organisations that would have ignored the sales revenue figures in determining whether or not to purchase.

89. For the reasons given, and on a consideration of all the evidence placed before it, the Tribunal has had no difficulty in coming to the determination that the financial data contained in the prospectus constituted material information in that it would clearly have influenced a large number of potential investors, encouraging them to proceed to make purchases or, at the very least, would have been likely to have had that influence on them.

CHAPTER 5

LOOKING TO THE THIRD ELEMENT: FALSITY

90. As indicated in Chapter 3, proof of market misconduct pursuant to the provisions of section 277(1) of the Ordinance requires proof of each of four elements. The third such element is proof that the information that has been disseminated is false or misleading as to a material fact or is false or misleading by the omission of a material fact.

Early difficulties in exercising due diligence

91. Determination of the issue of falsity requires a consideration of certain matters that arose in the listing process itself, that is, when due diligence was being exercised.

92. In about December 2013, the professional parties engaged to guide the listing of Tianhe ('the due diligence team') discussed the required scope of third-party due diligence. In doing so, it was agreed that, among other leading customers of the Tianhe Group, interviews should be conducted with representatives of the three companies: CITIC, PetroChina and Shanghai High-Lube.

93. It was further agreed that, as part of the general due diligence process, certain interviews should be conducted at the business premises of customers. In this regard, it was agreed that the first interview with CITIC should be held at its offices.

94. The intentions of the due diligence team were conveyed to Wei Xuan and his advisers. The reaction was hostile. On 28 December 2013, Michelle Kong

of Morgan Stanley sent an explanatory email to Wei Xuan and other senior officers of Tianhe. In that email, she explained that, among other matters, the Stock Exchange of Hong Kong ('the SEHK') required that independent due diligence interviews be conducted with Tianhe's key customers, including the three companies. In the email, she said that the SEHK had laid down particular guidance in respect of dealers –

> "… which requires that sponsors shall conduct due diligence on sales modes of listed companies and dealers, independence of dealers, and end customer groups [including whether their demands for listed companies' products are steady and sustainable for growth]; on the other hand, the SEHK has specially strict requirements for due diligence on high-growth and high-profit businesses and products. Considering that fluoride is one of the Company's priorities in recent years and a key source for the Company's profits, we predict that the SEHK will raise many questions and has stricter requirements for due compliance…"

95. It is also to be emphasized that Wei Xuan himself was under an obligation to sign an undertaking to the Stock Exhange before listing. So he too could have been under no misunderstanding as to the importance of ensuring accuracy of all relevant information.

96. In addition, Michelle Kong set out the requirements of the SEHK in regard to ensuring the true identity of representatives who were to be interviewed. In this regard, she specified that the representatives were to provide the following when the interviews took place: a letter of authority to be supplied by the company being represented, that letter to come from a third party within the company; a duplicate copy of the company's business licence; the representative's personal name card and his or her personal identity card.

97. Those working for Tianhe made it clear that Wei Xuan, and his top people, were very unhappy with the delivery up of identification documentation. Indeed, it was reported to the due diligence team that those at Tianhe were "furious" about the requests and were threatening to change sponsors.

98. Further concern was expressed by Wei Xuan and his team that the three companies should be subject to interview at their own offices. In particular it was said that CITIC, being a "blue-chip company", should not be subject to a physical visit.

99. While the Tribunal accepts that in the PRC, in commercial circles, different courtesies may have existed at that time, it is to be remembered that the due diligence team contained a number of people with knowledge of PRC ways and, more importantly, Wei Xuan himself would have known that Hong Kong, as a separate jurisdiction, had its own demands to ensure the integrity of the listing process.

100. The due diligence team, however, waivered, agreeing to a number of concessions. First, it was agreed that representatives of the three companies need not come to the interviews armed with letters of authorization. Second, in respect of CITIC, it was agreed that the first interview with its representative need not take place at the offices of CITIC itself but at the offices of Tianhe in the city of Jinzhou. It was said that, if required, further interviews may be conducted at the offices of the companies – with the exception of CITIC which was apparently, so it was said, still smarting from an earlier interview process when Tianhe had unsuccessfully attempted a listing on the London Exchange.

101. The due diligence interview with CITIC therefore took place, not at CITIC's own offices as first required, and where it would have been easy to

consult with other senior officers of the company, but at the offices of the Tianhe Group in Jinzhou.

102. The CITIC representative who attended the meeting was a man who called himself Li Bin, apparently holding the position of Deputy Operations Manager. When he was asked to confirm the accuracy of the sales figures related to CITIC, Li Bin was happy to do so. Difficulties arose, however, when Li Bin was asked to provide some form of proof of identity as an employee of CITIC. It was then apparently that the tone of the meeting changed; he flew into a temper, rejecting any suggestion that he should have to identify himself, and stormed out of the meeting, not to return.

103. Irene Lau, a representative of Simpson, Thacher & Bartlett, attended the meeting. She said that, after Li Bin had stormed out of the meeting, Wei Xuan sought to assure her of Li Bin's true identity, informing her that he had in fact taken a business trip with Li Bin in the past and had a copy of Li Bin's passport. He was able to show her the copy. Wei Xuan himself, therefore, sought personally to vouch for Li Bin's identity as a senior officer of CITIC, somebody with whom he had worked directly in the past.

104. That identification by Wei Xuan, however, does not accord with other evidence that arose later, that evidence being to the effect that Li Bin had never been an employee of CITIC. That other evidence arose out of the private investigations of a company called Temasek International which was at one time proposed as a 'cornerstone investor' and which was invited, as part of its own due diligence, to make inquiries of CITIC through Li Bin. However, when it sought to contact Li Bin at CITIC, it was informed that nobody by that name had ever been employed by CITIC. Temasek declined to invest.

105. At a later stage, during the course of SFC investigations, CITIC, through its senior management, formally confirmed it had no knowledge of anybody named Li Bin.

106. The preponderance of the evidence, therefore, points clearly to the fact that Li Bin, had not at the time been a *bona fide* member of CITIC; put more bluntly, that he had been part of an attempt to undermine the integrity of the due diligence process. That finding, of course, must lead to real concern as to Wei Xuan's own actions in seeking to support Li Bin's identity. Despite the numerous issues that arose casting doubts on Li Bin's true identity, Wei Xuan does not appear at any time to have discussed the matter with a view perhaps to further investigations.

107. A worrying postscript to the matter of the CITIC due diligence is the fact that, after the initial interviews had been completed, Wei Xuan was informed by the due diligence team that brief follow-up interviews would be conducted with the top three purchasers of additives and the top three purchasers of fluorochemicals. Wei Xuan was specifically informed that CITIC would be one of the companies to be interviewed. Wei Xuan rejected the request, saying: "the company [Tianhe] suggests taking PetroChina as the major interviewee in respect of lubricating oil additives since CITIC is only a distributor and cannot prove the questions provided." The due diligence team agreed that PetroChina should be substituted. In the result, Wei Xuan, by his actions, had blocked any form of follow-up interview taking place at the physical offices of CITIC.

Objective evidence that the sales revenue figures of CITIC contained in the prospectus were false

108. In respect of the CITIC financial data published in the prospectus, evidence of central importance came before the Tribunal during the course of its

investigations in the form of a witness statement made by a man named Lv Bo[14] who had joined CITIC in 2010 and who, at the time of making his witness statement in 2017, held the position of head of the Finance Department of CITIC.

109. During the important years of 2011 to 2013 – the track record years – Lv Bo had held the position of Deputy Manager of the Finance Department. It was Lv Bo's evidence that at all material times he was responsible for reviewing and approving the execution of contracts and this included contracts for the purchase of chemical products from the Tianhe Group through Jinzhou.

110. Lv Bo said that, according to the accounting records of CITIC, the total amount of purchases actually made over the three-year period constituting the track-record period (calculated in renminbi) was very materially less than posted in the prospectus. The following sets out Lv Bo's figures contrasted with the purported sales revenues in the prospectus –

FY	Actual sales amount	Purported sales amount
2011	12,880,540	828,999,000
2012	6,181,140	953,140,000
2013	3,421,440	1,485,449,000
Total	22,483,120	3,267,588,000

111. Lv Bo further said that the purported contracts between Jinzhou and CITIC had never been signed by an authorized member of CITIC: further evidence of a manipulation of relevant records.

112. It should be added that Lv Bo said that, during his years at CITIC, he had never known a member of staff by the name of Li Bin.

[14] The name – Lv Bo – is a transliteration from the Mandarin.

Objective evidence that the sales figures of PetroChina contained in the prospectus were false

113. The key evidence in respect of PetroChina's dealings with the Tianhe Group came from Zhao Yaode, the Deputy General Manager of PetroChina's department of legal affairs. Zhao Yaode said that all purchases were of lubricant additives and, during the track record years (calculated in renminbi), were as follows –

FY	Actual sales amount	Purported sales amount
2011	19,172,919	1,080,791,000
2012	20,575,543	1,046,298,000
2013	11,535,310	1,065,054,000
Total	51,283,773	3,192,143,000

114. Zhao Yaode stated that the purported sales contracts with the Tianhe Group had never been signed by an authorised member of PetroChina.

115. He further confirmed that the listing of sales by the Tianhe Group to three purported subsidiaries of PertroChina - Dalian Qixing, Gansu Xinxing and Lanzhou Hongye[15] had to be incorrect as these companies were not subsidiaries of PetroChina.

116. In addition, he confirmed that no staff from PetroChina had participated in the due diligence interviews conducted by Tianhe's due diligence team in the lead-up to the listing – evidence that whoever attended were, like Li Bin, imposters. Again, therefore, there was evidence of some form of manipulation of the due diligence process.

[15] The full names of these supposed subsidiaries were Dalian Qixing Lubricant Technological Development Co.; Gansu Xinxing Ruididi Petrochemical Co. Ltd, and Lanzhou Hongye Fine Chemicals (Sanye) Co.

117. As to the truthfulness of Zhao Yaode's evidence, PetroChina's legal department issued a formal legal opinion confirming its accuracy.

Objective evidence that the sales figures of Shanghai High-Lube contained in the prospectus were false

118. In respect of Shanghai High-Lube, its general manager, Xu Weiming – who had been with the company since 2002 – submitted a witness statement to the Tribunal in which he stated that the company had never purchased any product from Jinzhou. Its business dealings had instead been with a company called Liaoning Tianhe.

119. Xu Weiming said that the purported sales contracts, each purporting to be signed by him, were not signed by him: yet further evidence of the manipulation of records.

120. As stated at the beginning of this report[16], Liaoning Tianhe had at all material times been a private company controlled by the Wei family and was not a part of the Tianhe Group. Put simply, therefore, sales made by the Tianhe Group had been incorrectly boosted by incorporating sales made by the independent company, Liaoning Tianhe, to Shanghai High-Lube.

121. According to Xu Weiming, Shanghai High-Lube's production manager, Liu Huibo, had participated in a due diligence interview in the lead-up to the listing of Tianhe but Liu Huibo had at all times understood that the interview concerned the affairs of the Wei family company, Liaoning Tianhe. He had been asked to participate in the interview with the "financing parties" of that company and not the representatives of the Tianhe Group. On the face of the due diligence questionnaire, the interviewers, however, did not distinguish clearly between

[16] See paragraph 6.

Liaoning Tianhe and the Tianhe Group. The expression 'Tianhe Group' was often mentioned. In short, the interview became an exercise in talking at cross purposes.

122. In this regard, the Tribunal accepts the force in the submission by leading counsel for the SFC that Wei Xuan, who was at the meeting, must have appreciated the risk of confusion but apparently did nothing to seek clarity – as was his obligation.

Can there be any doubt as to the falsity of the sales revenue figures?

123. In the judgment of the Tribunal, having considered all the evidence, there is no reason to doubt the essential correctness of the revenue figures presented by the three companies after each had conducted internal investigations.

124. John Lees, an accounting expert briefed by the SFC, surveyed the accounting evidence in detail. It was his evidence that a number of international accounting guidelines (including Hong Kong, the United States and the United Kingdom) have adopted a 5% deviation in profits before tax as constituting a material deviation.

125. Among other sets of calculations, John Lees calculated that, after making adjustments to reflect the sales revenue obtained by Tianhe from the three companies in accordance with the evidence of those three companies, Tianhe's gross profit should have been reduced by 60.1% to RMB594 billion in 2011; by 49.6% to RMB1.3 billion in 2012 and by 52.7% to RMB1.4 billion in the year 2013. These percentages dwarf a 5% deviation which, in accordance with accounting guidelines, is considered today to be a material deviation. John Lees incorporated these percentage decreases into a detailed table of figures[17] which revealed the consequent adjustments to percentage decreases in profit before tax

[17] The Table – Table 8 in the report prepared by John Lees – is annexed as Annexure "C" to this report.

and net profit. The relevant percentages decreases are drawn from that detailed table as follows –

	2011	2012	2013
Decrease in gross profit	60.1%	49.6%	52.7%
Decrease in profit before tax	77.0%	49.3%	51.8%
Decrease in net profit	94.5%	57.5%	61.1%

126. In the judgment of the Tribunal, on the basis of the evidence put before it, the sales revenue figures contained in the prospectus (and figures emanating from them) were clearly false or misleading as to material facts or were false or misleading through the omission of material facts.

127. Essentially, expressed in layman's terms, what was hidden from the market in the prospectus was the fact that a group of companies – the Tianhe Group - had over the past three years earned some 50% - or less - of its proclaimed sales revenues.

CHAPTER 6

THE QUESTION OF CULPABILITY

128. In seeking to determine the question of culpability, what must be asked is whether the two Specified Persons, Wei Xuan and Tianhe, acted recklessly or negligently in permitting the grossly exaggerated sales revenue figures to be published in the prospectus.

129. Despite the fact that, on the evidence, it was clear that certain persons in the ranks of Tianhe, or in the ranks of those allied to Tianhe, had sought to manipulate matters to disguise and/or keep hidden the true dimensions of Tianhe's sales revenue figures, it was never part of the SFC case that Wei Xuan himself had participated as a knowing party in such conduct. In the proceedings before this Tribunal, therefore, it was not asserted that Wei Xuan had sought actively to deceive. It was instead submitted that Wei Xuan and, through his directing will, the Tianhe Group, had acted recklessly in disseminating those materials. It was further submitted that, should the Tribunal not be able to find reckless conduct, then manifestly there had been negligence on the part of both parties.

Putting the evidence of recklessness or negligence into context

130. At all material times, Wei Xuan was the CEO of Tianhe. As such, he was the highest-ranking executive in the Tianhe Group. In the prospectus it was said that he was responsible for "general management and day-to-day operation of the Group". Broadly speaking, a CEO's primary responsibilities include making major corporate decisions, managing the overall operations and managing the resources of a company. A CEO is also the point of communication between the board of directors and the management staff of a company. The

Tribunal accepts that the role of the CEO varies from one company to another. As such, the Tribunal accepts that Wei Xuan could not be expected to have had a highly detailed, month-to-month knowledge of the sales figures. That said, driving the revenues of the Group must have been part of his responsibilities. Sales dictated the level of success of the Group. He could not have fulfilled his responsibilities as a CEO without a fair grasp of the source, the size and the regularity of those revenues. In the expectation of a public listing, an understanding of the dynamics of sales revenues would have grown in importance.

131. Yet, as the Tribunal has found, there was over the length of the critical three-year lead-up period a gross exaggeration of the true sales revenue earnings. As earlier indicated, current accounting standards consider an exaggeration of true sales revenue earnings of 5% as being material. In respect of the Tianhe Group, however, that exaggeration rose to be close to 50% of revenue sales. It was an inflation divorced from the reality of operations on the ground: hence the need for invention, the creation of fictitious contracts and the like.

132. Yet, over that three-year period, if Wei Xuan is to be believed, in the day-to-day running of the Group right through until the publication of the prospectus, he had no cause to question the accuracy of the sales revenue figures. Nor was he alerted to revenue figures that did not match production figures nor to any other discrepancies appearing in the construction of the Group's accounts that pointed, or could have pointed, to an artificial inflation in sales figures of such magnitude.

Wei Xuan's position of leadership in Tianhe

133. Prior to the listing, Wei Xuan (and his family) held a commanding financial interest in the Tianhe Group. Importantly, in respect of the listing exercise, Wei Xuan – on the admission of his own brother – was the person

directly responsible for ensuring the success of the listing. As such, he bore ultimate responsibility for ensuring the correctness of all matters set out in the prospectus.

134. As to Wei Xuan's involvement in the listing exercise, it is to be remembered that he was no stranger to the process. There had been unsuccessful attempt at listing in London a few years earlier. In respect of the Hong Kong listing, Wei Xuan was the one who played an active role in liaising with the professional advisers. He was the person responsible for providing the advisers with the names and details of representatives of top customers of the Group. More than that, he was the one who took a personal interest in overseeing the logistics of interviews, being personally involved with matters when he considered them to be of concern. It was on this basis, for example, that Wei Xuan was able to raise such strong objection to certain interviews taking place at the offices of customers – such as CITIC – rather than at the offices of Tianhe.

135. The question to be asked, of course, is why an ability to influence venue and the true identity of persons attending the meetings would be of any real concern to Wei Xuan if the sole purpose was to confirm the accuracy of historical data that would be put into the prospectus. Companies like CITIC were major conglomerates with international reach. Any concerns as to etiquette or causing offence could always be smoothed over. The evidence, however, was that Wei Xuan was so outraged at the proposals related to the due diligence interviews that he threatened to dismiss the three sponsors. Viewed objectively, this show of outrage speaks more of tactics than any genuine, rational and well-founded concern. The Shakespeare comment: 'the lady doth protest too much' comes to mind.

136. Even assuming that Wei Xuan was genuinely distressed at the prospect of senior officers of customer companies – such as CITIC – being forced to obtain

formal identification, the question must be asked: why the objection as to venue? In that regard, a compelling inference to be drawn is that Wei Xuan wished to isolate the interview process, to ensure that facts and figures could not be double-checked simply by walking from one office to another or by calling in other senior managers. And there could only be one reason for such a desire to isolate the interview process, namely, to maintain a more immediate control over that process, to avoid any result that may point to inaccuracies in relevant data.

Wei Xuan's attempt to distance himself from knowledge of the sale revenues

137. Despite the evidence of his close involvement in the day-to-day management of Tianhe in the run-up period to its listing, Wei Xuan sought to distance himself from what must have been a central part of the Group's operations, namely, the sales of its products: the lubricant additives and speciality fluorochemicals.

138. Wei Xuan went so far as to claim that he had limited knowledge of sales to specific customers; to use his words: he did not "take charge of such minor things". Yet the prospectus itself, in respect of which Wei Xuan took a leading role in its assembly, laid emphasis on the nature and shape of Tianhe's sales, emphasizing, for example, the Group's dealings with state-owned enterprises and recognising the risk of concentrating its sales business on too few leading customers. On any objective consideration, understanding the true dynamics of sales to leading customers was far from a "minor thing".

139. Wei Xuan further sought to distance himself from any immediate knowledge of the dynamics of the Group's sales by claiming that his responsibilities were mainly "external". When asked to identify the person on the board of Tianhe who held responsibility for sales, Wei Xuan was unable to do so.

140. Wei Xuan, however, could not simply rely on the assertion that he took little interest in sales and related issues. He knew, indeed he appears to have been present, when Li Bin, the supposed representative of CITIC, walked out of a due diligence meeting. He also knew of Temasek's concerns as to the true identity of Li Bin. On any common sense, rational approach, Li Bin's evidence related to the integrity of the CITIC sales figures demanded to be reviewed. But it was not. Fault may have rested with Tianhe's professional advisers and sponsors[18]. On the evidence, it is clear, however, that it also rested on the shoulders of Wei Xuan. Indeed, on any objective assessment of the relevant evidence, Wei Xuan should have been the principal party seeking assurances as to the integrity of the sales figures appearing in the prospectus. Instead, it appears that he was a principal party seeking to adjust matters so that, in the absence of Li Bin, there was no further examination of relevant matters with representatives from CITIC.

141. Another matter that raises concerns is the fact that it was not until after listing, when the SFC initiated investigations, that a further material error in the accounts of the Tianhe Group was discovered, namely, that sales that should have been recorded as being from the Wei family's privately-owned company, Liaoning Tianhe, to Shanghai High-Lube were recorded as being from the Tianhe Group, thereby further boosting its purported sales figures in the prospectus.

The Tribunal's determination as to recklessness

142. On a consideration of all relevant evidence – and remembering that the false inflation of the track record period sales figures exceeded some RMB 3 billion – the Tribunal has had no hesitation in dismissing any suggestion that Wei Xuan genuinely did not appreciate or foresee the risks involved to the integrity of the market if he proceeded with the publication of the prospectus. To

[18] The Tribunal understands that certain of the professional parties assisting Tianhe were subject to disciplinary proceedings.

the contrary, on a consideration of all the evidence, the Tribunal is satisfied to the required standard –

(a) that Wei Xuan must have been, and was, well aware of the very real risk that the sales revenue figures in the prospectus were so massively exaggerated as to be materially false or misleading;

(b) that Wei Xuan must also have been, and was, well aware that the risk was of such gravity, that is, of such substance, that in the circumstances it was unreasonable to ignore it; and

(c) that Wei Xuan, although well aware of the risk and its dimensions, went ahead and authorized the publication of the prospectus.

143. On the basis that Wei Xuan was the primary directing will of Tianhe itself, his proven culpability must be attributed to Tianhe.

144. The two parties are therefore found to be culpable on the ground of recklessness.

The alternative of culpability based on negligence

145. As it was put by counsel for the SFC, if Wei Xuan and Tianhe were not reckless in their publication of the prospectus, they were plainly negligent.

146. The concept of negligence has been considered earlier[19]. The question to be asked may be termed as follows: did Wei Xuan and, through his direction, did Tianhe itself exercise that level of care to avoid the inclusion in the prospectus of false or misleading information as to material facts that would have been required of a reasonably prudent person in their positions?

147. Viewed within this objective context, a good many of the issues considered by the Tribunal when determining recklessness are of equal, if not greater, force.

148. As counsel for the SFC submitted, Wei Xuan's failure to more fully investigate, indeed to investigate at all, the red flags raised in respect of Li Bin was clearly negligent.

149. Equally, Wei Xuan's insistence that, even though he was the CEO of the Tianhe Group, he was not responsible for sales and could not therefore confirm – or dispute – their accuracy, is itself, in the circumstances, indicative of a culpable lack of care. There must always be an obligation on a reasonably prudent CEO to understand and have command of the dynamics of revenue: what is earned, from what sources and how. Yet, if Wei Xuan is to be believed, he had no idea of the massively inflated – and false – revenue figures, figures extending over three years.

150. As counsel for the SFC submitted, a reasonably prudent CEO in the position of Wei Xuan, even if sales and marketing was not his commercial strength, should have had (at the very least) an educated idea as to the true size of Tianhe's business. A questioning mind was essential and there would have been sufficient qualified persons to investigate such matters and report back. But

[19] See paragraphs 72 – 74 (inclusive).

Wei Xuan, when questioned by the SFC, chose to distance himself from adopting any such essential and active role.

CHAPTER 7

CONSEQUENTIAL ORDERS MADE

151. In the event of the Specified Persons being found culpable of market misconduct, the SFC sought the following three consequential orders –

> "In the event that Wei Xuan was found to have acted recklessly, a disqualification order pursuant to section 257(1)(a) of the Ordinance for a period of four years.
>
> A 'cease and desist' order against both Tianhe and Wei Xuan pursuant to section 257(1)(c) of the Ordinance.
>
> Costs orders for the Government and the SFC against both Tianhe and Wei Xuan pursuant to section 257(1)(e)-(f) of the Ordinance."

The application for a disqualification order

152. Section 257(1)(a) of the Ordinance empowers the Tribunal to order that a person found culpable of market misconduct shall not, without leave of the Court of First Instance, be, or continue to be, a director of a listed corporation or in any way, directly or indirectly, be concerned or take part in the management of a listed corporation for a period not exceeding five years.

153. The purpose of disqualification orders is essentially protective in nature; first, to protect the market against the future conduct of persons whose past conduct as directors of listed companies has shown them to be a threat to the market and, second, as a general deterrence, a warning that reckless or negligent

conduct of a material nature which poses a threat to the market will not be tolerated[20].

154. Wei Xuan was reckless in his conduct. That recklessness was of a serious nature. Nothing emerges from the evidence of any value by way of mitigation.

155. The Tribunal considers a disqualification order of four years to be appropriate.

Application for a 'cease and desist' order

156. Section 257(1)(c) of the Ordinance empowers the Tribunal to order that a person found culpable of market misconduct shall not again perpetrate any conduct which constitutes market misconduct. 'Cease and desist' orders, as they are commonly called, do not shut out the person who is the subject of the order from the financial markets of Hong Kong. Instead, on pain of criminal punishment, they seek to ensure that all future dealings by that person avoid the market misconduct detailed in the order. 'Cease and desist' orders may be made without a time limit.

157. The Tribunal is satisfied that Wei Xuan and Tianhe should both be the subject of such an order. It also agrees with the submission of counsel for the SFC that the order should be broadly worded. In the circumstances, the Tribunal will order that neither Wei Xuan nor Tianhe shall again perpetrate any conduct which constitutes market misconduct.

[20] See SFC v Fung Chiu & Others [2009] 2 HKC 19 at paragraph 12.

158. The Tribunal is satisfied that its orders, including the costs orders set out below, should be registered by the Court of First Instance so that they become for all purposes orders of that court.

Application for costs orders

159. Section 257(1) of the Ordinance gives the discretionary power to the Tribunal to make orders as to costs in respect of persons identified as having engaged in market misconduct –

(a) Pursuant to section 257(1)(e), an identified person may be ordered to pay to the Government such sum as the Tribunal considers appropriate for the costs and expenses reasonably incurred by the government in relation to, or incidental to, the proceedings. These, it appears, are essentially the Tribunal's own costs.

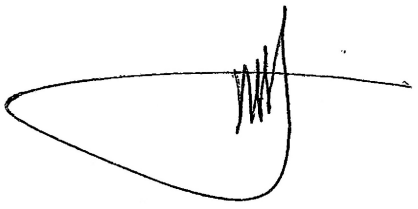
(b) Pursuant to section 257(1)(f)(i), an identified person may be ordered to pay costs to the SFC in such sum as the Tribunal considers appropriate for the costs and expenses reasonably incurred by the SFC in relation to, or incidental to, the proceedings.

(c) Pursuant to section 257(1)(f)(ii), an identified person may be ordered to pay to the SFC such sum as the Tribunal considers appropriate for the costs and expenses reasonably incurred by the SFC arising out of the investigation into the person's conduct prior to the institution of proceedings.

160. The Tribunal sees no reason why it should not make awards in respect of each of these categories. As to the amount of each award, the Tribunal will make its determinations when the required figures are presented to it.

161. In this case, the Tribunal considers it equitable that the order to pay costs should be made against both Wei Xuan and Tianhe, the order being joint and several in its effect.

Mr. Michael Hartmann, GBS
(Chairman)



Mr. Siu Yiu-wo, Clement
(Member)

Ms. Yau Nga-ki, Idy
(Member)

Dated 25 January 2022