



## **Consultation Paper**

### **Possible Reforms to the Prospectus Regime in the Companies Ordinance**

**The following are the views of the Law Society's Securities Law Committee on the proposals in the Consultation Paper:**

#### **1. Proposal 8 – Persons Liable for Prospectus**

##### **Question 8A**

Do you think that prospectus liability should be extended to the issuer and/or offeror of the shares or debentures and the sponsor of an issue (each within the meaning of paragraph 15.7 of the Consultation Paper), as well as to persons who accept, and are stated in the prospectus as accepting, responsibility for the prospectus? Are there any other parties involved in the prospectus preparation or public offering process who in your view should also be subject to the civil liability regime?

**We agree that prospectus liability should be extended to issuers of shares and debentures. However, we disagree with the proposal to extend such liability to sponsors. We would like to reserve comment on the proposal to extend liability to offerors as it is not clear from note 63 to the Consultation Paper whether it is intended that:**

- (i) offerors should be liable only in the circumstances in which they are currently liable under Section 41 Companies Ordinance; or**
- (ii) offerors should be liable in all offers for sale.**

##### **Sponsors**

**The primary responsibility for the accuracy of prospectus information should rest with the issuer and its directors. There is a concern that the proposed extension of sponsor liability would make sponsors (rather than issuers) the primary targets in the event of any litigation. This seems unfair given that the role played by sponsors is to assist the issuer with its listing application and advise it as to the Listing Rules'**

requirements, not to guarantee the information provided by the issuer. The proposal also shifts to sponsors the responsibility of other experts (for example reporting accountants and valuers) for the sections of the prospectus prepared by them.

The Consultation Paper justifies the proposal by the fact that sponsors are able to “*verify the accuracy and completeness of disclosure*”. This is questionable in circumstances where information is deliberately withheld by the issuer, however rigorous the sponsor’s due diligence.

In the United Kingdom the sponsor regime was recently strengthened by amendments to the UK Listing Rules which came into effect on July 1, 2005. Sponsors were not however made liable to investors for prospectus inaccuracies. Sponsors duties under the UK Listing Rules are owed to the Financial Services Authority and breaches of such rules are subject to disciplinary action by the FSA. Likewise in Hong Kong, sponsors’ due diligence obligations are covered by the Listing Rules and any breach of such obligations is subject to the disciplinary procedures of the Hong Kong Stock Exchange. The Securities and Futures Ordinance also imposes liability in respect of misrepresentations made fraudulently, recklessly or negligently to induce the sale of securities.

We doubt that the term “*promoters*” in Section 40 Companies Ordinance covers sponsors as suggested at paragraph 15.5 of the Consultation Paper. Rather, as reflected in Section 40(5) Companies Ordinance, “*promoters*” means persons (other than professionals) who procure the formation of a company. Significantly, the UK Prospectus Rules (Rule 5.5.9) state that a person shall not be responsible for a prospectus by reason only of his giving advice about its contents in a professional capacity. We would argue that in the UK, a sponsor is excluded from liability by virtue of this provision.

#### **Question 8B**

Do you think that liability under the prospectus regime of “*promoters*” and persons who “*authorize the issue of*” a prospectus should be removed?

**The practice of “*promoting*” a company is still common, notably in the PRC. We do not agree that there is justification for removing the liability of such persons where they are party to the preparation of a prospectus.**

#### **Question 8C**

Do you think that the same classes of persons should be subject to both civil and criminal liability for misstatements in prospectuses (with experts liable only in respect of untrue statements in their reports)?

**We agree that civil liability under Section 40 should extend to issuers as well as to those persons currently liable under Section 40. For the reasons set out above, we do not consider that the extension of liability to sponsors is justified.**

**Section 298 SFO imposes criminal liability on anyone disclosing information to induce the purchase of securities where the information is false or misleading as to a material fact and the person knows or is reckless as to whether the information is false or misleading as to a material fact. We would question whether it is necessary to have a separate section in the CO dealing with criminal liability. There is no equivalent to Section 40A Companies Ordinance in the UK Financial Services and Markets Act (“FSMA”). Section 397 FSMA preserves criminal liability for persons knowingly or recklessly making false or misleading statements, dishonestly concealing material facts or intentionally creating a false or misleading impression. We consider that criminal liability should be imposed only where there is intent or recklessness as to whether prospectus information is false or misleading. Under Section 40A, a person has a defence only if he had reasonable grounds for believing that the statement in question was true.**

## **2. Proposal 9 – Misstatements: Persons who may claim compensation**

### **Question 9**

Do you consider that a secondary market purchaser should be able to bring a claim for compensation for loss resulting from an untrue statement in a prospectus?

**We disagree with the proposal that secondary market purchasers should be able to claim compensation under S40 CO. If an investor’s loss is to be recoverable, in accordance with basic legal principles, it should result from the misrepresentation and the investor should have relied on the misrepresentation.**

## **3. Proposal 10 – Misstatements: Reliance on the prospectus**

### **Question 10**

Do you consider that the requirement for claimants to prove that they have actually read and relied on the prospectus when making a claim for compensation under Section 40 of the CO should be repealed?

**For the reasons given in response to proposal 9 above, we disagree with this proposal.**

**4. Proposal 11 – Defence for those liable: due diligence**

**Question 11**

Do you believe that the reasonable belief defence contained in sections 40(2)(d)(i), 40(3)(c) and 40A(1) of the CO should be subject to the requirement that such belief must be founded on all inquiries which were reasonable in the circumstances having been made?

**We suggest that it be made clear that the requisite inquiries should be those which were reasonable in the circumstances existing at the relevant time.**

**5. Proposal 13 – Disclosure for rights issues**

**Question 13**

Do you consider that rights issues and issues of shares and debentures which are uniform in all respects with listed shares or debentures should not be entirely exempt from the contents of the prospectus regime?

**We would question whether an increase in the disclosure requirements for rights issues might discourage such issues to the detriment of the existing shareholders.**

**6. Proposal 15 – Pre-deal research**

**Question 15A**

What are your views on (i) a requirement to publish leaked pre-IPO research by connected analysts coupled with commentary by the company in the prospectus on information that does not already appear in the prospectus; and (ii) a prohibition on the issue of written pre-IPO research reports by connected analysts? If you think there is an alternative way to address the concerns in paragraph 29.8, please describe it.

**A possible alternative would be to restrict the distribution of pre-deal research to “professionals” as defined in Schedule 1 to the SFO and in the Securities and Futures (Professional Investor) Rules.**

**7. Proposal 16 – Supplemental prospectus and right of withdrawal**

**Question 16A**

Do you consider that there should be a statutory obligation on issuers of prospectuses to publish a supplemental or replacement prospectus if they become aware of a significant change affecting any of the prospectus disclosures?

**We support this proposal.**

**Question 16B**

Do you think that this obligation should apply until the close of the offer period of the actual allotment and issue of the applicable shares or debentures?

**For listed issuers, the obligation should apply until the date of listing which is the current requirement under the Listing Rules.**

**The Law Society of Hong Kong  
The Securities Law Committee  
30 November 2005**

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