Resumption toolkit for suspended issuers

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In the past several years, a number of suspended issuers were delisted by the Stock Exchange of Hong Kong as a result of their failure to secure a resumption before the expiry of the 18 months remedial period.

In this article, Joseph Chu, Mike Suen and Alex Ye will discuss some practical guidance about seeking a resumption of trading.

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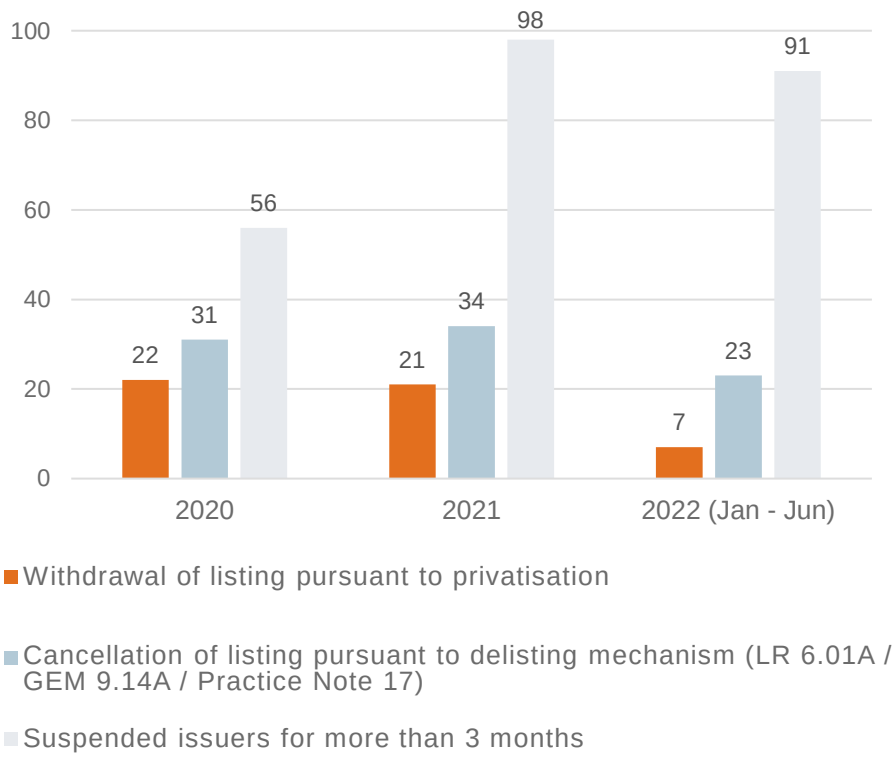
Introduction

This document will provide some practical guidance to the suspended issuers whose shares have been suspended from trading on the Stock Exchange of Hong Kong (the "**Exchange**") and who are committed to seek a resumption of trading.

Delisting mechanism

Rule 6.01A(1) of the Listing Rules allows the Exchange to delist a suspended issuer which fails to resume trading within 18 months after the date of suspension.

In the past several years, a number of suspended issuers were delisted as a result of their failure to secure a resumption before the expiry of the 18 months remedial period.



The 18 months remedial period is a hard deadline for resolution of the issues giving rise to a suspension and for a resumption of trading – the deadline will only be extended by the Listing Committee under exceptional circumstances.

Prolonged suspension

Trading of shares in issuers could be suspended from trading, either voluntarily at the request of the issuers, or at the direction of the regulators (the Exchange and SFC).

The period of suspension should, in theory, be kept as short as possible – the reason is that "*a continuation of suspension denies reasonable access to the market and prevents its proper functioning*" (LR6.05).

If the issuer has any issues that may affect the suitability of the issuer or its business for continued listing, the likelihood is that the issuer will not be able to achieve resumption unless the issues are properly addressed to the satisfaction of the Exchange. This would, very often, lead to a prolonged suspension.

Suitability for listing depends on many factors. The Exchange has a broad discretion to interpret and apply the concept of suitability for the purpose of maintaining market confidence. If the Exchange is of the view that an issuer or its business is no longer suitable for listing, it will delist the issuer.

GL95-18 and GL96-18 set out various examples of situations where the Exchange would have concerns over an issuer's suitability for continued listing:

- Companies with no sufficient operation or assets
- Material breach of the rules
- Inability to disclose material information
- Non-compliance with laws and regulations
- Suitability issues concerning directors or person with substantial influence
- Fraud
- Material internal control failure
- Failure to maintain a sufficient public float
- Disclaimer and adverse audit opinion on financial statements

What should a suspended issuer do?

Within the first 3 months of the suspension of trading, the Exchange will issue resumption conditions/ guidance to the issuer, setting out the requirements that the issuer must fulfil before trading can be resumed.

The specific conditions/ guidance would generally depend on the matters that gave rise to the suspension.

Below are examples of specific resumption conditions/ guidance that may be imposed by the Exchange:

A forensic investigation of the material irregularities

In cases where allegations of potential irregularities or fraudulent activities are raised against the listed issuers, their officers and/or business, the suitability of the issuers and their officers would be called in question, and an independent forensic investigation would become necessary.

To avoid any potential conflict of interest, generally speaking, an independent board committee ("**IBC**") will be established for the independent investigation. The IBC will be responsible for commissioning a forensic investigation expert to review matters. It will report to the board of directors on the findings of the investigation and their recommendations.

Forensic investigation expert has an important role to play in the process. The expert will need to properly determine the scope of the investigation in consultation with the IBC, its advisors and the auditors; to take appropriate steps and use appropriate tools to investigate the issues; to prepare a report to be submitted to the IBC; and to answer questions that the IBC, its advisors and the regulators may have about their investigation.

Depending on the facts of each case, a forensic investigation could take months to complete.

Following the forensic investigation, the issuer will need to disclose the key findings in an announcement together with the views of the IBC and to address any issues identified in the forensic investigation.

Publication of all outstanding financial statements

Shareholders and potential investors must be given all necessary information to enable them to make an informed investment decision.

Therefore, a failure to disclose material information by an issuer will raise an issue about the suitability for continued listing.

Every year, a number of listed issuers were suspended as a result of their failure to publish their financial results "*not later than three months after the end of the financial year*" as required by the Listing Rules.

This might be due to auditors not being able to complete the audit in time due to external factors (for example, COVID, travel restrictions), disagreements between the company and the auditors over certain material issues (for example, scope of the audit procedures, timetable for completion of the audit), or a resignation of the auditor.

If an auditor resigns, the issuer is required to disclose matters which the auditor considers necessary to be brought to the attention of the shareholders in an announcement. The issuer should appoint a replacement auditor promptly and should address all audit issues raised by the auditor. The replacement auditor will need to pay particular attention to the issues raised by the former auditor in their resignation letter.

Addressing audit qualifications

In cases where the auditor comes to a view that the financial statements are not free from material misstatement (or is unable to obtain sufficient appropriate audit evidence), the auditor may issue one of the three types of modified opinions, namely a qualified opinion, an adverse opinion or a disclaimer of opinion.

A disclaimer opinion will generally be given where the auditor could not obtain sufficient and appropriate audit evidence with pervasive effect; an adverse opinion is an opinion that a company's financial statements contain material and pervasive misstatements.

By LR 13.50A, the Exchange will require suspension of trading if the auditor has issued or has indicated that it will issue a disclaimer opinion or adverse opinion.

The suspension will remain in force until the issuer has addressed the issues giving rise to the disclaimer or adverse opinion, or has provided comfort that a disclaimer or adverse opinion would no longer be required. This could normally be achieved by a full year audit (or a special interim audit) of the issuer's financial statements, or a special engagement of the auditor to perform audit on a single financial statement of the issuer.

Demonstrating sufficient operations and assets

LR 13.24 provides that: "*An issuer shall carry out, directly or indirectly, a business with a sufficient level of operations and assets of sufficient value to support its operations to warrant the continued listing of the issuer's securities*".

The purpose of LR13.24 is "*to maintain overall market quality*".

Issuers that fail to meet this rule may be "*blue sky companies*" that would attract speculation on their possible acquisitions in the future and lead to opportunities for market manipulation, insider trading and unnecessary volatility in the market which are not in the interest of the investing public.

The question of whether an issuer maintains "*a sufficient level of operations*" and "*assets of sufficient value*" is not a "*counting*

exercise" under which the assets and revenue of the issuer are measured against a quantitative or comparative benchmark.

The touchstone is whether the issuer can demonstrate, by reference to its level of operations and assets, that it has a viable and sustainable business so as to warrant continued listing. The test of viability and sustainability is a qualitative one and is a matter of professional judgment for the Exchange. The applicable authority is the Court of Final Appeal case of *Sanyuan Group Ltd v. The Stock Exchange of Hong Kong* (FAMV52/2009), which was recently applied by the Court of Appeal in *China Trends Holdings Ltd v. The Stock Exchange of Hong Kong Limited* [2021] 3 HKLRD 554.

As explained in GL106-19, issuers with the following characteristics would generally be considered by the Exchange not to have a viable and sustainable business: (1) issuers with minimal operations (for example, resulting from a discontinuance of its principal business, or a continual deterioration of the issuer's business); (2) issuers disposing its core business; (3) issuers losing its major operating subsidiaries or becoming insolvent; (4) the issuer's business model lacking business substance; (5) the issuer's new business having limited historical track record.

To demonstrate compliance of LR13.24, an issuer should make proper disclosure of its business affairs, the status of its operations and financial performance.

Management integrity

Directors are responsible for the management and operation of the issuer.

Hence, any incident casting doubts on a director's character or integrity would be serious matters that would be relevant to the suitability issue.

Matters or allegations concerning management integrity must be properly and thoroughly investigated. Not only this is fair to the individuals, but is also important to the issuers as this will enable them to demonstrate to the Exchange that no officers of the issuer would pose any risk to shareholders and investors or damage market confidence.

Adequate and appropriate internal control

Material internal control failure is detrimental to the interests of shareholders and the fair, orderly and informed market for trading of securities.

The board of directors has a duty to ensure that the issuer establishes and maintains appropriate and effective risk

management and internal control systems on an on-going basis.

To demonstrate the adequacy of the internal control system, the issuer would generally need to engage an independent internal control consultant to review its internal control system. If any material internal control deficiencies are identified, prompt steps must be taken to remedy them.

When the issuer considers that it has complied with all the resumption conditions/ guidance, it should seek a confirmation from the Exchange. Trading will only resume after the Exchange gives the confirmation.

Practical points to note

Based on our experience in advising suspended issuers on resumption, three practical points should be noted:

First, careful planning and precise and speedy implementation of the action points are required. There is no time to waste.

Second, the resumption process is a difficult, time-consuming and expensive process. The issuer would need supports from professional advisors (such as forensic investigation experts, internal control consultants, financial advisors, auditors and lawyers), a dedicated management team and the stakeholders (such as shareholders, business partners and creditors). It is recommended that professional advice be sought at an early stage.

Third, a resumption of trading is unlikely to be the end of the matter. The regulators will investigate wrongdoings identified during the entire process and will punish the wrongdoers; the issuer will need to take action to recover losses and damages from the wrongdoers. Therefore, when seeking resumption, one should not overlook potential regulatory and legal risks, and should, insofar as it is possible, seek to mitigate them.

A final note: before travelling back in time to gather the infinity stones, Steve Rogers said to the Avengers: "*You know your teams, you know your missions. Get the stones, get them back. One round trip each. No mistakes. No do-overs.*"

These remarks to the Avengers are also the key practical guidance to suspended issuers and their professional advisers when it comes to seeking a resumption of trading.

You know your teams, you know your missions. Get the stones, get them back. One round trip each. No mistakes. No do-overs.

Steve Rogers

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