REPORT OF THE MARKET MISCONDUCT TRIBUNAL OF HONG KONG

on whether a breach of the disclosure requirements has taken place

in relation to the listed securities of

Health and Happiness (H&H) International Holdings Limited
(formerly known as Biostime International Holdings Limited)

(Stock Code 1112)

and other related questions

The Report of the Market Misconduct Tribunal on whether a breach of the disclosure requirements has taken place in relation to the listed securities of

Health and Happiness (H&H) International Holdings Limited
(formerly known as Biostime International Holdings Limited)

A report pursuant to section 307(J)1(a) and (b) of the Securities and Futures Ordinance, Cap. 571

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CHAPTER 1

OVERVIEW

The issue of the SFC Notice

1. On 16 November 2018, the Market Misconduct Tribunal ("the Tribunal") received a notice from the Securities and Futures Commission ("the SFC") requiring the Tribunal to conduct proceedings in order to determine whether there had been a breach of the disclosure requirements within the meaning of sections 307B and 307G of Part XIVA of the Securities and Futures Ordinance, Cap 571 ("the Ordinance"). The Notice issued by the SFC is attached to this report marked Annexure "A".

The Specified Persons

2. One incorporated body and one individual were specified by the SFC in the Notice as being subject to inquiry. They were:

(a) Health and Happiness (H&H) International Holdings Limited ("the Company"), a company listed on the Main Board of the Stock Exchange of Hong Kong, principally engaged in the manufacture and sale of pediatric nutritional and baby care products for the Mainland market; and

(b) Luo Fei, the Chairman, Chief Executive Officer and an executive director of the Company ("Mr Luo")

Relevant provisions of the Ordinance

3. Section 307B of the Ordinance lays down a listed corporation's disclosure requirements, namely, as soon as reasonably practicable after any 'inside information' has come to its knowledge, to disclose that information to the market. The subsection reads:

> "(1) A listed corporation must, as soon as reasonably practicable after any inside information has come to its knowledge, disclose the information to the public.
>
> (2) For the purposes of subsection (1), inside information has come to the knowledge of a listed corporation if–
>
> (a) information has, or ought reasonably to have, come to the knowledge of an officer of the corporation in the course of performing functions as an officer of the corporation; and
>
> (b) a reasonable person, acting as an officer of the corporation, would consider that the information is inside information in relation to the corporation."

4. The concept of 'inside information' is well established. In the present context, it is specific information about a listed corporation that is not generally known to the persons accustomed to, or likely to, deal in the listed securities of the corporation but would, if generally known to them, be likely to materially affect the price of those securities. Section 307A(1) defines 'inside information' as follows:

> "Inside information, in relation to a listed corporation means specific information that–

(a) is about–

(i) the corporation;

(ii) a shareholder or officer of the corporation; or

(iii) the listed securities of the corporation or their derivatives; and

(b) is not generally known to the persons who are accustomed or would be likely to deal in the listed securities of the corporation but would if generally known to them be likely to materially affect the price of the listed securities".

5. Section 307C prescribes the manner in which inside information must be disclosed, namely, that it must be made in a manner that enables the market to have equal, timely and effective access to that inside information. The subsection reads:

"(1) A disclosure under section 307B must be made in a manner that can provide for equal, timely and effective access by the public to the inside information disclosed.

(2) Without limiting the manner of disclosure permitted under subsection (1), a listed corporation complies with that subsection if it has disseminated the inside information required to be disclosed under section 307B through an electronic publication system operated by a recognized exchange company for disseminating information to the public."

6. Section 307G lays down the circumstances in which an officer of a listed corporation – an officer including a director or manager – will be held to be

in breach of the disclosure requirements. This includes a failure generally to take reasonable measures to ensure that effective safeguards exist. The subsection reads:

> "(1) Every officer of a listed corporation must take all reasonable measures from time to time to ensure that proper safeguards exist to prevent a breach of a disclosure requirement in relation to the corporation.
>
> (2) If a listed corporation is in breach of a disclosure requirement, an officer of the corporation–
>
> (a) whose intentional, reckless or negligent conduct has resulted in the breach; or
>
> (b) who has not taken all reasonable measures from time to time to ensure that proper safeguards exist to prevent the breach,
>
> is also in breach of the disclosure requirement."

The Mandate given to the Tribunal

7. The Tribunal was required by the Notice to conduct proceedings in order to determine the following, namely–

> (a) whether a breach of the disclosure requirements had taken place; and, if so,
>
> (b) the identity of any person found to be in breach of those requirements.

The factual background

8. The factual basis upon which the SFC directed that an inquiry should take place is set out in detail in the Notice itself. In addition, during the course of proceedings, the parties were able to settle an agreed statement of facts. The following, however, as the Tribunal understands it, constitutes a broad overview–

(i) Shortly before 23 June 2015, the consolidated management accounts of the Company and its subsidiaries became available. These accounts revealed a significant deterioration in the Company's financial performance when compared with the corresponding period for the year before, that is, when compared with the corresponding period in 2014. Among other matters, the accounts revealed the following:

(a) A drop in revenue by 48.9% in May 2015 when compared with the revenue in May 2014;

(b) A drop in revenue by 13.7% in the first five months of 2015 when compared with the revenue in the first five months of 2014;

(c) A loss after tax of HK$45.9 million in May 2015, compared with a profit after tax of HK$19.2 million in May 2014; and

(d) A decrease in profit after tax by 28.9% in the first five months of 2015 when compared with the profit in the first five months in 2014.

(ii) When compared with the Company's financial performance in the first five months of 2014, the significant year-on-year deterioration in the corresponding period in 2015 was due to its performance in one month – the month of May 2015 – in that:

(a) There was a drop in revenue by 54.5% in May 2015 when compared with the revenue in April 2015; and

(b) There was a loss after tax of HK$45.9 million in May 2015, compared with a profit after tax of HK$82.5 million in April 2015.

(iii) The Notice issued by the SFC said that Mr Luo became aware the Company's position on or about 23 June 2015 when he received an email from the Financial Reporting Manager bearing the endorsement: 'Key performance data'.

(iv) However, a Profit Warning was not released to the market until 23 July 2015. There was therefore a delay of 30 days in informing the market of the significant deterioration in the Company's financial performance.

(v) As to the nature of the information that was withheld from the market, the SFC asserted that it constituted 'inside information' in that it was specific information about the Company that was not generally known to the persons who were accustomed to, or would be likely to, deal in the listed

securities of the Company but would, if generally known to them, have been likely to materially affect the price of the securities.

(vi) In this regard, the Notice asserted that following the publication of the Profit Warning, the share price of the Company on 24 July 2015 traded between $16.90 and $18.90 per share, and closed at $16.94 per share. The closing price represented a decrease of 21.6% when compared with its closing price on 23 July 2015, on an increased trading volume from 2.8 million shares on 23 July 2015 to over 19.4 million shares on 24 July 2015.

(vii) It was not disputed that Mr Luo, as Chairman and Chief Executive Officer, was the officer of the Company principally responsible for ensuring disclosure of inside information to the market as soon as reasonably practical. In light of this, it was the SFC's allegation contained in the Notice that both the Company and Mr Luo were in breach of the disclosure requirements contained in the Ordinance.

Circumstances surrounding the delay in disclosure

9. As to how it was that a delay of 30 days was occasioned, it needs to be emphasised at the outset that at all material times procedures were in place in the management systems of the Company to ensure that inside information was shared with the market without delay. Those systems were functioning satisfactorily.

10. It further needs to be emphasised that, when the inside information was generated, Mr Luo, in his capacity as Chairman and Chief Executive Officer of the Company, came to know of it without delay and it is accepted that he gave it due consideration. The decision to withhold the information from the market was therefore a considered decision, not one brought about by a lack of appropriate systems or by reckless conduct. As the Tribunal understands it, Mr Luo's culpability, and that of the Company, is to be found instead in his failure to exercise his decision-making discretion with an appropriate understanding of all relevant factors considered in the light of the Company's obligations under the Ordinance.

11. The circumstances in which Mr Luo came to make the decision to withhold the relevant information from the market may be summarised as follows:

(a) Over the first five months of 2015 there had been a material year-on-year deterioration in the Company's financial performance. That deterioration was due almost entirely to the Company's poor performance in the last month of that five-month period, that is, in May 2015. Over the first four months of 2015, there had been no significant decrease in net profit: to the contrary there had been an increase. However, in May 2015 there had been a year-on-year drop in revenue of 48.9% and a loss after tax of HK$45.9 million compared to a profit after tax in May 2014 of HK$19.2 million.

(b) Records of earlier fluctuations, however, had shown that it was not unusual for the Company's financial performance in April and May to be lacklustre but for the performance to show significant recovery in June. By way of example, in

May 2014 the Company had made a net profit of some RMB 19 million but a very materially increased net profit in the following month, that is, in June 2014, of RMB129 million.

(c) In addition, the financial forecast given to the board of the Company at its meeting on 14 May 2015 projected an increase of 6.3% in revenue and an increase of 4.1% in net profits for the first half of that year compared to the same period in 2014.

(d) It should also be said that, as at 23 June 2015, Mr Luo did not have the benefit of updated financial forecasts which would have given him a more accurate, that is, a more informed picture of the likelihood that the Company's results for the first half of 2015, instead of showing increased profits, would in fact show a continued deterioration in the Company's finances.

(e) In light of these matters, the decision was made not to divulge the materially decreased financial performance of the company for the first five months of 2015 but to wait for a period of approximately a month in the hope that better figures would be placed before the Board at its meeting in July 2015. That hope was not realised. The finances of the company showed a continuing poor performance.

(f) In the result, at its meeting in July, the decision was made by the board to issue a profit warning without further delay.

(g) In summary, using layman's language, it had been hoped that the May 2015 figures had constituted a single aberration and that the June 2015 figures would correct that aberration, presenting a far more positive set of figures. That hope, however, had not been founded on solid ground and had sought to circumvent the disclosure responsibilities contained in the Ordinance. Mr Luo had been negligent in his decision-making.

CHAPTER 2

PROCEEDINGS LEADING TO AGREEMENT AS TO CULPABILITY AND SANCTIONS

The preliminary conferences

12. In respect of the Tribunal's inquiry, on 30 January 2019, the Chairman, sitting alone, held a preliminary conference. The SFC was represented by Derek Chan SC, Presenting Officer. The Specified Persons were both represented by Victor Dawes SC and Peter Dong. During the course of this first preliminary conference, the Chairman was informed that the parties were in discussion to see if it was possible to avoid a contested hearing. The parties were of the opinion that they would require until about mid-April to conclude their discussions. In the result, the proceedings were adjourned to 16 April 2019.

13. At the second preliminary conference the Chairman was informed by the parties that they had been able to agree the relevant facts[1]. These facts were set out in a written statement – the 'Statement of Agreed Facts'- which had been signed by or on behalf of all the parties. A copy of the Statement of Agreed Facts is attached to this report marked Annexure "B".

14. It was accepted by the parties that the Statement of Agreed Facts demonstrated that the Company and Luo were both culpable.

15. The requirement to disclose inside information in a timely and effective manner is essential to maintaining the integrity of the market. In this regard, the

[1] This was with the exception of one issue which did not go to the fact of culpability and was later agreed.

"Guidelines on Disclosure of the Inside Information" published by the SFC state that:

> "8. The statutory requirements to disclose inside information are central to the orderly operation and integrity of the market and underpin the maintenance of a fair and informed market.
>
> 9. To comply with the obligations, corporations should consider their own circumstances when deciding whether any inside information arises and how it should be disclosed properly to the public. Disclosure should be made in a manner that provides for equal, timely and effective access by the public to the information disclosed." [emphasis added]

16. In the present case, while the Company, after taking legal advice, did make disclosure to the market, it was accepted that such disclosure should have been made earlier. Put another way, it was accepted that the inside information in the possession of the Company was not made as soon as reasonably practical. There was a delay of 30 days – effectively one month – before, the inside information was shared with the market.

17. Having considered the nature and import of the Agreed Facts, the Tribunal was satisfied that both the Company and Mr Luo had breached the disclosure requirements contained in the Ordinance.

18. The matter of culpability having been determined by the Chairman alone, it was agreed that he would also determine the issue of appropriate sanctions alone.

19. At the hearing held on 25 June 2019 to consider the issue of sanctions, the parties, having agreed together, proposed to the Tribunal that the two following orders would be appropriate, namely that–

i. Pursuant to s. 307N(1)(d) of the Ordinance, an order that the Company and Luo shall each pay to the Government a regulatory fine of HK$1,600,000. The maximum regulatory fine that may be imposed is HK$8,000,000.

ii. Pursuant to s. 307N(1)(i) of the Ordinance, an order that Luo undergo a training programme approved by the SFC on duties of compliance, directors' duties and corporate governance.

20. It was further agreed that the Specified Persons should be liable to pay costs. In this regard it was agreed that two orders should be made; first, an order that the Company and Mr Luo be jointly and severally liable to pay to the Government the costs and expenses reasonably incurred by the Government in relation or incidental to the proceedings before the Tribunal, this being pursuant to section 307N(1)(e) of the Ordinance and, second, an order that they be jointly and severally liable to pay to the SFC the costs and expenses reasonably incurred in relation or incidental to its investigation and the proceedings before the Tribunal, this being pursuant to section 307N(1)(f)(i)-(iii).

21. This was not the first time that an agreement between the parties as to appropriate sanctions had been put before the Tribunal for endorsement[2]: see for example, the Report in respect of *Fujikon Industrial Holdings Limited* dated 22 May 2019.

22. The Tribunal, of course, was not bound by any such agreement between the parties. In the exercise of its supervisory jurisdiction, it was first for the Tribunal, looking to all the facts and circumstances, such circumstances to include aggravating and mitigating factors, to be satisfied that the agreed sanctions fell

[2] The Tribunal presumes that the agreement as to sanctions was put before the Tribunal pursuant to section 33 of Schedule 9 of the Ordinance.

within an ambit of discretion that the Tribunal itself would consider appropriate to impose.

23. Having had the opportunity to consider the written submissions of counsel representing both the SFC and the two Specified Persons, and having had the benefit of oral submissions[3] at the sanctions hearing itself, the Tribunal was able at that hearing to confirm that it considered the proposed sanctions, including the proposed orders as the costs, to be appropriate and relevant orders were made orally. Those orders are attached to this Report marked Annexure "C".

Looking to the appropriate sanctions

24. As it was put by the Presenting Officer, the information which was not disclosed in a timely fashion related to a substantial decrease in revenue and profit of the Company. There was therefore a substantial breach. The investing public was entitled to be made aware of the material change in the company's financial position as soon as reasonably possible after it came to the Company's knowledge, more especially as earlier announcements had given the impression that 'all was well'.

25. As it was further put by the Presenting Officer, during the 30 days of delay investors who purchased shares in the Company were denied material information about it and thereby bought shares at prices higher than would likely to have otherwise been the case. In this regard, an expert opinion obtained by the SFC calculated that the notional losses amounted to an aggregate sum of HK$198,208,154. It was suggested that a notional loss of this magnitude could

[3] In support of the submissions, counsel made reference to a number of previous reports of the Market Misconduct Tribunal, assisting the Tribunal with a full breakdown of the sanctions imposed and the factors relevant to their imposition. The reports put before the Tribunal were the following: The *Report on Yorkey Optical International (Cayman) Limited* (dated 27 February 2017); the *Report on Mayer Holdings Limited* (dated 5 April 2017); the *Report on Fujikon Industrial Holdings Limited* (dated 22 May 2019) and the *Report on AcrossAsia Limited* (dated 29 November 2016).

not be ignored and hence the proposed regulatory fine of HK$1,600,000 for each of the Specified Persons.

26. In response, counsel for the Specified Persons argued that the notional loss had not been correctly calculated and, so it was argued, was far too high. Nevertheless, in light of the overall nature and extent of the sanctions proposed, the quantum of the regulatory fines was not disputed.

27. In addition to the factors just outlined, the Tribunal took account of the following matters that were essentially mitigatory in nature -

(a) For both Specified Persons this was a first time offence; neither had been found culpable of any previous market misconduct.

(b) The Company was at all times aware of the requirements under the Ordinance concerning the timely disclosure of inside information; internal protocols were in place. In this regard, by way of illustration, in February 2015 the Company had approved a standard in accordance with which profit warnings and/or announcements of positive profit forecasts needed to be made.

(c) As it was, in respect of the parties' admitted culpability, the fault lay not in a failure to make disclosure but in a failure instead to make such disclosure in a timely manner. As indicated earlier in this report, disclosure was made by the company but after a delay of some 30 days.

(d) Once that fault was identified, it is accepted that the specified persons cooperated fully in the investigations and accepted their culpability at a very early stage of proceedings before the Tribunal. In this regard, as mentioned earlier in this report, at the very first preliminary conference the Tribunal was informed that negotiations were taking place to settle the issue of liability.

(e) Importantly, while there was a failure to divulge the inside information as soon as reasonably practicable, it has never been suggested that Mr Luo, the Chairman and Chief Executive Officer of the Company, acted in bad faith.

(f) No suggestion has been made that Mr Luo profited personally from the delay.

(g) Nor indeed has it been suggested that he acted recklessly. What was alleged, and what was agreed, was that Mr Luo had been guilty of negligent conduct. He believed that the figures constituting the inside information - focused essentially on performance in the month of May 2015 - were an aberration, a 'one-off' that did not reflect the underlying financial health of the Company and would be corrected in the following month. Nor can it be said that it was an entirely reckless hope; past figures gave him some comfort although, as it transpired, it was a cold comfort.

28. In light of these factors, and particularly having regard to the central role of Mr Luo, the Tribunal was satisfied that an order pursuant to section

307N(1)(i)[4] of the Ordinance requiring Mr Luo to undergo a training programme approved by the SFC concerning directors' duties, duties of compliance and corporate governance was entirely appropriate.

29. The Tribunal was further satisfied that, in light of all relevant factors, a regulatory fine was appropriate. The disclosure requirements of the Ordinance had to have some teeth. Section 307N(1)(d) of the Ordinance provides that a listed corporation and a director or chief executive may be ordered to pay a regulatory fine not exceeding HK$8,000,000.

30. Section 307N(3) of the Ordinance directs that a regulatory fine may not be imposed unless it is proportionate and reasonable in relation to the breach of the disclosure requirements. For that purpose, it is provided that the Tribunal may take into account a number of matters including whether the conduct was intentional, reckless or negligent; whether that conduct benefited the culpable individual and the degree to which the conduct may have damaged the integrity of the market.

31. In light of these matters, the Tribunal was drawn to the conclusion that a regulatory fine of HK$1,600,000 for the Company and Mr Luo was appropriate.

Should there have been further sanctions?

32. On behalf of the Specified Persons, it was submitted that the SFC had been clearly right in not pursuing other additional orders; for example, a disqualification order, a cold shoulder order, a cease-and-desist order or an order

[4] The subsection states as follows:

"if the person is an officer of a listed corporation, any order that the Tribunal considers necessary to ensure that the officer does not again perpetrate any conduct that constitutes a breach of a disclosure requirement including, but not limited to, an order that the officer undergo a training program approved by the Commission [the SFC] on compliance with this Part, directors' duties and corporate governance."

appointing an independent professional adviser. This was especially so as, first, there had been an early admission of liability and cooperation with the authorities; second, there had all times been procedures in place to ensure compliance with the disclosure requirements and this had been a single oversight; third, there was no allegation of reckless or intentional conduct. It was pointed out that invariably disqualification orders, for example, are only imposed where there has been reckless or intentional behaviour on the part of senior management.

33. In light of the fact that no further sanctions were sought by the SFC, and there being, in the opinion of the Tribunal, nothing to suggest that this limitation was clearly wrong, either in fact or law, the Tribunal accepted that the two forms of sanction were sufficient.

Ancillary matters

34. The Tribunal's orders were duly registered in the Court of First Instance three days later, that is, on 28 June 2019, pursuant to sections 307S and 264 of the Ordinance.

35. At the sanctions hearing held on 25 June 2019, it was recognised that, as the Chairman of the Tribunal was that time engaged in conducting a lengthy Commission of Inquiry, the preparation of this Report would have to be delayed. Regrettably, the later onslaught of the COVID pandemic with the resulting regime of 'lock downs' exacerbated that delay.

Mr. Michael Hartmann, GBS

(Chairman)

Dated 5 February 2021