Enforcement News

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25 September 2008

SFC seeks disqualification and compensation orders against former and current directors of Rontex International Holdings

The Securities and Futures Commission (SFC) has commenced proceedings in the High Court to seek disqualification and compensation orders against the current chairman, Mr Cheung Keng Ching, a current executive director, Ms Chou Mei, and a former executive director, Mr Lau Ka Man Kevin, of Rontex International Holdings Ltd (Rontex), a Hong Kong-listed company engaged in the trading of garments and premium products.

The SFC alleges that the three directors:

- breached their fiduciary duty and/or duty of care owed to Rontex;
- failed to ensure Rontex fully complied with disclosure requirements under the Listing Rules; and
- failed to exercise reasonable skill, care and diligence in entering into a number of transactions, resulting in Rontex suffering losses and damages of about $19 million.

According to the SFC's case, the alleged breaches are centred on four investments involving:

- the acquisition of 3.62 million shares in Grandtop International Holdings Ltd, a company listed on the Stock Exchange of Hong Kong, for $9.263 million, which represented an unjustifiable premium of 45% over the prevailing market price for such shares;
- the acquisition of $15 million in options for shares in Macau Asia Investments Ltd, a United States-incorporated company listed as a Pink Sheet stock on the American Stock Exchange;
- three payments totalling $27.7 million to a Mainland Chinese citizen named Wan Lin; and
- an investment of $8.454 million in Beijing Kut Ka Lok Fashion Apparels Ltd.

The SFC alleges Rontex suffered losses and damages of about $19 million as a consequence of the alleged misconduct by the three directors. The SFC is seeking orders that the three directors be disqualified as company directors and that they pay compensation to Rontex.

This is the second case this month in which the SFC has sought court orders to commence compensation proceedings by a listed company against company directors for alleged misconduct (Note 2).

The High Court is scheduled to hear the petition on 12 November 2008. A summary of the transactions and the allegations is posted on www.sfc.hk.

End

Notes:

1. Rontex was listed on the main board of the Stock Exchange of Hong Kong Ltd on 8 November 2002. The company is involved in garments and premium products trading.
2. Under section 214 of the Securities and Futures Ordinance, the court may make orders disqualifying a person from being a company director or being involved, directly or indirectly, in the management of any corporation for up to 15 years, if he or she is found to be wholly or partly responsible for the company's affairs having being conducted in a manner involving defalcation, fraud or other misconduct. The court may also order a company to bring proceedings in its own name against any person specified in the order. The SFC made the first application for a compensation order against former and current executives of Styland Holdings on 9 September 2008 (Please see press release on www.sfc.hk).

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SFC's Allegations against Respondents

(an extract from the SFC's Petition filed with the Court)

1. At all material times Mr. Cheung Keng Ching ("1st Respondent"), Ms. Chou Mei ("2nd Respondent") and Mr. Lau Ka Man, Kevin ("3rd Respondent") (collectively "the Directors") were the only executive directors of the Company and thus in control of the Company.

2. The 3rd Respondent resigned from his position as an executive director of the Company on 2nd November 2005. The 1st and 2nd Respondents remain as executive directors of the Company as of the date of this Petition.

3. According to the Prospectus and the Company's Annual Reports 2003, 2004 and 2005, the division of labour between these three executive directors at all material times was as follows:-

   (1) The 1st Respondent, the founder of the Group and the Chairman of the Company, was responsible for overall business strategy and merchandising functions of the Group;

   (2) The 2nd Respondent, the wife of the 1st Respondent and co-founder of the Group, was responsible for the procurement functions of the Group; and

   (3) The 3rd Respondent was responsible for the financial management and

corporate finance matters of the Group.

4. At all material times, each of the 1st, 2nd and 3rd Respondents owed to the Company and the Group the fiduciary duty to act in good faith and in the best interest of the Company and the Group. Further, each of them also owed to the Company and the Group the duty of care at common law to exercise due and reasonable skill, care and diligence in the course of acting as the executive directors of the Company.

5. In order to act as the directors of the Company, each of the 1st, 2nd and 3rd Respondents were required to and did sign a formal declaration and undertaking *as per* Form B of Appendix 5 to the Rules Governing the Listing of Securities on the SEHK (the "Listing Rules") whereby each of them undertook that they would in the exercise of their powers and duties as directors of the Company comply and procure the Company to comply with, *inter alia*, the Listing Rules from time to time in force.

6. Under Rule 3.08 of the Listing Rules, each of the directors of the Company, both collectively and individually, was required to discharge their fiduciary duties and duties of skill, care and diligence to a standard at least commensurate with the standard established by Hong Kong law and was further required to, *inter alia*, (i) act honestly and in good faith in the interest of the Company as a whole, (ii) act for proper purpose, (iii) be answerable to the Company for the application or misapplication of its assets, and (iv) apply

such degree of skill, care and diligence as may be reasonably be expected of a person of his knowledge and experience and holding his office within the Company.

Summary of the Questionable Transactions carried out by the Company

7. Based on the evidence obtained from an investigation by the SFC under Section 179 of the SFO, it appears to the SFC that there were a number of transactions entered into by the Company and/or the Company's subsidiaries within the Group which constituted (i) breaches of fiduciary duty and/or common law duty of care owed by the 1st, 2nd and 3rd Respondents to the Company, (ii) conduct unfairly prejudicial to the interest of the members of the Company and/or (iii) breaches of the Company's disclosure obligations under the Listing Rules. These questionable transactions took place between November 2002 and November 2005 when the 1st, 2nd and 3rd Respondents acted as the only executive directors of the Company.

8. There were four questionable transactions in question and they are summarised as follows:-

(1) **Transaction 1**: The acquisition of a total of 3.62 million shares of Grandtop International Holdings Limited ("Grandtop"), a company listed on the SEHK, for a total consideration of HK$9,263,121 between December 2003 and January 2004;

(2) **Transaction 2**: The acquisition of a HK$15 million option for shares in Macau Asia Investments, Limited ("MAIL"), a US incorporated company listed as a Pink Sheet stock on the American Stock Exchange ("ASE") in about January 2004;

(3) **Transaction 3**: Payments to a PRC citizen called Wan Lin ("Wan") in the sum of HK$18.2 million in late 2002 and in the sums of HK$3 million and HK$6.52 million in early 2005;

(4) **Transaction 4**: Investment in the sum of HK$8.454 million in Beijing Kut Ka Lok Fashion Apparels Limited ("KKL Fashion") in about August 2004.

Transaction 1: Acquisition of Grandtop Shares

9. At all material times, Grandtop was a company listed on the SEHK. Between December 2003 and January 2004, the Company acquired a total of 3,620,000 shares of Grandtop ("Grandtop Shares") in three lots: (a) the first lot of 2,200,000 Grandtop Shares were acquired on or about 22nd December 2003, (b) the second lot of 1,170,000 Grandtop Shares were acquired on or about 27th January 2004, and (c) the third lot of 250,000 Grandtop Shares were acquired on or about 28th January 2004.

SFC's Investigation regarding the Initial Acquisition of 2,200,000 Grandtop Shares

10. Regarding the acquisition of the first lot of 2,200,000 Grandtop Shares, the

Company acquired the shares directly from two individuals and thereafter deposited the shares in an account (the "Securities Account") maintained with Ever-Long Securities Company Limited ("Ever-Long") in the name of Keen Choice Technology Limited ("Keen Choice"), which is and was at all material times one of the wholly owned subsidiaries of the Company within the Group.

11. According to two sets of bought and sold notes both dated 22nd December 2003, Keen Choice purchased 1,400,000 Grandtop Shares from Madam Chan Jenny Chun Nei ("Chan") and 800,000 Grandtop Shares from Mr. Lau Pak Lun at a price of HK$2.00 per share. For this purpose, a board minute dated 22nd December 2003 was signed by 1st and 2nd Respondents approving the acquisition of 2,200,000 Grandtop Shares at the total consideration of HK$4,400,000 (i.e. HK$2.00 per share).

12. Notwithstanding that the purchase price for the 2,200,000 Grandtop Shares set out in the said bought and sold notes and the said board minute was HK$2.00 per share, the internal accounting records of the Company prepared by the 3rd Respondent (the "Internal Records") reveals that the said 2,200,000 Grandtop Shares were in fact purchased at a consideration of HK$2.90 per shares at a total cost of $6,380,000 (before transaction costs).

13. The SFC believes that the purchase price of HK$2.90 per share for the said 2,200,000 Grandtop Shares set out in the Internal Records of the Company

was the actual price paid because it was found to be entirely consistent with the information contained in the Company's Annual Reports for 2004 and 2005. In the Company's Annual Reports for 2004 and 2005, the Company's investment in listed equity securities in Hong Kong (at cost) was shown to be in the total sum of HK$9,346,000. The said total sum shown in the Company's Annual Reports for 2004 and 2005 was about the same as the grand total of the entries contained in the Internal Records regarding the value (at cost) of the listed equity securities in Hong Kong acquired by the Company.

14. Regarding the discrepancy in the purchase price for the acquisition of the first lot of 2,200,000 Grandtop Shares shown in the Company's documents, the officers of the SFC conducted various interviews with the 1st, 2nd and 3rd Respondents seeking explanation from each of them.

15. So far as the 1st Respondent is concerned, in his interview held on 29th June 2005, he admitted that he decided to purchase Grandtop Shares because he knew one Mr. Edmund Siu ("Siu") of Grandtop and was optimistic of the prospect of Grandtop, which was also engaged in the garment industry. The 1st Respondent, however, claimed in his interview held on 1st June 2007 that the acquisition was handled by the 3rd Respondent and he had no knowledge of such price discrepancy.

16. So far as the 2nd Respondent is concerned, in the interview held on 24th

February 2006, she admitted that she signed the board minutes dated 22nd December 2003 approving the acquisition of 2,200,000 Grandtop Shares. The 2nd Respondent, however, also claimed that she did not have any recollection of the contents of the said board minute since it was her practice to sign whatever her husband, the 1st Respondent, had signed without raising any questions.

17. So far as the 3rd Respondent is concerned, he gave two inconsistent accounts of events:-

(1) Initially, in his interview held on 27th September 2005, the 3rd Respondent claimed that the Internal Records and, hence, the entries in the Company's Annual Reports for 2004 and 2005 (which were based upon the Internal Records) regarding the Company's investment in listed equity securities in Hong Kong were incorrect. The 3rd Respondent alleged that the purchase price of the 2,200,000 Grandtop Shares was overstated in the Internal Records and that the actual purchase price for those shares should be HK$2.00 per share.

(2) Subsequently, for reasons unknown to the SFC, the 3rd Respondent changed his evidence in his interview held on 18th October 2005 and confirmed that the 2,200,000 Grandtop Shares were purchased at HK$2.90 per share and the payment in the sum of HK$6,386,380 (i.e. 2,200,000 Grandtop Shares x HK$2.90 *per* share plus transaction costs) was paid by way of cash in the mainland through a PRC subsidiary of the Company to Chan and Mr. Lau

Pak Lun.

18. The SFC contends that if the 2,200,000 Grandtop Shares were acquired by the Company on or about 22nd December 2003 at a price of HK$2.90 per share, such acquisition was not in the interest of the Company and its shareholders since the prevailing market price of Grandtop Shares was around HK$2.00 per share. The purchase price of HK$2.90 per share for the acquisition of 2,200,000 Grandtop Shares from Chan and Mr. Lau Pak Lun represented about 45% premium above their prevailing market price at the time of the acquisition.

19. In the light of the answer given by the 3rd Respondent regarding the purchase price for the said 2,200,000 Grandtop Shares, the officers of the SFC conducted further interviews with the 3rd Respondent with a view to obtaining an explanation from him as to why the Company decided to purchase the said 2,200,000 Grandtop Shares at a price approximately 45% higher than the prevailing market price in late December 2003.

20. Initially, in his interview held on 18th October 2005, the 3rd Respondent could not offer any explanation. Subsequently, in his interview held on 3rd November 2005, the 3rd Respondent sought to give some explanation by alleging that he discussed the acquisition with a person from Ever-Long (whose name could not be remembered by the 3rd Respondent) in around June 2003 and the Company agreed to purchase the said 2,200,000 Grandtop

Shares at HK$2.90 per share in around June 2003, at which time the then prevailing market price of Grandtop Shares was about HK$3.00 per share.

21. The SFC contends that the latest explanation given by the 3rd Respondent as to why the said 2,200,000 Grandtop Shares were purchased at HK$2.90 per share is untrue for the following reasons:-

(1) First, despite his assertion that the Company agreed to purchase 2,200,000 Grandtop Shares in about June 2003, the 3rd Respondent could not explain why the relevant bought and sold notes were only signed on 22nd December 2003 or why the said 2,200,000 Grandtop Shares were only deposited into the Securities Account on about 30th December 2003;

(2) Secondly, the explanation given by the 3rd Respondent contradicts the assertion made by the 1st Respondent in his interview dated 29th June 2005 that he only instructed the 3rd Respondent to arrange for the purchase of the 2,200,000 Grandtop Shares in December 2003, and not June 2003;

(3) Thirdly, it also contradicts the assertion of Mr. Ng Shun Fu ("Ng"), the managing director of Ever-Long, in his interview held on 9th February 2006 and the assertion of Mr. Loong Kwok Cheung ("Loong"), the account executive of Ever-Long, in his interview held on 23rd December 2005 that Ever-Long was not involved in arranging for the acquisition of 2,200,000 Grandtop Shares by the Company, whether as alleged by the 3rd Respondent

or at all. Loong further said in the same interview that the 3rd Respondent confirmed to him that 2,200,000 Grandtop Shares were purchased at HK$2.00 per share shortly after he received the relevant bought and sold notes from Keen Choice;

(4) Fourthly, such explanation is also inconsistent with the entries contained in the monthly statements of Chan's account maintained with Ever-Long and the monthly statements of Mr. Lau Pak Lun's account maintained with Concord Capital Securities Limited which showed that the 1,400,000 and 800,000 Grandtop Shares sold in their names were only withdrawn and transferred to the securities account under the name of Keen Choice in December 2003, and not June 2003; and

(5) Finally, it is also contrary to the assertion of Mr. Lau Pak Lun in his interview held on 13th January 2006 that he was asked by one Mr. Han Bin to transfer 800,000 Grandtop Shares via his securities account to a securities account under the name of Keen Choice in around October or November 2003, and not June 2003 as claimed by the 3rd Respondent.

SFC's Complaints regarding the Acquisition of 2,200,000 Grandtop Shares

22. By reason of the matters aforesaid, the SFC contends that the evidence available establishes a clear case that the Company (through Keen Choice) purchased 2,200,000 Grandtop Shares on or about 22nd December 2003 at the

price of HK$2.90 per share, which price was about 45% higher than the price that Grandtop Shares were trading on SEHK.

23. The SFC will therefore contend that:-

(1) The acquisition of the said 2,200,000 Grandtop Shares at such a high purchase price through private channels was not justified by any good commercial reason and was, therefore, not in the interest of the Company or its shareholders.

(2) The said acquisition by the Company (through Keen Choice) constituted a misfeasance, misconduct and/or defalcation in relation to the business and affairs of the Company within the meaning of Section 214(1)(b) of the SFO.

(3) Further or alternatively, the acquisition was also unfairly prejudicial to the interests of the members of the Company (or a part thereof) within the meaning of Section 214(1)(d) of the SFO.

(4) Regarding the signing of the relevant bought and sold notes dated 22nd December 2003 by the 3rd Respondent and the signing of the Company's board minutes dated 22nd December 2003 by the 1st and 2nd Respondents, such acts also constituted misfeasance and/or misconduct in relation to the business and affairs of the Company within the meaning of Section 214(1)(b) of the SFO in that the purchase price of the said 2,200,000

Grandtop Shares set out in these documents understated the actual purchase price paid by the Company for the shares.

24. If (contrary to the primary contention of the SFC) this Honourable Court were to find that the said 2,200,000 Grandtop Shares were acquired by the Company at the purchase price of HK$2.00 per share as shown in the relevant bought and sold notes and the Company's minutes all dated 22nd December 2003, the SFC will contend that:-

(1) The information contained in the Company's Annual Reports for 2004 and 2005 about the Company's investment in listed equity securities in Hong Kong was false and/or inaccurate in that such information was provided on the basis that the 2,200,000 Grandtop Shares were purchased at the price of HK$2.90 per share as set out in the Internal Records.

(2) Hence, the issue and publication of the Company's Annual Reports for 2004 and 2005 resulted in the Company's members not having been given all the information with respect to its business or affairs that they might reasonably expect within the meaning of Section 214(1)(c) of the SFO.

(3) Further or alternatively, the acquisition also constituted a misfeasance, misconduct and/or defalcation in relation to the business and affairs of the Company within the meaning of Section 214(1)(b) of the SFO in that, contrary to the accounting entries contained in the Internal Records and the Company's Annual Reports for 2004 and 2005, the actual purchase price

paid by the Company for the acquisition of the said 2,200,000 Grandtop Shares was only HK$2.00 per share and the Company failed to account the difference between the purchase price booked in such accounting entries and the actual purchase price paid by the Company for such Grandtop Shares.

SFC's Investigation regarding Acquisition of additional 1,420,000 Grandtop Shares

25. After the initial acquisition of 2,200,000 Grandtop Shares in December 2003, a total of 1,420,000 additional Grandtop Shares were acquired by the Company on 27th and 28th January 2004 from the open market.

26. In connection with these subsequent acquisitions, two board minutes respectively dated 27th and 28th January 2004 were produced by the Company showing the board of directors' approval of these acquisitions. The total amount of the consideration paid by the Company for this acquisition as set out in the said two board minutes was more or less the same as that set out in the Internal Records.

27. As a result of the subsequent acquisitions of an additional 1,420,000 Grandtop Shares in January 2004, the Company (through the Securities Account maintained by Keen Choice) held a total of 3,620,000 Grandtop Shares as its investment in listed equity securities, which shares were worth HK$9,263,121 at cost.

SFC's Complaints regarding the Acquisition of Grandtop Shares

28. In the "*Risk Factor*" Section of the Prospectus, the board of directors of the Company stated that they would use the surplus funds of the Group to invest in "*balanced investment portfolio*" including investment in "*high quality listed equity securities*".

29. However, contrary to the said statement contained in the Prospectus, the Company's investment in Grandtop Shares represented approximately 99% of its investment portfolio in listed equity securities up to 31st March 2006. As shown in the Company's Annual Reports for 2004, 2005 and 2006, the total investment made by the Company in listed equity securities at cost was only in the sum of HK$9,346,000. Out of the said sum of HK$9,346,000, the sum of about HK$9,263,121 related to the acquisition of the said 3,620,000 Grandtop Shares in December 2003 and January 2004.

30. Not only did the Company's management fail to diversify its investment in listed equity securities as the Company represented it would in the Prospectus, the Company also over-invested in listed equity securities, in particular, Grandtop Shares. As shown in the Company's Annual Report 2004, the net assets of the Group as at 31st March 2004 were in the sum of HK$97,402,000 only. The Company's investment in the said 3,620,000 Grandtop Shares, therefore, represented 9.5% of the Group's net assets as at 31st March 2004.

31. The Company's investment in Grandtop Shares was very substantial. The Company's management should have carefully studied the business and financial status of Grandtop and prudently weighed other investment options before they decided to invest in Grandtop Shares.

32. However, when they were questioned about the reason(s) for the acquisition of the said 3,620,000 Grandtop Shares in their respective interviews with the officers of the SFC, the 1st, 2nd and 3rd Respondents were unable to offer any rational explanation to justify the Company's decision to acquire such a large quantity of Grandtop Shares:-

(1) When the 1st Respondent was asked in his interview held on 29th June 2005 about his decision to invest in Grandtop Shares, he stated that he came to know Mr. Edmund Siu of the management of Grandtop and was optimistic about the prospects of Grandtop and had confidence in it. The 1st Respondent failed to give any sufficient basis to justify his view about the future prospects of Grandtop;

(2) When the 2nd Respondent was asked about the same subject matter in her interview held on 24th February 2006, she claimed that she had no recollection as to why she signed the board minutes approving the purchase of Grandtop Shares and she simply trusted and relied on her husband (i.e. the 1st Respondent) in relation to all business decisions of the Company; and

(3) When the 3rd Respondent was questioned on the same subject matter in his interview held on 1st August 2005, he claimed that he had checked Grandtop's annual report, its assets and liabilities and calculated its profit/expenses ratio, but did not take any professional advice on purchasing the shares before giving his verbal analysis to the 1st Respondent. The 3rd Respondent claimed that he talked to the 1st Respondent about diversifying the Company's asset holdings, but the 1st Respondent simply instructed him to continue to purchase Grandtop Shares. The 3rd Respondent thereafter acted according to the 1st Respondent's instructions.

33. Contrary to the 1st Respondent's assertion about the prospects of Grandtop, the trading price of Grandtop Shares was at all material times on a downward trend. Its share price dropped gradually from around HK$3.00 per share in June 2003 to around HK$2.00 per share in December 2003 and further to HK$0.16 per share in December 2005. Furthermore, no dividends were declared by Grandtop between March 2003 and March 2005.

34. By reason of the matters aforesaid, the SFC contends that the Company's acquisition of a total of 3,620,000 Grandtop Shares in December 2003 and January 2004 constituted misfeasance and/or misconduct in relation to the business and affairs of the Company within the meaning of Section 214(1)(b) of the SFO and/or conduct unfairly prejudicial to the interest of the members of the Company (or a part thereof) within the meaning of Section 214(1)(d) of the

SFO in that:-

(1) The Company's management failed to maintain a "*balanced investment portfolio*" in respect of its investment in listed equity securities as stated in the Prospectus;

(2) The Company's management failed to support or justify its decision to acquire the said 3,620,000 Grandtop Shares as its investment with any well founded commercial reasons; and

(3) The Company's management failed to review its investment policy and still held the said 3,620,000 Grandtop Shares in 2005, despite the very substantial decrease in its share price since the acquisitions in December 2003 and January 2004.

Transaction 2: Acquisition of MAIL's Share Option

SFC's Investigation regarding the Acquisition and Exercise of MAIL's Share Option

35. By a board minute dated 2nd April 2003, the board of the Company resolved to approve the acquisition of an option to acquire an equity interest in a company to be listed on the ASE (the "Proposed Listed Company") at a consideration of HK$15 million. By the same board minute, Madam Shu Oi Yung ("Shu") was approved as the authorised person to represent the Company to sign the agreement with Emerging Growth Partners, Inc. ("EGP"), or its representative,

for the acquisition.

36. On 2nd January 2004, a letter of appointment was signed by the 1st Respondent on behalf of the Company to appoint Shu to represent the Company to sign an agreement with EGP in relation to the acquisition of a share option of the Proposed Listed Company for the sum of HK$15 million.

37. On 7th January 2004, an agreement was signed between Shu and one Mr. Wong Tak Chi ("Wong") whereby Wong would arrange delivery of an equity interest in the Proposed Listed Company of a value equal to HK$15 million to Shu and Shu would pay the said HK$15 million within 90 days of the signing of the agreement. In the event that the Proposed Listed Company could not obtain listing status in the US, Wong would refund the said HK$15 million to Shu. Wong also guaranteed to Shu that the Proposed Listed Company would have a profit of not less than HK$5 million per annum or equivalent.

38. By a receipt dated 21st March 2004, Wong acknowledged that he had received from the Company a sum of RMB 15,900,000 in cash for the purpose of purchasing an equity interest in the Proposed Listed Company pursuant to the agreement dated 7th January 2004.

39. On or about 5th April 2005, the Company decided to exercise the said option and acquired the equity interest in the Proposed Listed Company. The 3rd Respondent, in his interview held on 3rd November 2005, stated that in or around

September 2005, the Company received a share certificate representing 10 million shares in MAIL (the "Share Certificate") issued in the name of Magic Ace Enterprises Limited ("Magic Ace"), which was at all material times a wholly owned subsidiary of the Company within the Group.

40. The 1st Respondent in his interview held on 21st February 2006 admitted that, shortly after the exercise of the said share option on or about 5th April 2005, the value of the said 10 million shares issued by MAIL was completely written off from the Company's assets in its 2005 Interim Report for the period of 6 months ended on 30th September 2005 on the basis that these shares had no market value.

41. Regarding the said acquisition of MAIL's share option, each of the 1st, 2nd and 3rd Respondents was questioned about the reason(s) for such acquisition in their respective interviews held with officers of the SFC. Their responses can be summarized as follows:-

(1) In his interview held on 20th July 2005, the 1st Respondent claimed that towards the end of 2003, he came to know one Mr. Kevin Welch ("Welch") who recommended him to invest in the Proposed Listed Company which was engaged in the information technology business. The 1st Respondent further claimed that he then discussed the proposal with the 3rd Respondent and, after conducting some research in relation to the profitability and prospect of the Proposed Listed Company, he decided to purchase an option

for the shares of the Proposed Listed Company.

(2) So far as the 2nd Respondent is concerned, she claimed in her interview held on 24th February 2006 that she had never seen any documentation relating to the acquisition of MAIL's share option and was unaware of the transaction.

(3) In his interviews held on 27th September 2005 and 3rd November 2005, the 3rd Respondent also claimed that the acquisition of MAIL's share option was initiated by Welch, who was introduced to him by the 1st Respondent. Since Welch had shown him some examples of successful investment, the 3rd Respondent had confidence in Welch and, therefore, did not check Welch's background when he started negotiating with Welch in relation to the acquisition. The 3rd Respondent also confirmed that the Company did not conduct any due diligence in respect of the business of MAIL or seek any professional advice before committing itself to the acquisition. The 3rd Respondent stated that he simply conducted his own analysis based on the information provided by Welch without any verification and he did not even read any annual report of MAIL. The 3rd Respondent claimed that he had not kept any documents or data about the background of MAIL, his own analysis of MAIL or of the discussions about the price of the option.

42. In the light of the answers given by the 1st and 3rd Respondents in their respective interviews, officers of the SFC made enquiries with Welch who

has given the SFC a sworn Affidavit. Contrary to the allegations made by the 1st and 3rd Respondents in their interviews, Welch confirmed in his Affidavit that he had never heard of the Company before receiving enquiries from the SFC on 13th December 2005 and had never met or spoken to the 1st and/or 3rd and/or 4th Respondents, nor had he ever recommended the 1st and/or 3rd Respondents to invest in MAIL or any other companies, whether as alleged or at all.

43. The SFC contends that the allegations made by the 1st and 3rd Respondents concerning the reasons why the Company decided to acquire MAIL's share option and the involvements of Welch in that acquisition are highly incredible and, hence, untruthful for the following reasons:-

(1) First, the board minutes recording the board's approval for the acquisition of the HK$15 million share option was dated 2nd April 2003. This is inconsistent with the 1st Respondent's own claim that Welch recommended the investment in MAIL at the end of 2003 and also the fact that MAIL, according to the information obtained from the website for Pink Sheet stocks, was only incorporated in 2004.

(2) Secondly, notwithstanding that the board minutes dated 2nd April 2003 and the letter of appointment dated 2nd January 2004 made reference to an agreement to be signed between Shu (on behalf of the Company) and EGP in relation to the acquisition, the agreement eventually signed on 7th January 2004 was one

between Shu and Wong and there was nothing on the face of the agreement to suggest that Wong was signing on behalf of EGP.

(3) Thirdly, in a document entitled "Notes to Partners" prepared by the staff of HLB Hodgson Impey Cheng ("HLB"), the auditors of the Group, it was stated that the staff of HLB met Welch and reviewed an option agreement dated 7th January 2004 signed by Cheung and Welch. However, the only agreement made available to the SFC by the Company was the said agreement signed between Shu and Wong. Neither the Company nor HLB has been able to produce any agreement signed between Cheung and Welch as referred to in the said "Notes to Partners".

(4) Fourthly, when the 1st Respondent was asked about the reason why the Company invested heavily in Grandtop in his interview held on 29th June 2005, he replied by saying that he did not want the Company to invest in industries that he was not familiar with. Similarly, when the 3rd Respondent was asked the same question in his interview held on 1st August 2005, he also confirmed that the 1st Respondent was not fond of the idea of diversification. However, when the 1st Respondent was questioned as to why he approved the acquisition of MAIL's share option, he changed his stance and said that he felt the Company's core business had developed to a very mature stage and that the Company should diversify its business and investment.

(5) Fifthly, as shown by the information obtained from the website for Pink Sheet stocks, Siu, a director of Grandtop, was in fact one of the directors and the secretary of MAIL. In their interviews respectively held on 29th June 2005 and 1st August 2005, the 1st and 3rd Respondents admitted that they knew Siu and they met him from time to time. The 1st Respondent also stated that knowing Siu was a reason for his decision to invest in Grandtop. Given the close connection between Siu and the Company's management, it is to be inferred that the Company's management was aware of the involvement of Siu in MAIL. However when the 3rd Respondent was asked about the names of those persons in charge of MAIL, the 3rd Respondent only chose to mention one Guo Liange the CEO and one James Harry Lesperance the President, and omitted any reference to Siu.

44. On or about 19th May 2007, officers of the SFC examined the website for Pink Sheet Stocks once again and discovered that the corporation information relating to MAIL could no longer be found on that website. This raises the inference that MAIL had by no later than 19th May 2007, ceased trading as a Pink Sheet Stock.

SFC's Complaints regarding the Acquisition and Exercise of MAIL's Share Option

45. The SFC contends that the Company's management in breach of their duties failed to exercise due and/or reasonable care and failed to act in the best interest of the Company in making its decision to invest HK$15 million in the acquisition of MAIL's share option in that:-

(1) The Company's management failed to carry out any due diligence exercise. They claim that they simply relied on the unverified information provided by Welch for their assessment of the viability of the investment and the analysis of the 3rd Respondent. This was confirmed by the 3rd Respondent in his interviews held on 27th September 2005 and 3rd November 2005. However, the 1st, 2nd and/or 3rd Respondents were unable to produce any documents containing information or analysis of MAIL during or after their interviews with the SFC.

(2) The 1st and/or 3rd Respondents did not have any clear idea as to the percentage of shareholding in MAIL represented by the 10 million shares issued under the said share option. This was confirmed by the 1st Respondent in his interview held on 6th December 2005 and also by the 3rd Respondent in his interview held on 3rd November 2005.

(3) The 1st Respondent did not personally verify, or require anyone else to verify with Welch or anybody else, the prevailing market value of MAIL. This was confirmed by the 1st Respondent in his interview held on 21st February 2006.

(4) As to the manner in which the investment in the 10 million shares issued under MAIL's share option could be realised by the Company, both the 1st and 3rd Respondents in their interviews held on 6th December 2005 and 3rd November 2005 respectively admitted that they had very little idea as to how the shares

could be sold in the market and did not keep track of the market value of the shares.

(5) The 1st Respondent was unable to locate the original copy of the Share Certificate. Also, he did not instruct any of the Company's staff to check the prevailing value of the 10 million shares issued by MAIL or to try to realise the shares. This was confirmed by the 1st Respondent in his interviews held on 21st February 2006, 22nd May 2007 and 1st June 2007.

46. Further or in the alternative, if this Honourable Court were to find that the explanations given by the 1st and 3rd Respondents concerning the reasons why the Company decided to acquire MAIL's share option and the involvement of Welch in that acquisition are incredible and untruthful, the SFC will contend that the Company's management, in breach of their duties, failed to act honestly and/or candidly in the management of the business and affairs of the Company, particularly in relation to the Company's decision to invest HK$15 million in the acquisition of MAIL's share option.

47. Further or in the further alternative, the SFC contends that the Company was required to make disclosure under the Listing Rules in respect of the exercise of its option to acquire 10 million shares in MAIL on or about 5th April 2005. Wrongfully and in breach of the Listing Rules, the Company failed to make any such disclosure, whether properly or at all, concerning its decision to exercise the share option to acquire 10 million shares issued by MAIL.

48. By reason of the matters aforesaid, the SFC contends that:-

(1) The Company's acquisition and exercise of MAIL's share option (through Magic Ace) in the aforesaid manner constituted a misfeasance, misconduct and/or defalcation in relation to the business and affairs of the Company within the meaning of Section 214(1)(b) of SFO;

(2) Further or alternatively, given that the Company in the Prospectus represented to its members that the Company's principal business was the manufacture and trading of garments and that its investment in listed equity securities would be confined to a "*balanced investment portfolio*" of high-quality listed equity securities, the Company's acquisition and exercise of MAIL's share option in the aforesaid manner was also unfairly prejudicial to the interests of the members of the Company (or a part thereof) within the meaning of Section 214(1)(d) of the SFO and inconsistent with such statement in the Prospectus; and

(3) Further or alternatively, the failure on the part of the Company to make proper disclosure under the Listing Rules in respect of the exercise of its option to acquire 10 million shares in MAIL on or about 5th April 2005 resulted in the Company's members not having been provided with all the necessary information with respect to its business or affairs that they might reasonably expect within the meaning of Section 214(1)(c) of the SFO.

Transaction 3: Payments to Wan

The SFC's Investigation regarding payments made to Wan

49. Pursuant to a board resolution dated 10th January 2003, the Company approved the appointment of Wan, a PRC resident, as the agent of the Company to arrange for the establishment or acquisition of a company to engage in the manufacturing and sale of garment products in the PRC. The board also approved the transfer of funds of HK$18.2 million to Wan for the purpose of establishing or acquiring a company.

50. Wan executed a memorandum dated 1st June 2003 acknowledging that, up to 31st March 2003 he had received a total sum of HK$18.2 million from the Company to be used for the aforesaid purpose. The memorandum also stated that Wan would return the sum of HK$18.2 million to the Company in the event that he failed to set up the new subsidiary.

51. As disclosed in the Company's Annual Report 2003, the said sum of HK$ 18.2 million was paid as a prepayment to an independent third party in the PRC to pursue and arrange for the establishment of a new subsidiary to engage in the manufacture and sale of garment production in the PRC. The prepayment was in respect of the acquisition costs of land use rights, building construction, leasehold improvements and plant and machinery.

52. Subsequently, as disclosed in the Company's Annual Report 2004, the Company's management had during the financial year ended 31st March 2004

identified an appropriate investment target and the negotiation of the terms of the investment were in progress. It appears from the Company's Annual Report 2004 that the said prepayment of HK$18.2 million still remained outstanding as at 31st March 2004.

53. As evidenced by a written confirmation dated 28th February 2005 signed between 1st Respondent on behalf of the Company and Wan, Wan further received additional sums of HK$3,000,000 and HK$6,520,000 in January and February 2005 respectively. This written confirmation also states that these additional sums, together with the initial prepayment of HK$18.2 million, were transferred to Wan for the purpose of appointing Wan to establish a company that engages in the manufacture and sale of garments and would be returned to the Company in the event that Wan could not arrange for the setting up of the new company.

54. The Company has not been able to provide the SFC with any board resolution(s) approving the transfer of the additional sums of HK$3,000,000 and HK$6,520,000 to Wan in January and February 2005 respectively.

55. By a board resolution dated 31st August 2005, the Company's board of directors resolved to approve the acquisition of the entire issued share capital of Wisefull International Limited ("Wisefull"), which held a 30% equity interest in a joint venture company in the PRC known as Beijing Langkun Garments Company Limited ("Langkun"), for a consideration of HK$27,720,000.

56. On the same day (i.e. 31st August 2005), a public announcement was issued by the Company in relation to its acquisition of the entire share capital of Wisefull. In this public announcement, it was stated that the consideration of HK$27,720,000 was to be partially settled by the prepayment of approximately HK$18 million previously made by the Company to Wan. However this public announcement made no reference to the use of the additional sums of HK$3,000,000 and HK$6,520,000 paid by the Company to Wan in January and February 2005.

57. However, according to the Company's Annual Report 2005, as at 31st March 2005, deposits and prepayments of approximately HK$27.721 million were paid to Wan for the purpose of settling the acquisition of the entire share capital of Wisefull.

58. The Company's Annual Report 2006, stated that the prepayments made by the Company to Wan in the total sum of HK$27.72 million (i.e. the initial prepayment of HK$18.2 million + additional prepayments of HK$3 million and HK$6.52 million) were used to pay off the consideration for the acquisition of Wisefull and Langkun.

The SFC's Complaint regarding Payments made to Wan

59. The SFC contends that the payments made to Wan in the aforesaid manner constituted misfeasance, misconduct and/or defalcation in relation to the

business and affairs of the Company within the meaning of Section 214(1)(b) of the SFO in that:-

(1) No board resolution was ever adopted by the Company's board of directors to approve the payment of additional sums of HK$3,000,000 and HK$6,520,000 to Wan in January and February 2005 respectively;

(2) Further, the Company's management failed to exercise due and/or reasonable care in making the said prepayments in that it failed to impose any safeguards, whether adequate or at all, to ensure the return of all the prepayments from Wan to the Company.

(3) Further still, the Company's management failed to act in the best interest of the Company in making the said prepayments in that it failed to require Wan to deposit such prepayments in interest-bearing account(s) and/or failed to require Wan to pay interest to the Company in respect of such prepayments. As a result, the Company has suffered loss in terms of the loss of interest in respect of such prepayments during such period when the same were held by Wan but were not being used for the purpose of the Company's business.

60. Further or alternatively, the SFC contends that, by reason of the matters aforesaid, the making of prepayments to Wan without requiring him to pay any interest or deposit such prepayments into an interest-bearing account constituted conduct unfairly prejudicial to the members of the Company (or a

part thereof) within the meaning of Section 214(1)(d) of the SFO.

61. Yet further or alternatively, the SFC contends that the making of the prepayment of HK$18,200,000 by the Company to Wan was made to conceal a discloseable financial transaction under Chapters 13 and 14 of the Listing Rules in effect at that time. Wrongfully and in breach of the provisions of Chapters 13 and 14 of the Listing Rules in effect at that time, the Company failed to make any timely or proper disclosure in respect of the making of such prepayment to Wan. In the premises, the SFC contends that the failure on the part of the Company to make timely and proper disclosure of the prepayment of HK$18,200,000 by the Company to Wan resulted in the Company's members not having been given all the relevant information with respect to its business or affairs that they might reasonably expect within the meaning of Section 214(1)(c) of the SFO.

Transaction 4: Investment in KKL Fashion

The SFC's Investigation regarding the Investment in KKL Fashion

62. According to the information provided by the 3rd Respondent in his interviews held on 5th September 2005 and 27th September 2005, during the period between mid 2004 and early 2005, the Company invested a total sum of about HK$8.5 million in KKL Fashion.

63. The said transaction was approved by a board resolution dated 13th October 2004 signed by 1st and 2nd Respondents whereby the Company's board of directors approved the formation of KKL Fashion and authorised one Zhou Ying Chun ("Zhou") to hold the Company's equity interest in KKL Fashion on behalf of the Company.

64. In his interview held on 27th September 2005, the 3rd Respondent asserted that (i) Zhou invested RMB 1.25 million in KKL Fashion on behalf of the Company to acquire 62.5% equity interest in KKL Fashion, and (ii) the sum in excess of RMB 1.25 million paid by or on behalf of the Company in connection with this project was regarded as loan advanced by the Company to KKL Fashion. The loans were made in around August/September 2004 and the Company has produced a document dated 22 December 2004 from Zhu Xiaoying acknowledging receipt of RMB7,747,832 as a temporary loan to KKL Fashion.

65. As to the advancement of loans made by the Company to KKL Fashion in the sum of about HK$7.3 million (i.e. total investment of HK$8.5 million – investment of RMB 1.25 million for the acquisition of 62.5% equity interest in KKL Fashion), no board resolution has been produced by the Company showing the consideration or approval given by the Company's board of directors for the making of such loans.

66. As to the Company's decision to invest in KKL Fashion, the 3rd Respondent

in his interview held on 27th September 2005 claimed that the decision to invest in KKL Fashion was made by the 1st Respondent. The 1st Respondent, in his interview held on 6th December 2005, confirmed that he decided to invest RMB 1.25 million in KKL Fashion after he had studied and observed the setup, facilities and locations of other similar companies. The 1st Respondent also admitted in the same interview that his assessment was based on his own judgment and experience and that no professionals were engaged by the Company to appraise the value of KKL Fashion or to conduct due diligence.

67. In about early 2005, because of a disagreement between the shareholders of KKL Fashion, the Company decided to terminate its investment in KKL Fashion.

68. As confirmed by the 3rd Respondent in his interviews held on 27th September 2005 and 18th October 2005, when in early 2005 the Company indicated its intention not to invest further in KKL Fashion, the Company agreed with KKL Fashion and its shareholders that it would take back some of the stock to recover its investment in KKL Fashion. The Company thereafter sold the stocks recovered from KKL Fashion for about RMB 6,912,000 (i.e. about HK$6.5 million).

69. As confirmed by the 1st Respondent in his interview held on 1st June 2007, the only asset recovered by the Company from KKL Fashion for its

investment (including the advancement of loans) in KKL Fashion was some stock. The Company has ceased to own any equity interest in KKL Fashion.

70. The Company suffered a net loss of about HK$2 million in connection with its investment in KKL Fashion in that the Company invested a total sum of HK$8.5 million and was only able to recover about HK$6.5 million from the sale of stock recovered from KKL Fashion.

The SFC's Complaints regarding the Investment in KKL Fashion

71. The SFC contends that the provision of loans by the Company to KKL Fashion in the absence of any proper board resolution authorising or approving such advancement constituted misfeasance, misconduct and/or defalcation in relation to the business and affairs of the Company within the meaning of Section 214(1)(b) of the SFO.

72. Further or alternatively, the SFC contends that the Company's management failed to exercise due and/or reasonable care in making its decision to invest in KKL Fashion in that they failed to conduct any due diligence or proper appraisal and/or failed to seek proper advice from any professionals before making such decision. The SFC contends that such failure on the part of the Company's management constituted misfeasance and/or misconduct in relation to the business and affairs of the Company within the meaning of Section 214(1)(b) of the SFO.

73. Further or alternatively, the SFC contends the Company's management failed to exercise due and/or reasonable care and/or best endeavors in seeking full recovery from KKL Fashion or its shareholders in respect of the investment made by the Company in KKL Fashion. The SFC contends that such failure on the part of the Company's management constituted misfeasance and/or misconduct in relation to the business and affairs of the Company within the meaning of Section 214(1)(b) of the SFO.

74. Further or alternatively, by reason of the matters aforesaid, the Company's decision to acquire part of the equity interest in KKL Fashion and to advance loans to KKL Fashion constitute conduct unfairly prejudicial to the interest of the members of the Company (or a part thereof) within the meaning of Section 214(1)(d) of the SFO.