HCMP 1818/2012

IN THE HIGH COURT OF THE

HONG KONG SPECIAL ADMINISTRATIVE REGION

COURT OF FIRST INSTANCE

MISCELLANEOUS PROCEEDINGS NO 1818 OF 2012

IN THE MATTER of Ernst & Young (a firm)

AND IN THE MATTER of an investigation by the Securities and Futures Commission under section 182(1) of the Securities and Futures Ordinance (Cap 571) concerning Standard Water Limited

AND IN THE MATTER of an application under section 185(1) of the Securities and Futures Ordinance (Cap 571)

BETWEEN

THE SECURITIES AND FUTURES COMMISSION Plaintiff

and

ERNST & YOUNG (a firm) Defendant

Before: Hon Ng J in Court

Dates of Hearing: 27-28 March, 16 May, 11, 13-15, 17 June, 11-12 September 2013

Date of Judgment: 23 May 2014

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A. INTRODUCTION

1. This case raises important issues regarding the legal obligations of Hong Kong accounting firms to disclose information concerning listing applicants who operate and carry on business outside the jurisdiction.

2. By an Originating Summons dated 27 August 2012, the Plaintiff ("**SFC**") seeks an inquiry under section 185 of the Securities and Futures Ordinance, Cap 571 ("**SFO**") into the failure of the Defendant ("**EY**") to produce copies of records or documents, provide information and give assistance to an investigator directed by SFC to conduct an investigation concerning Standard Water Limited ("**Company**") upon having been required to do so in 9 statutory notices issued under section 183 of SFO between 12 April 2010 and 28 October 2011 ("**Notices**"). SFC further seeks an order compelling EY to comply with the Notices, if the court should find that it has no reasonable excuse not to do so.

3. The substantive hearing of the Originating Summons was originally set down for only two days on 27 & 28 March 2013. In the end, it took place in four separate phases: 27 & 28 March and then 16 May 2013 during which EY's factual witness viz Mr Leung Kwok Ki Alden ("**Mr Leung**") was examined on his Affirmation dated 7 December 2012 ("**Affirmation**"). Mr Leung is a partner of EY responsible for quality and risk management. He was not at any time personally involved in the audit of the Company with a view to its listing in Hong Kong. The next phase of the hearing took place between 11 and 17 June 2013 during which the parties' experts on PRC laws testified in court and were extensively

cross-examined. Finally, oral closing submissions were made by the parties on 11 & 12 September 2013.

B. BACKGROUND

4. EY is well-known and needs no introduction. It is regulated by the Hong Kong Institute of Certified Public Accountants ("**HKICPA**") and the Financial Reporting Council (the "**FRC**"). At the risk of stating the obvious, it is subject to the laws of Hong Kong, including the SFO.

5. Ernst & Young Hua Ming LLP ("**HM**") was established in 1992 as a sino-foreign cooperative joint venture between Hua Ming Certified Public Accountants and EY. The joint venture was converted into a special general partnership in September 2012. HM is a separate legal entity registered with and regulated by the Chinese Institute of Certified Public Accountants ("**CICPA**") acting under the authority granted by the Ministry of Finance ("**MoF**") of the PRC. It is further subject to the jurisdiction of the China Securities Regulatory Commission ("**CSRC**"). Also at the risk of stating the obvious, it is subject to the laws (which term includes statute law, regulations, rules and so on) of the PRC.

6. The Company was incorporated in the Cayman Islands and registered as a non-Hong Kong company under Part XI of the Companies Ordinance, Cap. 32. At the time of the Engagement referred to in paragraph 9 below, its majority shareholder (holding 50.1% of its issued share capital) was Mirage Group Investments Limited, an investment holding company incorporated in the British Virgin Islands, whose shares were held by four PRC individuals, namely Mr Zhang Zhi Gang, Mr Ma Ning Ping, Mr Li Yue Dong and Mr Cai Hong Liang. The only other

shareholder of the Company was CNA Group Limited, an investment holding company incorporated and listed in the Singapore. It would appear that the Company is a private rather than a state-owned enterprise ("**SOE**").

7. At all material times, through its two main operating subsidiaries, China Water Holdings Pte Limited ("**China Water**") and Crystal Water Company Limited ("**Crystal Water**"), the Company carried on the business of water supply and waste water treatment in the PRC. The Company's business consisted of two principal components viz. (i) environmental construction services, provided through China Water, which encompassed construction, equipment manufacturing and installation, and project management services for municipal projects in the PRC including waste water treatment plants, water treatment and supply plants and solid waste treatment plants; and (ii) environmental concession services, provided through Crystal Water, which involved financing, investment, construction, operation, management and maintenance services primarily for water and waste water treatment plants in the PRC.

8. In 2009, the Company intended to launch an IPO of its shares in Hong Kong and list them on the main board of the Stock Exchange of Hong Kong Limited ("**Stock Exchange**").

9. By a letter dated 28 August 2009 entitled "專業服務業務約定書" ("**Engagement Letter**"), the Company engaged EY as reporting accountant and independent auditor for that purpose ("**Engagement**"). The Engagement Letter incorporated EY's standard terms and conditions "安永的通用業務條款" ("**General Terms**") a copy of which was attached to it. So was a letter regarding EY's fees ("**Fees letter**").

10. While it was EY who contracted with the Company, it transpired that EY had used the services of HM to conduct the field work of the audit of the Company, as well as Crystal Water, in the PRC. The Engagement Partner was Mr Benjamin Yam ("**Mr Yam**"). He was a partner of EY and HM and stationed in Beijing as Hua Ming's personnel. The independent review partner for the Engagement was Miss Melody Lam ("**Miss Lam**"). She was also a partner of EY and HM and stationed in Beijing.

11. On 9 November 2009, the Company formally made a listing application to the Stock Exchange.

12. On 16 March 2010, while the listing application was still pending, EY resigned as reporting accountant and independent auditor with immediate effect, citing "*inconsistencies in documentation in a number of areas that lead us to the conclusion that we can no longer continue as auditors*" as the reason in its letter to the Company ("**Resignation letter**"). Two days later, EY informed the Stock Exchange of its resignation.

13. On 24 March 2010, the Company withdrew its listing application, after having been asked by its joint Sponsors to do so.

14. On 29 March 2010, SFC requested EY to provide documents and information relevant to its initial assessment of whether there was any implication of false accounting in the Company's listing application. On 7 April 2010, EY replied to SFC, stating it was bound by the Code of Ethics for Professional Accountants which permitted disclosure of its

clients' affairs in limited circumstances only, and that it could not *voluntarily* provide to SFC the information sought.[1]

15. In view of EY's reply, on 9 April 2010, SFC issued a direction to investigate whether any market misconduct or offences under sections 277, 298 and 384 of SFO might have been committed in relation to the listing application of the Company ("**the Investigation**").

C. THE NOTICES

16. On 12 April 2010, SFC's investigator issued the first of the Notices to EY under section 183(1) of the SFO ("**1st Notice**") requiring it to *inter alia* (1) explain, in details and with supporting documents, the reason for resigning as reporting accountant of the Company in its listing application, and in particular, the inconsistencies in documentation it encountered; (2) provide a list of all staff involved in the listing application of the Company with names, titles, phone numbers etc; (3) supply all correspondence between EY and the Stock Exchange/ the Company/ the joint Sponsors in relation to the preparation of the Company's accounts for the purpose of the listing ("**relevant correspondence**").

17. EY's response came in a letter dated 30 April 2010. In the letter, EY explained to SFC that it had in fact used the services of HM to perform the Engagement. According to the letter, "all the underlying working papers of the Engagement were created by [HM] in the PRC and all communications with the Company and the Sponsors were also conducted through staff of [HM] in the PRC."

[1] EY ceased to rely on the Code of Ethics after receiving the Notices referred to below.

18. EY further alleged there were legal impediments under PRC laws which restricted the ability of HM and its staff to disclose information and documents generated in the course of the Engagement and it was unable to compel HM to provide any more information or documents other than those set out in the letter.

19. In the letter, EY did provide a list of 7 staff said to be involved in the listing application. EY also provided five documents to the SFC viz copies of the Engagement Letter, the General Terms, the Fees letter, the Resignation letter and its letter to the Stock Exchange.

20. On SFC's case, EY's non-compliance with the 1st Notice consisted of its failure to (1) give a full explanation of the reason for its resignation and the inconsistency in documentation or provide any supporting documents, (2) provide the name and other details of Mr Yam to SFC, (3) supply all correspondence exchanged between HM's audit team and the Company during the Engagement ("**HM correspondence**").

21. On 6 May 2010, SFC's investigator issued the second of the Notices to EY ("**2nd Notice**") requiring it to make available to SFC (1) the names of the documents mentioned in paragraph 1 of its 30 April 2010 letter together with copies, (2) all audit working papers relating to the Company's listing application.

22. By letter dated 14 May 2010, EY replied it was unable to compel HM to provide copies of the documents sought or to give it access to the audit working papers, again citing legal impediments under PRC laws as the reason.

23. On SFC's case, EY has totally failed to comply with the 2nd Notice.

24. Afterwards, SFC's investigator issued 7 more notices to EY, the details of all of which need not be repeated here. This is because at the substantive hearing of the Originating Summons, SFC confined its complaints to EY's non-compliance with the 3rd Notice dated 14 May 2010, the 4th Notice dated 1 June 2010 and the 7th Notice dated 6 October 2011.

25. In the 3rd Notice dated 14 May 2010, SFC sought further information on:

(1) the roles and responsibilities of the EY staff involved in the listing application;

(2) those PRC laws and regulations under which HM was allegedly prohibited from disclosing information obtained and documents generated in the course of the Engagement;

(3) whether EY had signed any service agreement with HM in relation to the Engagement; and

(4) correspondence circulated among EY, HM, the Joint Sponsors and the Company during the listing process in discussion of the issues raised a document (attached as an Appendix to the 3rd Notice) provided by the Company to the Joint Sponsors.

26. On 25 May 2010, EY replied that it had not signed any service agreement with HM in relation to the Engagement, and that certain

provisions of the PRC laws, the most notable of which was Article 19 of the CPA Law which prohibited the disclosure to third parties of documents, including audit work papers, and confidential information obtained during the professional work by a certified public accountant. In that reply, EY had once again omitted to mention the role and responsibility of Mr Yam and failed to disclose any correspondence circulated among EY, HM, the Joint Sponsors and the Company as sought on the ground that it had no involvement in the preparation of the Appendix or in the discussion of the issues raised in it.

27. Meanwhile, by letter dated 24 May 2010, SFC requested the assistance of CSRC to obtain all working papers in relation to HM's audit of the Company, pursuant to the Memorandum on Regulatory Cooperation ("**MORC**") dated 19 June 1993 between *inter alia* SFC and CSRC as well as the International Organization of Securities Commissions ("**IOSCO**") Multilateral Memorandum of Understanding ("**MMU**") to which both SFC and CSRC are signatories. CSRC then made a request to HM for the audit working papers but HM refused to do so on the ground of its duty of confidentiality and CSRC's lack of jurisdiction over the Company. By letter dated 23 July 2010, CSRC informed SFC accordingly.

28. In the 4th Notice dated 1 June 2010, SFC requested for the name and title of the person best placed to answer its inquiries in relation to the contents of a letter dated 21 May 2010 from the Company to EY challenging the latter's resignation as wholly unjustified, as SFC would like to interview that person.

29. EY did not provide the information sought in its reply dated 4 June 2010 or suggest it did not have such information. Nor did it,

on SFC's case, contain any proper explanation as to why HM was prohibited by PRC laws from disclosing the name and title of the person concerned, if that be the case.

30. Lastly, in the 7th Notice dated 6 October 2011, SFC sought the same information as requested in the 1st Notice. The reply from Linklaters, EY's solicitors, dated 13 October 2011 was also in essence the same as EY's previous replies.

31. In gist, SFC complains that EY has failed to comply with the Notices in the following respects ie :

(1) failing to give details of the "*inconsistencies in documentation*" which had led to EY's resignation together with all supporting documents;

(2) failing to provide the audit working papers, the relevant correspondence and the HM correspondence pertaining to the Engagement;

(3) failing to disclose the name, role and responsibility of Mr Yam in the listing application or the name and title of the person best placed to answer its inquiries in relation to the letter dated 21 May 2010 from the Company to EY.

D. FURTHER DISCLOSURE BY EY

32. EY filed and served the Affirmation in these proceedings on 7 December 2012. It was only in that Affirmation that EY for the first time identified Mr Yam as a partner of EY who had taken responsibility for and

supervised the Engagement. By then, Mr Yam has resigned from both EY and HM for over one and a half years.

33. EY said the day before the substantive hearing of these proceedings, it had discovered that the hard drive of the laptop used by Mr Yam ("**Hard Drive**") had been sent to the Forensic, Technology & Discovery Services Division ("**FIDS**") of Ernst & Young Advisory Services Limited ("**EYASL**") in Hong Kong for the purpose of creating a forensic (physical) image of the Hard Drive and that the computer hard drive ("**Imaged Hard Drive**") containing the said forensic image together with the Hard Drive had been kept in Hong Kong under the custody of FIDS ever since.

34. Further, EY said the day before the substantive hearing of these proceedings, it had also discovered snapshots of Mr Yam's email archives for the months of June & July 2009 and March to May 2010. They were stored in the email server backup tapes of HM in the PRC but had previously been extracted by an IT staff member of HM and sent to EYASL in Hong Kong for preservation. The soft copies of these extracted emails were stored in a hard drive ("**Email Hard Drive**") by FIDS in 2011 and have since been kept in Hong Kong. A duplicate of the Imaged Hard Drive and the Email Hard Drive was created on 28 March 2013 to ensure the contents of the Hard Drive, Imaged Hard Drive and Email Hard Drive (collectively "**three Hard Drives**") would be preserved.

35. The above was explained in an affirmation dated 27 March 2013 of Ms Beverly Kwong ("**Ms Kwong**"), an in-house legal counsel who only joined Ernst & Young Group Limited in January 2013, and a letter dated 24 April 2013 from Linklaters to SFC.

36. According to Ms Kwong, she was informed on 26 March 2013 that the Hard Drive was removed from Mr Yam's laptop and sent to Hong Kong for the purpose of creating a forensic (physical) image of it in connection with a "partner matter". No information was given by Ms Kwong as to when, how and by whom the Hard Drive was sent to Hong Kong. Nor was there evidence that EY or HM was, at that time, in any way concerned about the legal restrictions under PRC laws and dire consequences of violation of those restrictions now claimed by EY.

37. Ms Kwong affirmed that the information and files stored in the Hard Drive might contain materials responsive to the Notices. Although she said EY intended to disclose such materials to SFC in compliance with the Notices, it has not done so. Judging from the content of Linklaters' letter dated 24 April 2013, the reason appears to be that HM, by a letter dated 27 March 2013 to EY, has asserted proprietary rights over the Hard Drive and Imaged Hard Drive and their contents, prohibited EY from accessing the information in them and demanded their return.

38. Linklaters, in another letter dated 15 May 2013 to SFC, acknowledged that the three Hard Drives contained information responsive to the Notices, including the audit working papers and other archives. However, they said they were instructed that the Hard Drive was erroneously brought to Hong Kong by EYASL and the Imaged Hard Drive created by mistake. They also alleged the information contained in them was confidential to HM and other third parties and disclosure of it to SFC in response to the Notices might put EY and its staff in danger of violating various PRC laws and subject EY, as well as its partners who participated in and supported the decision to make the disclosure, to potential criminal liability.

39. EY subsequently filed an Affidavit of Ms Alison Davies ("**Ms Davies**"), another in-house legal counsel, dated 6 June 2013. In the Affidavit, she explained that the Hard Drive was brought to Hong Kong on a partnership matter unrelated to these proceedings, around February 2011. She also produced some emails between herself and Mr Duwenhorst, associate director of FIDS, some of which was copied to her boss, Mr Alan Collins ("**Mr Collins**"), formerly General Counsel for the Asia Pacific region, to show that a decision was initially made to instruct Mr Duwenhorst and the FIDS team to retrieve and process *inter alia* the Hard Drive and Mr Yam's email archives.

40. Lastly, as explained in Linklaters' letter dated 10 July 2013, EY had in the meantime conducted further investigation and identified more materials potentially responsive to the Notices: (1) two of EY's staff might have in their possession documents potentially responsive to the Notices; (2) EY found five other Hard Drives and at least two IT Servers which are in its or EYASL's physical possession in Hong Kong and which might also contain materials potentially responsive to the Notices; (3) one of the five Hard Drives was retrieved from the laptop of a staff of HM and brought to Hong Kong by EYASL for purposes unrelated to these proceedings.

E. THE STATUTORY REGIME

41. The relevant legislation is contained in Part VIII of SFO.

42. Section 182 of SFO provides for the initiation of an investigation where SFC has reasonable cause to believe that an offence or market misconduct may have been committed or taken place.

43. Section 183(1) SFO states as follows:

> "(1) The person under investigation or a person whom the investigator has reasonable cause to believe has in his possession any record or document which contains, or which is likely to contain, information relevant to an investigation under section 182 or whom the investigator has reasonable cause to believe otherwise has such information in his possession, shall –
>
> (a) produce to the investigator, within the time and at the place the investigator reasonably requires in writing, any record or document specified by the investigator which is, or may be, relevant to the investigation and which is in his possession;
>
> (b) if required by the investigator, give the investigator an explanation or further particulars in respect of any record or document produced under paragraph (a);
>
> ….
>
> (d) give the investigator all assistance in connection with the investigation which he is reasonably able to give, including responding to any written question raised by the investigator."

44. Under section 184(1) SFO, a person who, without reasonable excuse, fails to do what he is required to under section 183 is guilty of an offence.

45. Instead of prosecuting a person for the offence, SFC may make an application to the Court of First Instance under section 185(1) SFO in respect of his failure. The section provides that the Court may inquire into the case and

> (1) if the Court is satisfied that there is no reasonable excuse for the person not to comply with the requirement, order the person to comply with the requirement within a specified period, and

(2) if the Court is satisfied that the failure was without reasonable excuse, punish the person, and any other person knowingly involved in the failure, in the same manner as if he/they had been guilty of contempt of court.

46. For completeness, I should add that

(1) Section 178 SFO defines "audit working papers" as:

(a) any record or document prepared by or on behalf of an auditor; and

(b) any record or document obtained and retained by or on behalf of an auditor,

for or in connection with the performance of any of his functions relating to the conduct of any audit of the accounts of a corporation.

(2) Schedule 1 of SFO defines "auditor" to mean *inter alia* a certified public accountant (practicing) as defined in the Professional Accountants Ordinance, Cap. 50.

F. PRELIMINARY OBSERVATIONS

47. SFC takes the stance, in the view of this court advisedly, that section 183(1) SFO does not have or purport to have any extraterritorial effect in the same way that, for instance, section 106 of the US Sarbanes-Oxley Act of 2002 does. No legitimate parallel can be drawn between the present application and the US proceedings commenced by the

Securities and Exchange Commission ("**SEC**") against accounting firms in the PRC for the direct production of audit papers to the SEC and the Public Company Accounting Oversight Board ("**PCAOB**").

48. It is also SFC's avowed stance, again in the view of this court taken advisedly, that it does not intend to challenge the validity of any PRC laws or expose EY to the risk of prosecution under PRC laws.

49. It must therefore be emphasised that the decision of this court is concerned with and only with the obligation of EY as a firm in Hong Kong to comply with the Notices issued under the SFO as part of the laws of Hong Kong. HM has never been issued with any of the Notices and there is no question of HM being compelled by SFC or this court to directly produce to SFC any of the audit working papers or other relevant documents situated in the PRC.

G. SUMMARY OF THE PARTIES' POSITIONS

50. SFC's case can be summarized as follows.

51. First, EY plainly must know the reason for its resignation and details of the inconsistencies in documentation provided by the Company.

52. Second, EY has "possession" of the audit working papers and other relevant documents pertaining to the Engagement, whether in Hong Kong or in the PRC.

53. Third, in so far as the audit working papers and other documents responsive to the Notices are contained in any of the Hard

Drives in Hong Kong, EY has failed to demonstrate any applicable restrictions under PRC laws which prohibit it from disclosing them in Hong Kong to SFC.

54. Fourth, in so far as the audit working papers or any other documents responsive to the Notices are in the physical possession of HM in the PRC, EY has failed to establish any restrictions under PRC laws which prohibit HM from providing them to EY to enable it to comply with the Notices. Even for those PRC laws relied upon by EY, there are clearance procedures in place. If these procedures must be followed in order to bring the audit working papers and other documents across the border, it is incumbent upon EY, directly or via HM, to comply with them - EY could have but did not even attempt to do so.

55. In gist, EY is in possession of materials responsive to the Notices and has failed to provide any reasonable excuse for its non-compliance with them.

56. EY does not challenge the validity of the Notices. Its case can be summarized as follows.

57. The reasons for its resignation are very much tied to the audit working papers. Without the papers, it would be unreasonable to expect anyone in EY to be able to state accurately and comprehensively what has happened. Mr Yam is no longer with EY. It would not be meaningful to compel EY to give information which was in the knowledge of its former staff.

58. In relation to the audit working papers:

(1) All the on-site field work of the audit was undertaken by HM's audit team at the Company's offices in Beijing. All the papers were generated and kept by HM in Beijing. HM is a separate legal entity and the property in the papers resides in HM - EY does not have any right over them.

(2) EY has already provided SFC with all information and documents it was able to. Those further records and documents requested by SFC which are physically in the PRC are not within its possession but in the possession of HM. EY must comply with the guidelines issued by HKICPA which require it to comply with all relevant PRC laws.

(3) PRC laws restrict cross-border transmission of audit working papers and prohibit direct production of them to overseas regulators. EY does not have a presently enforceable right to HM's papers - even if EY were to sue HM in the PRC Court for the audit working papers or other HM's documents, the PRC Court would not order HM to hand them over.

(4) The appropriate channel for SFC to obtain HM's papers is through the CSRC. The two regulators have a cooperation mechanism for such mutual assistance. HM, through its lawyers, has indicated that it is willing to follow CSRC's instructions.

59. As for the three Hard Drives in Hong Kong:

(1) EY accepts that it has "possession" of the Hard Drives.

(2) HM has asserted a proprietary interest in the Hard Drives and their contents, demanded their return and forbidden EY from searching for potentially relevant documents.

(3) The Hard Drives came to be in Hong Kong by mistake. Handing them over or disclosing their contents to SFC may involve breaches of PRC laws and put EY and its partners at risk of criminal and/or administrative sanctions. The better channel for SFC to obtain the relevant materials is through CSRC.

H. MR LEUNG AS A FACTUAL WITNESS

60. While Mr Leung did not have any personal involvement in the Engagement, he says he has acquired sufficient knowledge concerning the manner in which the Engagement was performed from his involvement in (i) EY's decision to resign and (ii) the handling of the Notices: paragraph 7 of the Affirmation. He also says "The facts and matters to which I refer are within my own knowledge and are true": paragraph 3 of the Affirmation.

61. I mention this specifically because it is SFC's submission that Mr Leung has virtually no personal knowledge of the facts material to this case, he is unable to answer many relevant questions put to him in the course of his oral testimony and it queries why EY put him forward as its

principal factual witness in the first place. This court should add there is no suggestion in the Affirmation other partners of EY who were *personally* involved in the Engagement, most notably Miss Lam[2], a partner of both EY and HM and the independent review partner of the Engagement, or Mr Larry Mills ("**Mr Mills**"), the partner who signed off EY's replies to the Notices and retired only in November 2012, have refused to testify. In these circumstances, it is SFC's submission that EY is trying to provide as little information as possible to SFC and the court during the proceedings.

62. In my view, there is considerable force in the submission.

63. As a general observation, this court notes that Mr Leung was unable to answer a large number of questions put to him in the course of cross-examination, frequently on the grounds that (1) he had no recollection, (2) he was not clear about the matter asked of him or (3) he simply did not know. This is so even when the questions were directed at matters which he said he had personal involvement ie EY's decision to resign and in the handling of the Notices.

64. For instance, when cross-examined about his involvement in EY's decision to resign, it transpired that Mr Leung's involvement was limited to one brief oral consultation with Mr Yam in Beijing, days before the Resignation letter, details of which he could not recall as it took place years ago. Mr Leung also testified, during cross-examination, that he had received a "consultative memo" dated 13 March 2010 from Mr Yam to eight members of EY, including himself, Ms Lam and Mr Joe Tsang,

[2] In Linklaters' letter dated 10 July 2013, Miss Lam was still named as a current partner of EY.

a partner of EY and HM's leader of North China. However, Mr Leung said he did not read it thoroughly, even though the memo was for the express purpose of the intended resignation which was a serious matter for EY.

65. When cross-examined about his involvement in dealing with SFC's request for information, Mr Leung's testimony was essentially that he was informed of it but it was really the in-house counsel who handled the matter. The same applied to the Notices. Other than being informed of the Notices, Mr Leung had no involvement in their handling - it was Mr Mills, the designated partner working together with the in-house counsel, Mr Collins and Ms Alice Chu, who were responsible for drafting and signing off the replies to SFC.

66. Importantly, Mr Leung admitted, during the preparation of the Affirmation, he knew there were files within EY which recorded the steps taken to ascertain the answers to SFC's inquiries but he did not go through any of them. Nor did he inquire with any other partners who were consulted by Mr Yam in order to get further information on the decision to resign.

67. In addition, what Mr Leung did depose to in the Affirmation or testify in court is not entirely reliable either.

68. For instance, at paragraphs 41, 42 and 44 of the Affirmation, Mr Leung deposed that:

(1) All working papers created in the course of the audit of the Company were generated and have since been held by HM in the PRC. (paragraph 41)

(2) As far as he understood from HM's audit team including Mr Yam these working papers take three forms:

(i) Hard copies which, since their coming into existence, have been and are still held in the custody of HM at its office in Beijing.

(ii) Electronic work papers stored in the laptops of members of HM's audit team, which, since the start of the Engagement, have been and remain at HM's office in Beijing.

(iii) Email correspondence exchanged among HM's audit team, the Company's representatives and other professional advisers in the course of the Engagement, which was and remains on HM's server located in the PRC, to which neither EY nor any of its partners or employees have had access since the termination of the Engagement in March 2010. (paragraph 42)

(3) Since the termination of the Engagement in March 2010, neither EY nor any of its partners (including Mr Yam prior to his resignation from EY and HM in March 2011) continued to have access to the working papers which were and remain in the physical possession of HM in the PRC. (paragraph 44)

69. During his examination-in-chief, Mr Leung had to correct himself in that (1) the day before the substantive hearing, he was told an imaging of the Hard Drive was in Hong Kong, (2) he was recently

informed that a Hong Kong IT colleague could have access to the server in the PRC after the termination of the Engagement for the purpose of carrying out IT work, and (3) Mr Yam continued to have his laptop with him, which contained the audit working papers, up to his resignation in March 2011.

70. Further, during his cross-examination on Day 2, Mr Leung admitted that the opening sentence of paragraph 42 of the Affirmation was incorrect because he had not in fact talked to Mr Yam or any member of HM's audit team regarding the three forms of the audit working papers. He also admitted that for the purpose of preparing the Affirmation, he only deduced, without checking with Mr Yam or anybody else, that whatever was in HM's servers in the PRC, neither EY nor any of its partners or employees have had access to it after the termination of the Engagement.

71. Take another example. Mr Leung's oral testimony was that there was no specific agreement between EY and HM concerning the Engagement. Nor was there any standing arrangement or written agreement between them with regard to similar types of co-operation. Then, when asked whether there was even one piece of paper governing the relationship between EY and HM as member firms of the same Ernst & Young global network, Mr Leung at first said he had no personal knowledge, then he said he did not know and lastly admitted that there should be one although he did not know where it was.

72. Lastly, Mr Leung's evidence at paragraphs 32 to 35 of the Affirmation was that EY had very little involvement in the Engagement,

in that less than 1% of the total billable hours[3] was recorded by EY's staff and only 0.02% of the fees generated from the Engagement was allocated to EY, with the balance received by HM. There is no evidence from EY as to the actual amount of fees charged by it, but if the estimated fees of RMB 4,350,000 stated in the Fees letter are correct, EY would have only received less than RMB1,000 for the entire Engagement.

73. When asked about this in cross-examination, Mr Leung said when he looked at the figures, he felt they were reasonable, but went on to say it was not within his own knowledge. With respect to Mr Leung, if he meant to say the figure of less than RMB1,000 looked "reasonable" to him, this sounds unreal to this court. If he in fact had no personal knowledge of how much EY charged for the Engagement, he should have made that clear in the Affirmation.

74. With respect to Mr Leung, this court does not find him of much assistance as a factual witness. In so far as EY seeks to rely on his factual evidence in contending that it has already fully complied with the Notices, this court has come to the firm view that it cannot place weight on his evidence.

I. THE EXPERT WITNESSES ON PRC LAWS

75. There are three broad issues arising from the expert evidence adduced by the parties:

(1) Whether, after the termination of the Engagement, EY has a right enforceable under PRC laws to demand from HM the

[3] It should be less than 0.1% ie 88 out of a total of 15,072 hours.

documents sought in the Notices which are situated in the PRC, for the purpose of handing them over to SFC.

(2) Whether, after the termination of the Engagement, there is an applicable prohibition under PRC laws against the transmission from or the disclosure of the contents by HM to EY of documents sought in the Notices which are situated in the PRC, for the purpose of handing them over to SFC.

(3) Whether, after the termination of the Engagement, there are steps under PRC laws that may be taken by EY or HM, acting at EY's request, to obtain permission for the transmission from or disclosure of the contents by HM to EY of documents sought in the Notices which are situated in the PRC, for the purpose of handing them over to SFC.

76. SFC's expert is Professor Fu Hualing of the Department of Law, University of Hong Kong. His expertise is in public law, state secrets law, archives law, criminal law, cross-border legal relations between PRC and Hong Kong, the PRC legal system, the law-making procedure and legality of laws. On the other hand, his expertise is not in securities law, laws and regulations of accountants or accounting practice.

77. EY's expert is Professor Liu Yan from the Law School of Peking University. Her expertise is in securities law, corporate law, laws and regulations relating to accountants and accounting practice. She has obtained CPA qualifications and legal qualifications in the PRC. She has been a member of the Disciplinary Committee of CICPA. She is

admittedly not an expert in criminal law and there is no suggestion that her expertise covers public law in general.

78. Both professors are learned in their respective areas of expertise. On the whole, this court finds them fair and honest witnesses. As expected, the basic positions taken by Professor Fu and Professor Liu differ in material respects. Nevertheless, it is helpful that both professors are able to agree on some key issues in their Joint Report dated 4 June 2013 as follows:

(1) The nature of the relationship between EY and HM is governed by PRC laws, more specifically Chapter 21 of PRC Contract Law. Their relationship is one of agency of entrustment (委托合同).

(2) Apart from the Contract Law, the potentially relevant PRC laws, regulations, departmental rules (部门规章) and normative documents (规范性文件) in the present case are:

(i) Securities Law.

(ii) Law on Certified Public Accountants ("**CPA Law**").

(iii) State Secrets Law;

(iv) Archives Law.

(v) Regulation on Strengthening Confidentiality and Archives Administration Relating to Overseas Issuance and Listing of Securities (Circular [2009] No. 29 dated 20 October 2009 ("**Regulation 29**"), a departmental rule

jointly promulgated by the CSRC, the National Administration for Protection of State Secrets ("**State Secrets Bureau**"), and the State Archives Bureau. It specifically governs the preservation of records and documents generated during listing of PRC enterprises in overseas markets.

(vi) Reply letter dated 26 October 2011 ("**2011 Reply**") a normative document issued by the Accounting Department of the CSRC to the PRC affiliates of international accounting firms in response to their request for guidance on what the firms should do when overseas regulators request for production of audit working papers.

(vii) Localization Regulation promulgated on 2 May 2012 ("**Localization Regulation**") jointly by the MoF, the Industry and Commerce Bureau, the Ministry of Commerce, the State Administration of Foreign Exchange and the CSRC. It governs the conversion of sino-foreign joint venture firms into partnerships.

(3) Regulation 29 is the most important departmental rule governing cross-border transmission of auditors' working papers to overseas securities regulatory authorities. The PRC Courts, when determining a dispute between EY and HM as to whether to order such transmission, will take into consideration the provisions of Regulation 29. Separately, both professors in their respective reports are of the same view that Regulation 29 does not impose a *blanket*

prohibition on cross-border transmission of audit working papers to overseas securities regulatory authorities - such transmission is permissible if prior approval from the relevant government departments has been obtained. They do differ on the nature of the documents which require prior approval and which are the relevant government departments.

(4) The audit working papers generated by HM in the course of the Engagement should be considered archives under Art 16 of the Archives Law. Apart from Regulation 29, the law most germane to the present discussion would be Art 18 of the Archives Law and Art 19 of the Archives Law Implementation Rules.

(5) While HM owes a duty of confidence to the Company regarding the latter's commercial secrets pursuant to Art 19 of the CPA Law, in the ordinary course of business, such a duty cannot be used by HM to resist EY's request for information obtained by HM in the course of the Engagement.

(6) Whether the audit working papers contain State secrets or commercial secrets is fact sensitive. The answer to the question depends entirely on its contents. It is common ground that neither professors have been shown and therefore have not reviewed the contents of the audit working papers.

J. THE COURT'S APPROACH

79. EY submits, and this court accepts, that the proper approach of the court in dealing with an application by SFC under section 185 SFO should be:

(1) Firstly, to determine whether the documents which the SFC seeks are within EY's possession.

(2) Secondly, if the documents are within EY's possession, whether there is a reasonable excuse for EY not to have complied with SFC's request.

(3) Thirdly, the court retains a discretion throughout the inquiry. Even where the statutory conditions are fulfilled, the court is not bound to make an Order in favour of SFC. The court will have to look at all the circumstances of the case and decide what, if any, Order it should make in the justice of the case.

80. Before I turn to the facts, I should first examine briefly the applicable legal principles.

Possession of Records and Documents

81. Under the previous Securities and Futures Commission Ordinance, Cap. 24 (repealed), the burden was on SFC to establish, on balance of probabilities, that the records and documents sought in a notice issued under s 33(4) existed and were in the recipient's "possession" or under its "control": *Kwan Wing Kim v. Cheung Ka Kim* [1999] 2

HKLRD 331 at 335F-G. It is common ground that the legal position should be the same under the SFO ie the burden is similarly on SFC to establish, on balance of probabilities, that the records and documents sought in the Notices are in EY's "possession".

82. For the present purpose, "possession" in relation to any matter includes "custody, control and power" of or over the matter: Schedule 1 of SFO.

83. The words "possession", "custody", "control" and "power" are familiar concepts under Hong Kong laws in the context of discovery under RHC Order 24 r 1(1).

84. "*Possession*", in the context of discovery, means "the right to the possession of a document" – it does not require actual physical possession. "*Custody*" means "the actual physical or corporeal holding of a document regardless of the right to possession, for example a holding of a document by a party as servant or agent of the true owner." "*Power*" means "an enforceable right to… obtain possession or control of the document from the person who ordinarily has it in fact": *B v B* [1978] Fam 181, 186; Mathew & Malek Disclosure 4th Ed. pp 163-5.

85. In *Lonrho Ltd v. Shell Petroleum Co Ltd* [1980] 1 WLR 627, 635F to 636A, Lord Diplock further elucidated the meaning of "power" as follows:

> "The phrase [the documents which are or have been in his possession, custody or power]…looks to the present and the past, not to the future. ….and in the context of the phrase "possession, custody or power" the expression "power", must, in my view, mean a presently enforceable legal right to obtain from whoever actually holds the document inspection of it without the need to obtain the consent of any

> one else. Provided that the right is presently enforceable, the fact that for physical reasons it may not be possible for the person entitled to it to obtain immediate inspection would not prevent the document from being within his power; but in the absence of a presently enforceable right there is, in my view, nothing in Order 24 to compel a party to a cause or matter to take steps that will enable him to acquire one in the future." (emphasis added)

86. Hence, it is clear from Lord Diplock's judgment that what is required to constitute "*power*" over a document is a "*presently*" enforceable legal right to obtain inspection of it. As long as the right over the document is *presently* enforceable, it does not matter that the person entitled to the document cannot *immediately* obtain it from the person who has custody of it.

87. *Lonrho Ltd v. Shell Petroleum Co Ltd* was followed by the English Court of Appeal in *Dubai Bank Ltd v Galadari & Ors (no. 6)* Times 14 October 1992. The English Court of Appeal held, at p 4 of the Judgment, that "If a document is not in the possession or custody of a party to an action, but he is entitled as a matter of law to require the person who has custody of the document to hand over possession of it to him, the document is in his power. See *Lord Diplock in Lonrho Ltd v. Shell Petroleum* … It is clear, therefore, that the rule requires discovery of such a document".

88. The Court of Appeal in *Dubai Bank Ltd v Galadari & Ors* then went on to hold, at pp 9 – 10, that that there was no legal justification to make an order against a party, who did not have possession of the documents in question, to use all lawful means to obtain possession of documents from a third party so that an order for discovery of those documents might then be made against that party. This part of the

judgment in *Dubai Bank Ltd* is heavily relied upon by EY in resisting the present application.

89. To similar effect is the decision in *Dorajay Pty Ltd v Aristocrat Leisure Ltd* (2006) 230 ALR 549, also relied upon by EY, for the proposition at [11] that the addressee of a subpoena must produce that which he has in his "*possession, power or control*" but he is not obliged to take steps to bring documents that do not fall within these concepts into his "*power or control*".

90. EY also relies on *Dorajay Pty Ltd v Aristocrat Leisure Ltd* for the proposition at [12] & [15] that even if the addressee of a subpoena has the right to inspect and obtain copies of the documents sought from its affiliates, it has no obligation to do so in response to the subpoena – the reason being the addressee of a subpoena is not legally obliged to *create* documents ie copies of the actual documents sought. Further, while the addressee had the right to inspect and obtain copies of the documents sought, the court was not satisfied on the evidence that it had a right or power to compel its affiliates to provide it with the *actual* documents in question.

91. Lastly, EY relies on *Alstom Limited v Liberty Mutual Insurance Company* [2010] FCA 588, a decision of Siopis J of the Western Australia District Registry, at [22] for the proposition that if a person's contractual right to inspect certain documents is subject to a third party's claim to confidentiality, and that third party has refused to release its claim to confidentiality in the documents, he will not be regarded as having a

"presently enforceable legal right" to inspect the documents within Lord Diplock's definition in *Lonrho Ltd v. Shell Petroleum Co Ltd.*

92. For reasons which will be explained later in this judgment, this court accepts SFC's submission that, under PRC laws, EY has not just a right of access to and make copies of the audit working papers for the purpose of the Engagement, but also a presently enforceable legal right to demand their production from HM. In other words, the audit working papers are in the "*power*" and hence "*possession*" of EY. There is thus no question of requiring EY to obtain or otherwise bring the papers into its possession. Further, this court also finds, as a matter of PRC laws, HM cannot rely on its duty of confidentiality towards the Company in resisting production of the audit working papers to EY. For these reasons, both *Dorajay Pty Ltd v Aristocrat Leisure Ltd* and *Alstom Limited v Liberty Mutual Insurance Company* are clearly distinguishable and do not assist EY in its opposition to the present application.

93. Before moving on to the next topic, this court should mention one more point.

94. In the course of hearing the experts' testimony, considerable time has been spent on the question of whether EY or HM had ownership of the audit working papers. Further, extensive written submissions have been made by EY on the question of ownership.

95. In the view of this court, "ownership" as such is not the relevant test under section 183 SFO. Under that section, there is no express requirement that the record or document sought by the investigator must be

owned by the recipient of the statutory notice[4]. The key word is "possession". In its written closing submissions, EY argued that in deciding the issue of whether it has "possession" of the audit working papers, the first question to ask is which of EY and HM has property in the papers under PRC laws. With respect, this court is unable to accept this argument.

96. EY then puts forward the proposition that, whether or not this court accepts Professor Liu's evidence on the issue of property under PRC laws, Hong Kong law is to the same effect ie (i) the property in any papers created or produced by a professional person belongs to him, and not his client; (ii) the client does not have a right to the papers, not even for purposes of discovery or inspection: *Chantrey Martin v Martin* [1953] 2 QB 286, at 292-293 following *Leicestershire County Council v Michael Faraday & Partners* [1941] 2 KB 205.

97. It seems to this court that EY's reliance on the two cases is misconceived.

98. In *Leicestershire County Council v Michael Faraday & Partners*, the Court of Appeal held that the relationship between the Leicestershire County Council and Michael Faraday & Partners, a firm of rating valuers, was that of client and professional man, and *not* that of principal and agent. It was on this basis that the Court held that the documents which the valuers had prepared in carrying out their expert work were their own property, and in the absence of any agreement to hand them over to the client, the valuers were not bound to do so.

[4] Although it is accepted by Professor Liu that if EY owns the audit working papers, it must also have the right of possession over the papers.

99. Similarly, in *Chantrey Martin v Martin*, the Court of Appeal held that working accounts and other papers brought into existence by the plaintiff chartered accountant in the preparation of a final audit of a client's books were the property of the accountant and not of the client.

100. In the view of this court, the two cases may assist EY if the issue which calls for adjudication is whether its client viz the Company, had a right to the audit working papers. They are irrelevant to the present case. For reasons to be explained in the section "*Relationship between EY and HM*", this court finds their relationship is that of principal and agent, and *not* client and professionals. If so, it is trite law that an agent has a duty to produce to the principal all books and documents in his hands relating to the principal's affairs, even though the documents are prepared or created by the agent, so long as they are prepared or created for the purpose of the agency relationship: *Bowstead & Reynolds on Agency* 19th Ed. para. 6-090; 6-093.

Reasonable Excuse

101. Reasonable excuse is not defined in the SFO.

102. It is common ground that where a person relies on a defence of reasonable excuse, and the onus of proof being on him[5], the court will:

(1) identify the matters said to constitute reasonable excuse;

(2) examine whether the excuse is genuine; and

[5] Phipson on Evidence 17th Ed. para. 6-06.

(3) assess whether the excuse is reasonable.

HKSAR v. Adams Secuforce (International) Ltd [2008] 1 HKLRD 207 at 211 para. 10.

103. The assessment of whether the excuse put forward is reasonable is an objective one depending on the particular facts of the case: *HKSAR v. Adams Secuforce (International) Ltd* supra.

104. In *Bank of Valletta PLC v National Crime Authority* (1999) 164 ALR 45, the second respondent issued a notice to attend and produce to the National Crime Authority documents held by the applicant bank. The bank was incorporated in and carried on business in Malta. The documents in question were all kept in Malta. The bank contended that it had a reasonable excuse for not complying with the notice in that compliance would involve the bank in the commission of an offence under Maltese law, that conviction could trigger the imposition of restrictions on its Maltese banking licence and there were alternative avenues available to the Authority to obtain the documents in question without exposing the bank to criminal penalty.

105. The following principles can fairly be distilled from the judgment of Hely J:

(1) "Reasonable excuse" should be given an ordinary construction - it should not be given a narrow meaning as the phrase appears in a provision which can impose a criminal sanction for its breach [40].

(2) A reasonable excuse includes any excuse which would be accepted by a reasonable person to justify the non-compliance with a notice lawfully issued; in other words, the test is objective rather than subjective; each case is highly sensitive to its own facts [41], [47].

(3) Physical or practical difficulties in producing the documents are illustrative of matters constituting reasonable excuse. So are cases where the non-compliance is based on some right, privilege or immunity recognized by law. However, reasonable excuse is not confined to such cases [36], [38], [42].

(4) Inherent in the concept of "reasonable excuse" is a balancing of all the consequences of the refusal to give evidence or produce documents [44].

(5) If a reasonable person in the circumstances would conclude that the Australian public interest in the investigation of criminal activities outweighed any public or private interest in the maintenance of banker/customer confidentiality under Maltese law, then the possibility that the bank would be exposed to criminal liability under Maltese law did not establish a reasonable excuse for not complying with the notice [60].

(6) If there were alternative means to obtain the documents without materially adverse consequences to the investigation in Australia, then a *real and appreciable risk of prosecution* under Maltese law if the documents were produced would constitute a reasonable excuse for non-production [64].

106. Hely J's decision was upheld by the Full Court in *Bank of Valletta v National Crime Authority* (1999) 165 ALR 60. The Court held that whether the breach of foreign law constituted a reasonable excuse for failing to comply with a statutory notice to produce documents depended on the court balancing all the consequences of the refusal to give evidence, including the adverse consequences to the inquiry if questions were not answered or documents not produced, and the adverse consequences to the witness if he or she was compelled to answer a question or produce a document. At [9] – [10], the Full Court observed that:

> "[9]…The thrust of the decisions is that it is not a sufficient answer to a requirement that a person give evidence or produce documents to say that to do so will or may constitute a breach of a foreign law; nonetheless, a court will weigh the effect of compliance on the person in determining whether or not to insist upon it. In *Brannigan v Davison* [1997] AC 238, the Judicial Committee of the Privy Council held that statutory exceptions such as "sufficient cause" and "just excuse" provide ample scope for all the circumstances to be taken into account. At 251 the Committee said:
>
> > Inherent in these two expressions, which are synonymous in this context, is the concept of weighing all the consequences of the refusal to give evidence: the adverse consequences to the inquiry if the questions are not answered, and the adverse consequences to the witness if he is compelled to answer.
>
> [10] We agree with Hely J that this approach ought to be taken to determination of the question whether the possibility of breach of a foreign law constitutes a reasonable excuse for failing to comply with [the statutory notice]."

Discretion and Relief

107. By using the word "may", section 185 SFO gives the court a discretion in deciding whether and if yes what remedy to grant, even if all the statutory criteria set out in that section are fulfilled.

108. In *Kwan Wing Kim v Cheung Ka Kim supra* at 338, Le Pichon J (as she then was) held a relevant consideration in exercising the court's discretion under the predecessor of section 185 SFO was what remedy would more effectively advance the public interest. Her Ladyship went on to hold that public interest would best be advanced by granting a remedy which facilitated SFC in the discharge its statutory function ie by putting it in a position of furthering its investigation.

109. This sentiment is fully supported by the Court of Final Appeal in *P v Commissioner of ICAC* (2007) 10 HKCFAR 293 at paras. 28 – 30 where Li CJ held the statutory intent of section 14 Prevention of Bribery Ordinance, Cap. 201 was that the integrity and effectiveness of the ICAC's investigation, which was sought to be advanced by the use of the special investigative power under section 14(1)(d) of the Ordinance as authorized by a court order, should not be compromised. Consistent with this intent, the scope of the court's discretion is circumscribed. Hence, where the statutory criteria are satisfied, the test for the exercise of the discretion to *refuse* relief is whether an order compelling compliance with the statutory notice would be oppressive to the recipient - this is a high test.

K. AUDIT WORKING PAPERS AND OTHER RELEVANT DOCUMENTS IN THE PRC

110. The first question is whether EY has possession of the audit working papers and other relevant documents e.g. the HM correspondence which are in the custody of HM in the PRC.

111. To answer this question, it is necessary to consider the relationship between EY and the Company and between EY and HM under the Engagement.

Relationship between EY and the Company

112. As between EY and the Company, the position is governed by express contractual provisions.

113. Clause 8 of the General Terms provides that the documents and files produced during the course of providing the services under the Engagement, including working papers belong to EY and shall be "owned, managed and controlled" by EY. Clause 10 of the General Terms provides that EY may from time to time employ the service of the partners or staff of other members of the EY network. In that event, such partners or staff will be regarded as EY's employees or agents for whose acts EY will be responsible as if they were its partners or staff.

114. The contractual position is thus similar to that prescribed by law in any event: *Leicestershire County Council v Michael Faraday & Partners supra.*

Relationship between EY and HM

115. The first point to note is that it was EY, and not HM, who undertook the Engagement for the proposed listing of the Company. Clause 1 of the General Terms also makes it clear that the contracting party under the Engagement is EY, a Hong Kong partnership. This is due to a requirement in the Listing Rules that the accountant's report must be

prepared by a Hong Kong registered CPA firm qualified under the Professional Accountants Ordinance, Cap. 50.

116. The second point to note is that EY has failed to disclose any documents governing the relationship between it and HM. Mr Leung, in his oral testimony, mentioned that there should be one although he did not know where it was: see paragraph 71 above.

117. The third point to note is that it is EY's own case[6] the proper law which governs its relationship with HM is the laws of the PRC as being the system of law with which the transaction has the closest and most real connection: *First Laser Ltd v Fujian Enterprises (Holding) Company Ltd* (2012) 15 HKCFAR 569. It is also common ground among the PRC legal experts that the relationship between EY and HM is governed by PRC laws and is one of agency of entrustment.

118. The fourth point to note is that when HM entered into the agency arrangement with EY, it must have known, either through Mr Yam who signed the Engagement letter or otherwise, and accepted the terms agreed to by EY and the Company under the Engagement Letter, including the General Terms. This is amplified by the fact that the Engagement letter, the General Terms and the Fees letter were all issued under HM's letterhead. In particular, in entering into the agency arrangement with EY, HM must know and have accepted that the audit working papers generated by its staff during the Engagement should be regarded as generated by the individuals as EY's agents and employees (pursuant to clause 10) and shall be owned, managed and controlled by EY (pursuant to clause 8).

[6] EY's Opening para. 23

119. The fifth point to note is that in its letter dated 9 March 2011 to HM, EY in fact relied on the General Terms and asserted that it owned the documents created in the course of the Engagement, including the audit working papers. When HM declined EY's request for *inter alia* the audit working papers on 11 March 2011, it did so *not* because the General Terms were not applicable, but because of its perceived restrictions imposed by various PRC laws e.g. CPA Law, State Secrets Law, Archives Law and other Practising/ Professional Standards. In other words, it is clearly reflected in contemporaneous correspondence that *both* EY and HM accepted that their relationship was governed by the General Terms.

120. Since HM (and its staff) acted as the agent of EY in carrying out the audit field work, it has a duty to produce to EY all books and documents in his hands relating to the audit field work, even though they are created by HM (or its staff): *Bowstead & Reynolds on Agency supra*. Further, EY, as principal, is entitled to have continuing access to and make copies of HM's records relating to acts done on its behalf, even after the termination of the agency, unless there is an express agreement to the contrary. This is a duty imposed by law in consequence of the existence of the principal/agent relationship: *Yasuda Fire & Marine Insurance v Orion Marine Insurance* [1995] QB 174 at 186A-B.

121. The question is whether there is anything in PRC laws which contradicts this conclusion, to which I now turn.

EY's right to the audit working papers under PRC Laws

122. The experts agree that the relationship between EY and HM was one of agency of entrustment. Originally, it was Professor Liu's opinion that, subject to the question of approvals from the relevant authorities for cross-border transmission, HM was under a "statutory duty" to provide the audit working papers to EY as its principal[7] for the purpose of complying with the Notices. According to Professor Fu, the statutory basis of HM's duty to provide the audit working papers to EY is Art 404 of the Contract Law.

123. By the time of the Joint Report, Professor Liu appeared to have "backtracked" in two respects: (i) she raised the issue of *ownership* of the audit working papers and opined that HM owns them or, in her words, has "original property"[8] in them; (ii) she differed from Professor Fu's interpretation of Art 404 of the Contract Law.

124. Art 404 of the Contract Law (合同法) provides:

> "受托人处理委托事务取得的财产，应当转交给委托人".

125. A working translation of it reads:

> "The agent shall hand over to the principal the property obtained in the course of handling the entrusted matters".

126. EY submits that Professor Fu's opinion, based as it is on Art 404, is too simplistic. To start with, it is doubtful whether the audit

[7] Prof Liu's 1st Opinion para. 11.18.
[8] "原始所有权"

working papers created by HM are "取得的财产" ie "property obtained" within the meaning of Art 404. It submits that Professor Liu's opinion offers a more realistic interpretation of Article 404. In her 2nd Opinion, as well as the Joint Report, She pointed out that the term "property obtained" is not clearly defined. In order to properly apply Art 404, one must look to (i) the purpose of the agency of entrustment; and (ii) the probable intent of the parties in the particular legal environment. Professor Liu concluded it was inaccurate to interpret Art 404 as requiring *all* materials obtained or generated in the course of handling the entrusted matter as property that should be handed over to the principal.

127. This court is prepared to assume Professor Fu's approach is too simplistic and adopt Professor Liu's approach to the interpretation of Art 404 instead.

128. As far as the purpose of the agency of entrustment is concerned, it is to enable EY to prepare the accountant's report for the purpose of the Engagement. It is common ground between the experts that, under the agency of entrustment, EY at least has a right to inspect and use the audit working papers for that purpose. That must be the case since otherwise EY would not be able to fulfill its obligations as reporting accountant. Suppose *during* the Engagement, EY sent someone to Beijing to review and make copies of the audit working papers without taking them outside the jurisdiction, there was no question that HM must oblige and make them available to EY. Take that example one step further. Suppose *after* the termination of the Engagement, an issue arose as to whether or not the accountant's report signed off by EY had been properly prepared or whether certain parts of it were misleading, EY must be able to

have the audit working papers in hand in order to assess and defend its position as reporting accountant. Hence, as long as the purpose for which EY demands the audit working papers is a legitimate one, it is difficult to see why HM, as agent, should be allowed to refuse the demand from EY, its principal.

129. As far as the probable intent of the parties is concerned, this court's conclusion is that both EY and HM had accepted that their relationship was governed by the General Terms, and if so, they must also have accepted that the audit working papers generated by HM's staff should be regarded as generated by the individuals as EY's agents and employees, and should be "owned, managed and controlled" by EY pursuant to clauses 8 and 10 of the General Terms: see paragraphs 115 -120 above.

130. Hence, if one looks to the purpose of the agency of entrustment and the probable intent of the parties, it is difficult to escape from the conclusion that, pursuant to Art 404 of the Contract Law, HM as agent must on demand hand over the audit working papers to EY as its principal. This must be so *during* the Engagement. The position *after* the termination of the Engagement should be the same.

131. Further, even if one puts Art 404 aside for the time being, it is clear under Hong Kong law, HM as agent must on demand hand over the audit working papers to EY as its principal: *Bowstead & Reynolds on Agency supra; Yasuda Fire & Marine Insurance v Orion Marine Insurance supra.* Since neither expert is able to point to anything in the Contract Law which contradicts this conclusion, the legal position in the PRC is presumed to be the same as that under Hong Kong law.

132. In these circumstances, my conclusion is this: as between EY and HM, subject to any legal restrictions on cross-border transmission, EY has a presently enforceable legal right under PRC laws to demand the production of the audit working papers from HM.

Legal Impediments under PRC laws

133. The crux of the matter, on which the parties' experts profoundly differ, is whether there are legal restrictions on cross-border transmission of audit working papers and other relevant documents from the PRC to Hong Kong which render EY's right not a "presently" enforceable one and serve to excuse EY from complying with the Notices.

134. In their written closing submissions, EY's counsel have confined their arguments to the following five PRC laws, regulations, departments rules and normative documents:

(1) CPA Law.

(2) Archives Law.

(3) Regulation 29.

(4) 2011 Reply.

(5) Localization Regulation.

State Secrets / Commercial Secrets

135. The supposed legal impediment based on State secrets/ commercial secrets is conspicuous by its absence in EY's written closing submissions, reflecting a pragmatic and sensible view taken by counsel for

EY. Be that as it may, this court feels compelled to deal with this subject briefly, since not inconsiderable time and efforts have been spent on it, both before and during the substantive hearing, by the parties' experts in preparing their opinions and giving oral testimony and by this court in considering them.

136. It is common ground between the experts that whether the audit working papers constitute State secrets within the definition in the State Secrets Law or commercial secrets within the definition of the Anti-Unfair Competition Law is fact-sensitive - the answer to the question depends entirely on the contents of the audit working papers. Nevertheless, neither professors have been shown and therefore have not reviewed the papers – whatever their opinions might be on the probabilities of the papers containing such secrets, they are entirely hypothetical. Further, the audit working papers are not actually among the materials placed before this court so this court does not have the privilege of inviting the experts to consider the papers at the hearing and provide their opinions.

137. In view of the above, there is no way in which EY can establish to the satisfaction of this court that the audit working papers contain State secrets or commercial secrets under PRC laws which would preclude their transmission to EY in Hong Kong. As this court sees it, the objection based on State secrets or commercial secrets is a complete red herring.

138. During cross-examination of Professor Fu, it was suggested that, since it was unclear whether the audit working papers contained State

secrets or commercial secrets, the proper way of dealing with the potential "problem" was to first get clearance from the relevant authorities.

139. In the view of this court, that is not the appropriate way of looking into the matter. The burden is on EY to show an applicable legal restriction on the transmission of the audit working papers and other relevant documents from the PRC to Hong Kong. If it cannot do that by showing the papers or other documents do contain State secrets or commercial secrets, that is the end of the matter, as far as this part of EY's case is concerned.

140. Further, there is no evidence before this court that anyone, in particular HM, suspected the papers might contain State secrets or commercial secrets so that there was a "problem" to deal with. It follows that there is no evidence that either EY or HM has tried to deal with the "problem" by seeking clearance from the relevant authorities.

141. In these circumstances, this court does not accept that either the State Secrets Law or the Anti-Competition Law have the effect of precluding the transmission of the audit working papers and other documents to EY in Hong Kong.

CPA Law

142. As far as CPA Law is concerned, Art 19 provides that "CPAs have an obligation to keep confidential all commercial secrets that they learn of in the course of carrying on their business."

143. In my view, this is yet another red herring from EY since it is now accepted[9] that Art 19 of the CPA Law is engaged only if there are commercial secrets in the audit working papers and EY is not in a position to know whether that is so. In view of that, and in view of the fact there is no evidence before this court that the audit working papers do contain commercial secrets, this court must reject Art 19 of the CPA Law as an applicable legal impediment to the transmission of the audit working papers to Hong Kong.

Archives Law

144. First and foremost, it is accepted by Professor Liu in her Supplemental Opinion that there is nothing in the Archives Law which amount to "direct and explicit provisions in relation to the cross-border transmission of audit work papers". This is understandable since according to Professor Liu, the Archives Law was enacted in the mid-1990s when the issue of cross-border transmission of archives pertaining to overseas-listed enterprises was not as important a matter of concern as it is today.

145. Nevertheless, it is now common ground among the experts that audit working papers constitute "collectively-owned archives" (集体所有的档案) within the meaning of Art 16 of the Archives Law which states:

> "集体所有的和个人所有的对国家和社会具有保存价值的或者应当保密的档案，档案所有者应当妥善保管。对于保管条件恶劣或者其他原因被认为可能导致档案严重损毁和不安全的，国家档案行政管理部门有权采取代为保管等确保档案完整和安全的措施；必要时，可以收购或者征购。

[9] see paragraphs 295 – 301 EY's closing submissions.

前款所列档案，档案所有者可以向国家档案馆寄存或者出卖；向国家档案馆以外的任何单位或者个人出卖的，应当按照有关规定由县级以上人民政府档案行政管理部门批准。严禁倒卖牟利，严禁卖给或者赠送给外国人。

向国家捐赠档案的，档案馆应当予以奖励。”

146. A working translation of Art 16 reads as follows:

“Collectively-owned or individually-owned archives whose preservation is of value to the State and society or which should be kept confidential shall be properly safeguarded by the owners. If the Archives are considered liable to serious damage or unsafe because of the adverse conditions under which they are kept or because of any other reason, the State archives administration department shall have the right to take measures to ensure the integrity and safety of the Archives, such as keeping the Archives on the owner’s behalf or, when necessary, purchasing such archives or requisitioning them by purchase.

With respect to the Archives mentioned in the preceding paragraph, owners may deposit them with or sell them to State Archives repositories; selling of such archives to any units or individuals other than State Archives repositories shall, according to relevant State regulations, be subject to authorisation of the Archives administration departments of the people’s government at or above the provincial level. It shall be strictly forbidden to sell such archives for profit, or to sell them or give them to foreigners as gift. Any person, who donates Archives to the State shall be rewarded by the Archives repositories concerned.” (emphasis added)

147. Art 18 of the Archives Law states:

“属于国家所有的档案和本法第十六条规定的档案以及这些档案的复制件，禁止私自携运出境。”

148. A working translation of Art 18 reads:

“State-owned archives and the archives specified in Article 16 of this Law as well as duplicates of such archives shall not be carried or transported out of the country privately or on his/her own.”

149. Art 25 of the Archives Law states:

"携运禁止出境的档案或者其复制件出境的，由海关予以没收，可以并处罚款；并将没收的档案或者其复制件移交档案行政管理部门；构成犯罪的，依法追究刑事责任。"

150. A working translation of Art 25 reads:

"If anyone carries or transports out of the territory of the PRC archives or duplicates thereof, the exit of which from the country is forbidden, such archives or duplicates thereof shall be confiscated by the Customs, a fine may also be imposed; and the confiscated archives or duplicates thereof shall be transferred to the archives administration department; if the case constitutes a crime, criminal responsibility shall be investigated according to law."

151. Lastly, Art 19 of the Archives Law Implementation Rules provides:

"第十九条　各级国家档案馆馆藏的一级档案严禁出境。

各级国家档案馆馆藏的二级档案需要出境的，必须经国家档案局审查批准。

各级国家档馆馆藏的三级档案、各级国家档案馆馆藏的一、二、三级档案以外的属于国家所有的档案和属于集体所有、个人所有以及其他不属于国家所有的对国家和社会具有保存价值的或者应当保密的档案及其复制件，各级国家档案馆以及机关、团体、企业事业单位、其他组织和个人需要携带、运输或者邮寄出境的，必须经省、自治区、直辖市人民政府档案行政管理部门审查批准，海关凭批准文件查验放行。"

152. A working English translation of Art 19 reads:

"All Class One Archives deposited in all levels of Archives repositories shall not exit the PRC.

All Class Two Archives deposited in all levels of Archives repositories shall not exit the PRC without authorisation by the State Archives Administration.

> All Class Three Archives deposited in all levels of Archives repositories, all State-owned Archives other than Class One, Two or Three deposited in all types and levels of Archives repositories, all collectively-owned or individually-owned and other non-State owned Archives or duplicates of such Archives whose preservation is of value to the State and society or which should be kept confidential, shall not be carried or transported or sent by post out of the country by State Archives repositories, State organs, organisations, business enterprises units, other organisations or individuals without authorisation by the archives administration authorities at the provincial level, the autonomous region level, or the municipality level under the Central Government and the approved documentation from Customs." (emphasis added)

153. There is some disagreement among the experts as to the proper English translation of the phrase "私自" in Art 18. The translation of the phrase "私自", adopted by Professor Liu, is "without authorization". Professor Fu accepts that is the standard translation published on the website of the National People's Congress. However, he takes issue with that translation – he suggests the phrase should more appropriately be translated as "privately" or "on his/her own" or "in violation of the rules".

154. It is common knowledge that under PRC legal system, only the Chinese text is official and has the authority of law - an English (or any other) translation is just a translation. There is no suggestion from the parties to the contrary. Hence, this court is inclined to consider only the Chinese text of the Archives Law (or any other PRC laws). Looking at the matter in this way, this court considers the ordinary and natural meaning of the phrase "私自" should be "privately" or "on his/her own", rather than "without authorization". This court rejects Professor Liu's evidence that the phrase "私自" means "without authorisation" also for this reason: if the PRC legislature had intended to insert into Art 18 a requirement of seeking "authorization" before the relevant archives can be taken out of the Mainland, it could easily have used the phrase "批准" which literally

means "authorization", as it did in the second part of Art 16 of the Archives Law.

155. For the present purpose, the more important question is this: what kinds of archives are prohibited from being taken outside the Mainland under Art 18 of the Archives Law?

156. EY's argument, based on Professor Liu's opinion, is this: Art 6 of Regulation 29, promulgated by *inter alia* the State Archives Administration, requires archives, including working papers which are created in the PRC in the course of any overseas issuance and listing of securities, to be kept within the Mainland. Art 16 of the Archives Law, read together with Art 18 of the Archives Law and Art 6 of Regulation 29, apply to such audit working papers and prohibit their transmission out of the Mainland without authorization. Art 19 of the Archives Law Implementation Rules sets out the procedure for seeking authorisation. Art 25 of the Archives Law imposes severe punishment for any contravention of Art 18 of the Archives Law.

157. In the view of this court, this argument rather begs the question: (i) why do audit working papers fall within Art 16, and hence covered by the prohibition in Art 18, as being archives "*the preservation of which is of value to the State or society or which should be kept confidential"* ? (ii) from whom are the audit working papers supposed to be *kept confidential* in order to fall within Art 16, and hence Art 18, of the Archives Law ?

158. Professor Liu has made an assertion to the effect that audit working papers belong to the category of archives protected by Art 18 but

no real reason can be found in any of her opinions save and except that, in her view, the interpretation of Art 18 of the Archives Law should take into account Regulation 29 Art 6. Indeed, in her supplemental opinion, Professor Liu states there is as yet no published definition as to what materials constitute archives "the preservation of which is of value to the State or society or which should be kept confidential". Apart from that assertion, EY has adduced no other evidence on PRC laws which sheds light on the subject.

159. It is correct that Regulation 29 Art 6 refers to any archives, including working papers, which are created in the PRC in the course of any overseas issuance and listing of securities. But enterprises which seek a listing outside the PRC come in all sizes, shapes and forms. Some of their businesses, such as those of the SOEs, are more likely to have an important bearing on the PRC's economy and national security. Others are not. Without examining the contents of the audit working papers in the present case, how could Professor Liu come to a view as to whether their preservation is "of value to the State or society"?

160. As far as "should be kept confidential" is concerned, as stated in paragraph 78(5) above, it is common ground among the experts that, as between HM and EY, HM could not use its duty of confidence to the Company in resisting EY's request for the audit working papers. Further, this court has also ruled EY has failed to demonstrate the audit working papers contain State secrets or commercial secrets. If so, there is no basis, factual or legal, on which EY can support the contention that the audit working papers belong to the class of protected archives as something which "should be kept confidential".

161. In these circumstances, my findings are these: Art 18 of the Archives Law only applies to two types of archives viz. (a) state-owned archives and (b) archives falling within Art 16. Not every archive falls within the ambit of Art 16 - only those archives *whose preservation is of value to the State and society or which should be kept confidential* do. In so far as Professor Liu's opinion is to the effect that all audit working papers, irrespective of their contents and the nature of the enterprises in question, fall within Art 16, this court rejects her evidence. Since the burden is on EY to establish Art 18 of the Archives Law constitutes a valid legal impediment to the transmission of the audit working papers to Hong Kong, and since this court rejects Professor Liu's evidence, EY has failed to discharge that burden.

Regulation 29

162. Art 1 of Regulation 29 provides:

> "为保障国家经济安全，保护社会公共利益，根据《中华人民共和国证券法》、《中华人民共和国保守国家秘密法》和《中华人民共和国档案法》等法律法规的有关规定，制定本规定。"

163. A working translation reads:

> "For the purposes of safeguarding the security of the State's economy and protecting the public interests of the society, these Rules are formulated in accordance with the relevant provisions in the laws and regulations, including the Securities Law of the People's Republic of China, the State Secrets Law of the People's Republic of China and the Archives Law of the People's Republic of China."

164. Art 2 of Regulation 29 provides:

> "在境外发行证券与上市过程中，境外上市公司（包括拟上市公司，下同）以及提供相关证券服务的证券公司、证券服务机构应当严格贯彻执行有关法律法规的规定以及本规定的要求，增强保守国家秘密和加强档案管理的法律意识，建立和完善专项规章制

度，加强对有关人员的教育和管理，认真落实各项具体措施，进一步做好保密和档案管理工作。”

165. A working translation reads:

“An overseas listed company, hereinafter including those to be listed, as well as the securities company and securities service agent which provide relevant securities services shall, in the course of any overseas issuance and listing of the securities of such company, strictly and consistently implement the relevant laws and regulations as well as the requirements of these Rules to raise the legal awareness of State secrets protection and archives management, develop and improve area-specific rules and regulations, strengthen the education and management of the relevant personnel, earnestly implement concrete measures and make further effort in the protection of secrets and archives management.”

166. Art 6 of Regulation 29 provides:

“在境外發行証券與上市過程中，提供相關証券服務的証券公司、証券服務机构在境內形成的工作底稿等檔案應當存放在境內。

前款所称工作底稿涉及国家秘密、国家安全或者重大利益的，不得在非涉密计算机信息系统中存储、处理和传输；未经有关主管部门批准，也不得将其携带、寄运至境外或者通过信息技术等任何手段传递给境外机构或者个人。”

167. A working translation reads:

“Any archives, including work papers, which are created in the PRC by securities companies and securities service agent providing relevant securities services in the course of any overseas issuance and listing of the securities shall be stored in the PRC.”

“In the event that the above-mentioned work papers involve any State secrets, national security or other substantial interests of the State, such work papers shall not be stored in, processed with or transferred via any non-classified computer information systems; without the approval from the relevant competent authority, such work papers shall not be carried or sent abroad, or transferred to any overseas institution or individual through, among any other means, information technology.” (emphasis added)

168. Art 8 of Regulation 29 provides:

"证监会负责就境外发行证券与上市保密和档案管理工作涉及的跨境证券监管事宜，与境外证券监管机构和其他相关机构开展交流与合作。

……

境外証券監管机构和其他相關机构提出對境外上市公司以及為境外發行証券與上市提供証券服務的証券公司，証券服務机构（包括境外証券公司和証券服務机构在境內設立的成員机构、代表机构、聯營机构、合作机构等關聯机构）進行非現場檢查的，涉及國家秘密的事項，有關境外上市公司、証券公司和証券服務机构應當依法报有審批權限的主管部門批准。並报同級保密行政管理部門备案；涉及檔案管理的事項，有關境外上市公司、証券公司和証券服務机构應當依法报國家檔案局批准。涉及需要事先經其他有關部門批准的事項，有關境外上市公司，証券公司和証券服務机构應當事先取得其他有關部門的批准。"

169. A working translation reads:

"With respect to overseas issuance and listing of securities, the China Securities Regulatory Commission shall, for the purposes of protection of secrets and archive management in respect of cross-border securities regulatory matters, be responsible for liaising and cooperating with overseas securities regulatory authorities and other relevant authorities.

…..

Where overseas securities regulatory authorities and other relevant authorities request to conduct an off-site inspection of an overseas listed company, securities company or securities service agent providing securities services for overseas issuance and listing of securities (including such affiliated agencies to the overseas securities company or securities service agent that are established in the PRC as member institution, representative institution, associate institution and cooperative institution) involving matters of State secrets, the relevant overseas listed company, securities company and securities service agent shall report the same in accordance with the law to the competent PRC authorities which are empowered to approve for approval and shall file such request for inspection with the same-level secret protection administrative management department for record; where it involves archive management matters, the said overseas listed company, securities company and securities service agent shall report the same to the State Archives Bureau for approval. Where the inspection involves matters that require prior approvals from other relevant PRC authorities, the said

> listed company, securities company or securities service agent shall obtain prior approvals from such relevant PRC authorities."

170. The following three aspects of Regulation 29 are common grounds among the experts:

(1) First, Regulation 29 is the most directly relevant legal provision in the present context. The PRC Courts would use Regulation 29 as a reference in determining issues on the cross-border transmission of audit working papers.

(2) Second, Regulation 29 is neither a law nor an administrative regulation, but a departmental rule which only helps clarify the application of the Securities Law, State Secrets Law and the Archives Law – it does not create new legal obligations with regard to cross-border transmission of audit working papers.

(3) Third, Regulation 29 does not impose a *blanket* prohibition on cross-border transmissions of audit working papers to overseas securities regulatory authorities as such.

171. Professor Fu's opinion is that reading Art 6 of Regulation 29 as a whole, it is clear that, while the norm is that all audit working papers should be stored in the PRC (1st paragraph), only those audit working papers which involve state secrets, state security and significant public interest cannot be transmitted overseas without prior approval (2nd paragraph). Given that EY has not established by evidence that the audit working papers contain state secrets or involve state security or significant public interest, Regulation 29 does not prohibit their transmission from HM to EY in Hong Kong.

172. Professor Liu takes a different view as to the interpretation of Art 6. Her opinion is that it requires all audit working papers created for the purpose of overseas listing to be kept within the PRC and defines the regulatory procedure that should be followed for sending them to an overseas regulator. Unless and until the necessary approvals from all the relevant PRC authorities have been obtained, they effectively limit HM's ability to provide the audit working papers to EY for onward production to SFC. In this context, relevant PRC authorities include the State Secrets Bureau, the State Archives Administration and "other relevant departments" which term must at least include the CSRC and the MoF. Lastly, in her view, Professor Fu's interpretation would render the requirement under the first paragraph of Art 6 that audit working papers shall be stored in the PRC redundant.

173. This court prefers the evidence of Professor Fu to that of Professor Liu. The reasons are as follows.

174. First, it appears to this court that Professor Liu has not paid sufficient regard to the primary purpose of Regulation 29 as stated in Arts 1 and 2 viz. to safeguard the security of the State's economy and protect the public interests of society, to raise legal awareness of State secrets protection and archives management and to earnestly implement concrete measures and make further effort in the protection of secrets and archives management.

175. This primary purpose of Regulation 29 is amplified by:

(1) The second paragraph of Art 6 which specifically restricts the cross-border transmission of audit papers under limited and

well-defined circumstances ie only papers involving State secrets, national security or other substantial interests of the State are prohibited from cross-border transmission without prior approval.

(2) The 3rd paragraph of Art 8 which again emphasizes the need for prior approval in cases of off-site inspection requested by overseas securities regulatory authorities involving *inter alia* State secrets.

176. Second, if *all* audit working papers, as archives, must be stored in the PRC pursuant to the first paragraph of Art 6 under *any* circumstances, that would mean it is an absolute requirement and that Regulation 29 does impose a *blanket* prohibition on cross-border transmission of audit working papers to overseas securities regulatory authorities. In that case, Professor Liu would be contradicting herself.

177. Third, if Professor Liu's opinion is correct, it will mean the second paragraph of Art 6 is redundant – if the storage of *all* audit working papers within the PRC is mandatory and without exception, there is no need to specify that in the event that the work papers involve State secrets, national security or other substantial interests of the State, they shall not be carried or sent abroad without the approval from the relevant competent authorities.

178. Lastly, it is noteworthy that HM itself has not raised any issue of Regulation 29 with the CSRC when it refused to produce the audit working papers back in mid-2010. Regulation 29, the Archives Law, State Secrets Law and CPA Law were all in existence at that time.

As evident from its reply letter to SFC dated 23 July 2010, the CSRC was also not troubled by any issues concerning Regulation 29 and apparently took the view that, but for HM's refusal to cooperate and its challenge to CSRC's jurisdiction (on the ground that the Company was incorporated in the Cayman Islands) the audit working papers could be provided to SFC. This is so notwithstanding the absence of evidence that prior approval from the State Secrets Bureau, the State Archives Administration and the MoF as "other relevant department" has been obtained. Subsequently, HM, through its PRC legal advisers Fangda Partners, said in a letter dated 5 December 2012 that it was prepared to cooperate with the CSRC, again without making any reference to Regulation 29 or the need to also seek prior approval from the various other government departments.

179. In view of the above, and given the absence of evidence that the audit working papers contain state secrets, involve national security or substantial interests of the PRC, this court rejects EY's contention that Regulation 29 serves to prohibit the transmission of the audit working papers from HM to EY in Hong Kong.

The 2011 Reply

180. The 2011 Reply was issued by the Accounting Department of the CSRC to accounting firms in the PRC in the context of, and in response to, the US regulators' direct demands for audit documentation from the firms. Both experts agree that it is merely a normative document, and hence is not a formal source of PRC law. As Professor Fu opines in his Final Opinion in Reply, a normative document is formulated to explain and clarify legal or regulatory provisions regarded as unclear and unable to

operate. Nevertheless, while not binding on the PRC Courts, they will take it into account in considering any issues which arise in a case before them.

181. For the present purpose, the relevant parts of the 2011 Reply are set out in the second to the fourth paragraphs which state:

> "会计师事务所向境外提供审计工作底稿等审计档案文件,应当符合《中华人民共和国证券法》、《中华人民共和国注册会计师法》、《中华人民共和国保守国家秘密法》、《中华人民共和国档案法》等有关法律法规及规章制度,并经过相应的法律程序。
>
> 境外監管机构履行法定職責需要相關審計工作底稿等檔案文件的,應通過與中方監管机构的監管合作机制共同協商解決。
>
> 会计师事务所必须遵守中国有关法律法规及规章制度,妥善处理好相关事宜;违反有关法律法规及规章制度擅自向境外提供审计档案和其他文件的,有关部门将依法追究其法律责任。"

182. A working translation reads:

> "In providing archival audit documents such as audit working papers abroad, CPA firms shall comply with relevant laws, regulations and rules such as the Securities Law of the People's Republic of China, the Law of the People's Republic of China on Certified Public Accountants, the Law of the People's Republic of China on Guarding State Secrets and the Archives Law of the People's Republic of China, and undergo corresponding legal procedures.
>
> Overseas regulatory institutions requiring relevant archival documents such as audit working papers in the performance of their statutory duties should discuss with PRC's regulatory institution through the regulatory cooperation mechanism and resolve [the matter].
>
> CPA firms must deal with relevant matters properly in accordance with relevant PRC laws, regulations and rules. Relevant departments shall pursue according to the law the legal responsibility of (those firms) which have violated relevant laws, regulations and rules by providing audit archives and other documents abroad without authorization."

183. In the view of this court, the 2011 Reply does not add anything to EY's contention, based as it is on Regulation 29 and other PRC laws

mentioned above, that HM is prohibited from passing the audit working papers to EY in Hong Kong.

184. First, the 2nd and 4th paragraphs of the 2011 Reply are merely stating the obvious and what is already contained in Regulation 29 ie PRC accounting firms must comply with the applicable laws and regulations such as Securities Law, CPA Law, State Secrets Law, Archives Law etc. when it comes to cross-border transmission of audit working papers. Both experts agree that these two paragraphs do not create any new legal obligations over and above Regulation 29 – it is just a reminder to the accounting firms in the PRC to comply with the law.

185. Second, while it is common ground among the experts that the 3rd paragraph of the 2011 Reply purports to address overseas regulatory bodies and imposes a requirement on them to liaise with the CSRC as the "threshold step" (第一道门槛) when seeking audit working papers situated in the PRC, PRC laws cannot impose any procedural requirement on overseas regulators as such. Nor does the CSRC have power to dictate to foreign regulators what they should or should not do. This is acknowledged by Professor Liu in cross-examination.

186. Third, in the present case, EY will be the requesting party if this court grants an Order against it to comply with the Notices. SFC has not made and there is no question of it making any direct demand on HM for the audit working papers. Hence, even if the 3rd paragraph of the 2011 Reply can be read as an indirect message to CPA firms in the PRC like HM that they should not hand over audit working papers directly to overseas regulators, it has no application to the present case.

187. For these reasons, this court does not find the 2011 Reply of assistance in determining whether HM is precluded by PRC laws from handing over the audit working papers to EY.

The Localisation Regulation

188. On 2 May 2012, the MoF, the Industry and Commerce Bureau, the Ministry of Commerce, the State Administration of Foreign Exchange and the CSRC jointly promulgated the Localization Regulation to govern the conversion of sino-foreign joint venture accounting firms into partnerships, as in HM's case.

189. Art 22 of the Localization Regulation states:

> "会计师事务所采用特殊普通合伙组织形式后，原中外合作会计师事务所的各类文件档案应当妥善保存，未经财政部批准，不得擅自处理或以任何方式带离出境。会计师事务所的全体员工应当严格遵守国家保密法规制度的规定。"

190. A working translation of Art 22 reads:

> "After an accounting firm has adopted the organisational form of a special-general partnership, all the documents and archives of the original sino-foreign co-operative accounting firm shall be properly maintained and shall not be disposed of privately or brought out of the PRC in any manner without the approval of the Ministry of Finance. All staff members of the accounting firm shall strictly comply with the requirements stipulated in the State's legislation on confidentiality."

191. Although Professor Liu did not mention the Localisation Regulation at all in her First Opinion when she discussed the "key PRC Laws which restrict cross-border transmission of audit working papers to an overseas entity", EY submits that Art 22 again re-affirms the

requirement that audit working papers must be kept within the PRC and must not be taken out of the jurisdiction without prior approval – this time, approval from the MoF. Professor Fu, on the other hand, considers that Art 22 only applies to documents or archives which belong to HM, a sino-foreign cooperative accounting firm – it has no application to papers which belong to EY, a Hong Kong partnership.

192. In the view of this court, Professor Fu's view is to be preferred.

193. According to Art 1, the Localisation Regulation is enacted to regulate the transition of existing sino-foreign CPA firms to a local partnership and promote fair competition within the perimeters of the law. In this context, it is common ground that Art 22 deals with the preservation of the documents and records of the old CPA firms and requires them to be passed to the newly-formed local partnership so that they will not be destroyed or otherwise taken away by the foreign joint venture partners during the transition. But if the documents and records do not belong to the old CPA firms in the first place, but belong to, say, the foreign partners, there is no inherent reason why, for the purpose of the transition, they cannot be taken away by their rightful owners. None has been suggested by Professor Liu.

194. Further, it is accepted by both professors that the Localisation Regulation is not primarily a measure to regulate cross-border transmission of audit working papers. If so, the public interest considerations (such as protection of State secrets and so on) which may otherwise justify the prohibition of cross-border transmission of audit working papers do not come into play.

195. At this juncture, it is therefore necessary to consider the issue of property in the audit working papers.

196. Professor Liu's evidence is this: since HM created the audit working papers, it had the "original property" [10] in them. During cross-examination, Professor Liu supplemented her view by relying on the rule under PRC civil law concerning "ownership of the work of labour and creation"[11] ie whoever creates the property owns it ("**General Rule**").

197. EY then argues that even if it has a contractual right over the audit working papers vis-à-vis HM, the transfer of property is only the second step and is governed by Art 23 of the Property Law (物权法) which provides:

> "动产物权的设立和转让，自交付时发生效力，但法律另有规定的除外。"

198. A working translation of Art 23 of the Property Law reads:

> "The establishment and transfer of property right in moveable property becomes valid at the time of handover, unless the law otherwise provides."

199. On the basis of Art 23, EY argues that HM must still have retained property in the papers since, as a matter of fact, HM has not handed them over to EY and so the transfer of property in the papers has not become effective.

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[10] "原始所有权"
[11] "劳动创造所有权"

200. This argument, in my view, overlooks that part of Professor Liu's evidence in cross-examination which confirms that (1) the General Rule is subject to contrary arrangement between a principal and agent in an agency of entrustment; (2) since the audit working papers were generated in the course of the Engagement, the terms of the entrustment agency between EY and HM must be consistent with the terms of the Engagement including the General Terms.

201. As this court has concluded, by reason of clauses 8 and 10 of the General Terms, HM must have known and accepted that, vis-à-vis EY, the audit working papers were "*owned*, managed and controlled" by EY from the moment of their creation. Since the General Rule has been displaced, there is no need to consider whether property in the audit working papers has passed from HM to EY under Art 23.

202. For these reasons, this court rejects EY's contention that Art 22 of the Localization Regulation is apt to prohibit HM from passing the audit working papers to EY in Hong Kong.

Conclusion

203. In the premises, this court finds EY has failed to establish any applicable restrictions under PRC laws which prohibit HM from passing the audit working papers in the PRC to EY with a view to complying with the Notices.

L. WHO SHOULD APPLY FOR THE NECESSARY APPROVAL & EY'S APPLICATION FOR DIRECTION

204. These two issues can conveniently be dealt with together.

205. In the event that this court's finding on the absence of legal impediments under PRC laws is wrong and prior approval from the relevant authorities, whoever they may be, are required before the audit working papers can be sent to Hong Kong, the question arises as to who should make the application for approval.

206. EY's position on this question is embodied in its application for direction that SFC should take all necessary steps to liaise with the CSRC with a view to obtaining a complete set of the audit working papers.

207. In other words, it is SFC who should apply for approval through the channel of CSRC. EY submits that SFC should then report back to this court the "result" of its liaison with CSRC before this court finally decides what relief, if any, should be granted in these proceedings. What that means in effect is that, instead of determining the Originating Summons now, this court should defer its decision until there is a "result" from SFC's liaison with the CSRC.

208. The basis of EY's application is this.

209. The proceedings are inquisitorial in nature and the court has to determine:

(1) whether there has been non-compliance;

(2) whether there is a reasonable excuse for any non-compliance; and

(3) what remedy to grant.

210. The court must undertake a balancing exercise and one relevant consideration in this exercise is whether SFC has available alternative avenues to obtain the information/documents sought which would not expose EY to the risk of prosecution without materially adverse consequences to the inquiry: *Bank of Valletta v National Crime Authority supra*. In the present case, it is not disputed that:

(1) SFC has entered into the MORC with *inter alia* the CSRC which provided for a mechanism for mutual regulatory cooperation;

(2) on 24 May 2010, SFC, relying on the MORC, requested the assistance of CSRC in order to obtain the audit working papers to further its investigation into the Company for suspected breaches of the SFO by providing false or misleading information in its listing;

(3) in its reply dated 23 July 2010, the CSRC informed SFC that HM refused to hand over the papers on the grounds that it had a duty of confidence to the Company and, the Company being incorporated in the Cayman Islands, it was outside the jurisdiction of CSRC; the CSRC was unable to obtain the papers from HM;

(4) on 5 December 2012 ie after the commencement of these proceeding, Fangda Partners, on behalf of HM, wrote to Linklaters stating that, having received the 2011 Reply from CSRC, HM "is open to receive further instructions from the CSRC as to the particular steps [HM] should take in relation to the supply of the Work Papers pursuant to any regulatory cooperation mechanism the CSRC may have with the SFC. Upon receipt of such instructions, HM will be happy to work with the CSRC on the supply of the Work Papers in compliance with any applicable laws of the [PRC]";

(5) on 15 May and 3 June 2013, Linklaters urged SFC to take steps to liaise with the CSRC with a view to obtaining the papers through the mutual cooperative mechanism;

(6) on 6 June 2013, SFC responded to the said two letters from Linklaters, effectively rejecting their suggestion for various reasons which form the present basis of their opposition to EY's application for direction.

211. SFC opposes EY's application and submits that it is EY, either directly or indirectly via HM, who should make the application.

212. This court accepts SFC's submissions. The reasons are these.

213. First, it is incorrect to characterise these proceedings as inquisitorial. Pursuant to section 185 SFO, these proceedings have been initiated in accordance with the normal adversarial procedure which an Originating Summons entails. In the Reasons for Decision dated 14 March

2013, this court has also ruled that its function in these proceedings is to inquire into the matter "*within the parameters of an adversarial court system*". The description that these proceedings are inquisitorial is also contradictory to EY's opening submissions at paragraph 57 that "*there is no room for a roving or general enquiry*" under section 185 SFO.

214. Second, the court's function under section 185 SFO is to inquire into EY's non-compliance with the Notices and to make the appropriate orders within the terms of the section against EY, if it is satisfied that there is or was no reasonable excuse for the non-compliance. The section does not expressly confer jurisdiction on the court to make any order or direction against SFC. None can be implied. If SFC has an alternative means to obtain the audit working papers, it is up to SFC to decide whether to pursue that alternative means. If it refuses to do so, it is a relevant consideration pertaining to the issue of "reasonable excuse": *Bank of Valletta v National Crime Authority supra.*

215. Third, under Article 8 of Regulation 29, three separate approval procedures are stipulated in relation to requests for off-site inspection by overseas securities regulatory authorities. Both experts agreed that the entity who has primary responsibility for seeking all necessary approvals under Art 8 of Regulation 29 is either EY or HM. In response to this court's questions at the end of Day 8, Professor Liu expressed the view that HM could apply for the necessary approvals if it wanted to, but if HM refused, EY could apply instead. Professor Liu also told this court that: "Talking about audit working papers, of course, definitely, the application has to be made by a CPA firm".

216. SFC, on the other hand, is not in a position to determine what approvals may or may not be required under PRC laws for the simple reason that it does not have the papers and cannot send them to the relevant authorities for vetting and clearance. Further, it is not in a position to decide which are the relevant authorities, be they the State Archives Administration, State Secrets Bureau or MoF, without knowing the contents of the papers.

217. Fourth, if and in so far as Regulation 29 requires SFC to liaise with the CSRC, it has already done so as far back as May 2000. On the evidence before this court, SFC has not withdrawn its request for assistance and it is unclear from EY's submissions why there is a need for SFC to make another request for assistance from the CSRC. In fact, under clause 7 of the MORC, the CSRC can take the initiative to provide the information that SFC needs to enable it to fulfill its regulatory functions.

218. Lastly, this court is skeptical of HM's statement of intention that it is *"open to receive [sic] further instructions from the CSRC*" expressed in the letter dated 5 December 2012 from Fangda Partners to Linklaters. Given that the CSRC has previously requested the audit working papers from HM, it is unclear why it still insists on a further request by SFC to the CSRC before it is willing to do anything about the papers. If HM's previous refusal to cooperate was due to its alleged lack of guidance regarding the production of audit working papers to overseas regulatory authorities, such guidance has since been provided, according to EY, by the 2011 Reply. Given such guidance, there is no reason why HM cannot approach the CSRC and offer to hand over the audit working papers for onward transmission to SFC in Hong Kong.

219. For all these reasons, this court is of the view that, if prior approvals are required under PRC laws, it is up to EY to make the necessary applications.

220. It follows that EY's application for direction should be dismissed.

M. INFORMATION, RECORDS AND DOCUMENTS IN HONG KONG

221. Just to recap, in the 1st Notice dated 12 April 2010, SFC required EY to explain, in details, with supporting documents, the reason for resigning as reporting accountant of the Company in its listing application, and supply the relevant correspondence. In the 2nd Notice, SFC asked for *inter alia* all audit working papers.

222. Linklaters, in its letter dated 15 May 2013 to SFC, acknowledged that the three Hard Drives in Hong Kong contained *inter alia* the audit working papers and other information responsive to the Notices ("**HK Materials**"). Linklaters, in another letter dated 10 July 2013 to SFC, revealed that a further five Hard Drives and two IT Servers are in the physical possession of EY and EYASL in Hong Kong and may contain HK Materials.

Hard Drives and Servers

223. EY's possession of the Hard Drives[12] is admitted.

[12] The term "Hard Drives" used in this section is intended to cover all the Hard Drives and IT Servers disclosed by EY without differentiation.

224. Both in their written closing submissions and in the course of Leading Counsel's oral closing submissions, EY's counsel have indicated that they would take a *neutral* stance regarding the Hard Drives which are in Hong Kong and proposed to deal with them *in light of* this court's ruling. The *neutral* stance so adopted, in the view of this court, is entirely pragmatic and proper, and is to be welcomed. Nevertheless, since EY has not unequivocally conceded the issue of reasonable excuse, this court proposes to deal with it briefly now.

225. EY submits that it has a reasonable excuse for not having produced the information in the Hard Drives to the SFC and, in all the circumstances of this case, the court should not compel it to look into the Hard Drives, search for the HK Materials and produce them to the SFC.

226. In her 3rd report, Professor Liu opined that (i) EY's continued possession of the Hard Drives in Hong Kong would constitute a breach of Regulation 29, on the premise that the requisite approvals for taking them out of the PRC have not been obtained; and (ii) by providing the HK Materials directly to SFC, EY would be in breach of Regulation 29 and the 2011 Reply. This is so notwithstanding her acceptance that the application of PRC laws to Hong Kong CPA firms is not specified in any of the PRC laws, administrative regulations or departmental rules.

227. Professor Liu further opined that, depending on the actual information contained in the Hard Drives which she had not reviewed, its production to SFC might also constitute breaches of the Securities Law, State Secrets Law, Archives Law or CPA law and might give rise to criminal administrative or civil liabilities. In particular, to the extent that the HK Materials contain State secrets or commercial secrets,

their production to SFC, as well as EY's decision to produce them ("**Production Decision**"), would be a crime under Arts 111 or 219 of the Criminal Law.

228. According to the 4th report of Professor Fu, admittedly an expert in this area, PRC criminal law asserts extra-territorial jurisdiction through three legal principles viz (i) Personality principle ie PRC criminal law follows its citizens wherever they travel; (ii) Territorial principle ie a crime is regarded as having taken place in the Mainland if the act[13] or the consequence takes place in the Mainland; and (iii) Protective principle ie PRC criminal law punishes crime against PRC interests and citizens even though the crime is committed outside the Mainland. In his view, none of the above-mentioned principles have any application to the present case.

229. These three principles were not disputed by Professor Liu when being cross-examined on the subject. Where Professor Liu and Professor Fu differed is (i) whether the Territorial principle applies in that the *actus res* of a criminal offence has taken place in the Mainland; and (ii) whether the Protective principle applies in that the disclosure of the HK Materials is a crime against the interest of the PRC or its citizens.

230. Having considered the written Opinions and the oral testimony of both professors, this court is not satisfied that EY would be at a real risk of being subject to criminal, administrative or civil liabilities if it is compelled by a Court Order to produce the HK Materials to SFC.

[13] for this purpose, "act" is interpreted broadly to include any preparatory act for a crime, and any linkage of the act to the Mainland would suffice.

231. First, this court does not accept Professor Liu's evidence that the effect of Regulation 29 and the 2011 Reply is to preclude the transmission of the audit working papers to Hong Kong: see paragraphs 162-187 above.

232. Second, in order for the Territorial principle to apply, the onus is on EY to establish that the Hard Drives were sent from the PRC to Hong Kong unlawfully, so that an "act" of the criminal offence has been committed in the Mainland. In this regard, the circumstances under which the Hard Drives were disclosed by EY in these proceedings are set out in section D above. They clearly call for a fuller explanation from EY as to why, how and by whom the Hard Drives were brought to Hong Kong. Yet, such an explanation is conspicuous by its absence. It is also plain and obvious that neither Ms Kwong nor Ms Davies were in a position to provide this court with the full picture as their evidence is both second hand and sketchy at best.

233. If EY chooses not to fully explain how the Hard Drives were said to have been sent to Hong Kong unlawfully, there is no basis for this court to find the *actus res* of a criminal offence had been committed in the Mainland - there is thus no basis for the application of the Territorial principle. On the contrary, the fact that neither EY nor HM (or their partners) has so far been subject to any criminal prosecution or administrative penalties rather suggests that there was no violation of any PRC laws.

234. Third, this court rejects Professor Liu's opinion on the potential criminality of EY's partners for making a "Production Decision" within the PRC, so as to invoke the Territorial Principle. If this court is to

make an order compelling EY to disclose the HK Materials to SFC, EY would have to comply with it as a matter of Hong Kong law. There is no room for any decision to be made on the part of EY's partners. Further, even if a decision has to be "formally" made to authorize the disclosure to SFC, there is no reason why it has to be made by an EY partner in the PRC.

235. Lastly, Professor Liu's opinion is in part based on the assumption that the Hard Drives contain State secrets or commercial secrets. As Professor Liu has not reviewed the contents of the Hard Drives, there is no basis for this court to draw the inference that they do contain such secrets or that the disclosure of the HK Materials to SFC is a crime against the interest of the PRC or its citizens. In other words, EY has failed to establish that the Protective principle applies so as to make it a criminal offence for EY to disclose the HK Materials to SFC either.

236. In these circumstances, this court is not satisfied that EY has a reasonable excuse for not having produced or not producing the HK Materials to SFC.

Other Relevant Information etc. and EY's failure to comply with the Notices

237. SFC submits, and this court agrees, that EY must know the details of the reason for its resignation, the inconsistencies in the documentation supplied by the Company, the role and responsibilities of its staff in the Engagement, in particular those of Mr Yam, and the person best placed to answer the SFC's queries:

(1) through Mr Yam himself, the Engagement Partner, who only resigned in March 2011 ie almost a year after the 1st Notice;

(2) through those members of its senior management who were consulted prior to EY's decision to resign, including Ms Lam, a partner of EY and HM and the independent review partner of the Engagement.

238. Yet, in its reply to the 1st Notice, EY failed to identify Mr Yam as a partner who had taken responsibility for and supervised the Engagement, and who would be able to full explanation of the reason for its resignation and the inconsistency in documentation provided by the Company - it was only in the Affirmation that EY revealed Mr Yam's role in the Engagement.

239. In the course of Mr Leung's cross-examination, he further revealed that:

(1) Mr Yam would have intimate knowledge of the audit process as well as the work done for the purpose of preparing the accountant's report.

(2) Mr Yam would be in a position to know clearly about the inconsistencies in the documentation and what steps were taken to ascertain the inconsistencies he had found.

(3) Mr Yam must know what documents were in question, must have seen those documents and must know what answers were given by the management of the Company in relation to those documents and inconsistencies.

(4) On 13 March 2010, Mr Yam issued a consultative memo to eight senior management staff including Ms Lam, Mr Collins and Mr Leung himself on whether EY should resign.

240. Among the recipients of the memo, Ms Lam would know what the inconsistencies in the documentation were. So would Mr Collins, the then General Legal Counsel of EY, who was responsible for handling the Notices and for that purpose has talked to Mr Yam. EY, through these recipients of the memo, must therefore know what the inconsistencies in documentation were and the detailed reasons for its decision to resign. Yet, in its replies to the 3rd and the 4th Notices, EY has omitted to mention not just Mr Yam, but also Ms Lam and Mr Collins.

241. In view of the above, and in the absence of an innocent explanation, this court is compelled to draw the adverse inference that EY has deliberately withheld from SFC information in its knowledge which is responsive to at least the 1st, 3rd and 4th Notices. In so doing, this court has borne in mind the guidance set out in the speech of Lord Diplock in *British Railways Board v Herrington* [1972] AC 877 at 930, and the requisite standard of proof for the drawing of such adverse inference as stated in the judgment of Sir Anthony Mason in *HKSAR v Lee Ming Tee* (2003) 6 HKCFAR 336 paras. 72 – 74.

242. In addition, in the view of this court, it is inherently improbable that EY, as the reporting accountant of the Company, does not have any records in its files in Hong Kong in relation to the Engagement and its decision to resign, over and above what has already been provided.

243. At this junction, it is helpful to remind oneself of the professional obligations of EY under the Listing Rules as the reporting accountant and independent auditor and the relevant Hong Kong auditing standards.

244. First, Rule 4.03 of the Listing Rules provides:

> "All accountants' reports must normally be prepared by certified public accountants who are qualified under the Professional Accountants Ordinance for appointment as auditors of a company and who are independent both of the issuer and of any other company concerned to the same extent as that required of an auditor under the Companies Ordinance and in accordance with the requirements on independence issued by the Hong Kong Institute of Certified Public Accountants …"

245. Second, the HKICPA has issued guidelines on audit documentation which EY must comply with including *inter alia* the following:

(1) Hong Kong Standard on Auditing ("**HKSA**");

(2) Statement of Auditing Standards ("**SAS**"); and

(3) Statement 3.340 entitled "Auditing Guideline – Prospectuses and the Reporting Accountant" ("**Statement 3.340**").

246. The following guidelines on audit documentation are particularly germane to the present discussion:

(1) "The auditor should prepare, on a timely basis, audit documentation that provides (i) a sufficient and appropriate record of the basis for the auditor's report; and (ii) evidence that the audit was performed in accordance

with HKSA and applicable legal and regulatory requirements": para. 2 of HKSA 230.

(2) "[T]he accountant's report requires the same skill and care as an audit report": para. 6 (b) of Statement 3.340.

(3) "The reporting accountant should control and record his work. This will involve the direction and supervision of his staff and the review of their work, and the preparation of working papers to record the procedures carried out. A large part of the work performed will often take the form of reviewing files and documents, and discussions with the company's management, staff and professional advisers. Particular care should be taken to ensure that the working papers adequately reflect the nature of these procedures, the evidence examined and the conclusions reached": para. 27 of Statement 3.340.

(4) "The auditor should document discussions of significant matters with management and others on a timely basis": para. 16 of HKSA 230.

(5) "If the auditor has identified information that contradicts or is inconsistent with the auditor's final conclusion regarding a significant matter, the auditor should document how the auditor addressed the contradiction or inconsistency in forming the final conclusion": para. 18 of HKSA 230.

(6) "HKSQC [14] 1 requires firms to establish policies and procedures for the retention of engagement documentation.

[14] ie Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services.

As HKSQC 1 indicates, the retention period for audit engagements ordinarily is no shorter than five years from the date of the auditor's report, or, if later, the date of the group auditor's report": para. 29 of HKSA 230.

(7) "When the auditor believes there may be non-compliance [with laws and regulations], the auditor should document the findings and discuss them with management. Documentation of findings would include copies of records and documents and making minutes of conversations, if appropriate": para. 28 of HKSA 250.

247. In light of these guidelines, unless EY confesses it has completely failed to follow any of them, which it has not, and in the absence of any satisfactory explanation, this court is compelled to infer that there are further documents in its possession which are responsive to the Notices and which, through inadvertence or otherwise, it has omitted to disclose.

N. EXERCISE OF DISCRETION UNDER SECTION 185 SFO

248. In its written closing submissions, SFC invites this court to make an Order under section 185(1)(a) SFO that EY shall comply with the Notices ie the 1st, 2nd, 3rd, 4th and 7th Notices within the period specified in the Order. While SFC goes on to say that it is envisaged that EY may have to take a number of steps, such as asking HM to seek clearance from the relevant PRC authorities, if clearance is required, Mr Jat has indicated to this court that it is unnecessary to spell out the detailed steps required of EY.

249. I agree. It is up to EY, with the assistance of its legal advisers in Hong Kong and the PRC, to decide how best to comply with the said Notices. Take the audit working papers, for instance, requested by SFC under the 2nd Notice. If, as alluded to in the letter dated 15 May 2013 from Linklaters to SFC, the Hard Drives in Hong Kong already contain the audit working papers, it may not be necessary for EY to take any legal action in the PRC to compel HM for their production.

250. One of EY's objections to the present application is that SFC is in effect seeking a Court Order in Hong Kong compelling it to take legal action against HM in the PRC and/or to obtain clearance from the authorities in the PRC. This is said to be unprecedented and not what section 185 intends.

251. This is the first case under section 185 SFO where the court is asked to inquire into a Hong Kong auditor's non-compliance with notices issued by SFC and for orders directing compliance with them. To that extent, the relief sought by SFC against EY is unprecedented.

252. However, the court will only consider exercising the discretion to grant the Order sought if it is satisfied that EY has possession of the information, records or documents in question and has failed to show reasonable excuse for its non-compliance. *If*, owing to HM's non-cooperation, EY has no choice but to assert its right of possession by means of a legal action in the PRC, it is unclear from EY's submissions why that is outside the ambit of section 185 SFO. The relevant test is whether an order for compliance with the Notices would be "oppressive" to EY: *P v Commissioner of ICAC supra*. In the absence of cogent evidence

from EY, this court is not prepared to accept a bare assertion that it will be oppressive to grant an Order which *may* have the effect of compelling EY to assert what *ex hypothesis* is its right.

253. But the fundamental difficulties with EY's objections are two-fold.

254. First, there is no evidence that HM would refuse to cooperate so that EY will be compelled to take legal action in the PRC. On the contrary, in these proceedings, EY has repeatedly emphasised HM's indication of willingness to cooperate, as shown in a letter from its PRC lawyers Fangda dated 5 December 2012. If that is the case, all that EY has to do is to urge HM to take steps to "cooperate" by either (i) sending a complete set of the audit working papers and other relevant documents to CSRC for onward transmission to SFC; or (ii) producing the relevant documents to EY in the PRC for EY to seek whatever clearances as may be required for their onward transmission to SFC.

255. Second, according to Linklaters' letter dated 15 May 2013 to SFC, the Hard Drives which are presently in Hong Kong contain information responsive to the Notices including the audit working papers and other archives. If that is the case, it would not be necessary for EY to ask HM at all – EY already has the audit working papers in Hong Kong.

256. Either way, this court cannot discern any oppressiveness in granting an Order compelling EY to comply with the Notices. In these circumstances, this court considers that it should exercise its discretion in such a way that would facilitate SFC in the discharge of its statutory

function ie by making an Order in terms of paragraph 1 of the Originating Summons.

257. Regarding "punishment" for EY's past failures to comply with the Notices in question, SFC seeks an order that EY pays its costs on an indemnity basis.

258. This court clearly has jurisdiction to make such an order as a substantive relief under section 185 SFO: *Kwan Wing Kim supra* at 339; *Hong Kong Civil Procedure 2014* vol. 1 para. 52/1/11.

259. In the present case, this court has come to the conclusion that EY has deliberately withheld from SFC information in its knowledge which is responsive to the Notices: see paragraph 241 above. This court also views with dismay EY's failure to disclose, until the substantive hearing of these proceedings, the fact that it has had in its custody in Hong Kong the three Hard Drives since early 2011, despite the fact that its possession of them must be known to the FIDS team and the Office of General Counsel: see Affidavit of Ms Davies. In the absence of a satisfactory explanation, the inference that EY has failed to conduct all necessary internal investigation before responding to the Notices is again compelling.

O. CONCLUSION AND DISPOSITION

260. To conclude, for the above reasons, this court is satisfied that:

(1) EY was, as at the respective dates of the 1st to 4th and 7th Notices, and is in possession of records and documents

which are likely to contain information relevant to SFC's investigation;

(2) EY has failed to comply with the said Notices;

(3) there was, as at the respective dates of the said Notices, and is no reasonable excuse for EY not to comply with them.

261. There shall be an Order under section 185 SFO that:

(1) EY shall comply with the said Notices within 28 days from the date hereof or such other period as may be agreed in writing between EY and SFC.

(2) EY shall bear the costs of and occasioned by SFC's application on an indemnity basis, with certificate for two counsel.

262. If and in so far as may be necessary, there shall be an order *nisi* under RHC O 42 r 5B that EY shall bear the costs of and occasioned by SFC's application on an indemnity basis, with certificate for two counsel.

263. There shall also be general liberty to apply.

264. Lastly, I thank counsel for their detailed and helpful submissions.

(Peter Ng)
Judge of the Court of First Instance
High Court

Mr Jat Sew Tong SC and Ms Kay Seto, instructed by the Securities and Futures Commission, for the plaintiff

Mr Benjamin Yu SC, Mr Jose Maurellet and Mr Laurence Li, instructed by Linklaters, for the defendant