

HCMP 1094/2019

[2021] HKCFI 497

**IN THE HIGH COURT OF THE
HONG KONG SPECIAL ADMINISTRATIVE REGION
COURT OF FIRST INSTANCE**

MISCELLANEOUS PROCEEDINGS NO 1094 OF 2019

IN THE MATTER OF Shandong Molong
Petroleum Machinery Company Limited
and

IN THE MATTER OF Section 214 of
Securities and Futures Ordinance, Cap 571

BETWEEN

SECURITIES AND FUTURES
COMMISSION

Petitioner

and

SHANDONG MOLONG PETROLEUM
MACHINERY COMPANY LIMITED

1st Respondent

ZHANG EN RONG (張恩榮)

2nd Respondent

ZHANG YUN SAN (張雲三)

3rd Respondent

YANG JIN (楊晉)

4th Respondent

GUO HUAN RAN (國煥然)

5th Respondent

ZHAO HONG FENG (趙洪峰)

6th Respondent

DING ZHI SHUI (丁志水)

7th Respondent

YANG JUN QIU (楊俊秋)

8th Respondent

Before: Hon Linda Chan J in Court

Date of Hearing: 15 December 2020

Date of Further Submissions: 10 February 2021

Date of Judgment: 26 February 2021

J U D G M E N T

1. By Petition presented on 26 July 2019 the Securities and Futures Commission (“SFC”) applies under s 214(2) of the Securities and Futures Ordinance (Cap 571) (“SFO”) for (1) a disqualification order against the 2nd to 8th Respondents (collectively “Rs”), and (2) an order directing the 1st Respondent, Shandong Molong Petroleum Machinery Company Limited (“Company”), to reconstitute its Audit Committee and appoint an independent external auditor acceptable to the SFC to review and report on its internal control and financial reporting procedure to ensure compliance with all relevant rules and regulations and, thereafter, publish and implement the suggested measures as advised by the external auditor.

2. It is the SFC’s case that by reason of the overstatement of key financial information of the Company for the years 2015 and 2016, the business or affairs of the Company have been conducted in a manner (1) involving defalcation, misfeasance or misconduct towards the Company, its members or any part of itsmembers; (2) resulting in its members not having been given all the information with respect to the Company’s business or affairs that they might reasonably expect;and/or (3) unfairly prejudicial to its members or any part of itsmembers, within the meaning of s 214(1)(b), (c) and (d) of the SFO.

A. BACKGROUND

3. The claim against the Company was disposed of by way of *Carecraft* procedure whereby the SFC and the Company agreed to a statement of agreed facts and the agreed proposed orders appended to the consent summons dated 10 December 2019. In the Judgment of Anthony Chan J dated 29 April 2020, His Lordship was satisfiedthat the Court has jurisdiction to make the proposed orders and that it is appropriate to make such orders.

4. On 18 September 2019, the SFC obtained leave to serve the relevant documents out of the jurisdiction on Rs at their last known addresses or elsewhere in the Mainland. Thereafter, the SFC reached separate agreements with Rs to dispose of the Petition by way of summary procedure, which resulted in the parties signing:

(1) a Schedule for *Carecraft* Procedure in respect of the 2nd, 4th to 8th Respondents (“**R2, R4-8**”) dated 16 April 2020 containing, *inter alia*, statement of agreed facts and agreed proposed orders; and

(2) a Schedule for *Carecraft* Procedure in respect of the 3rd Respondent (“**R3**”) dated 17 July 2020 containing, *inter alia*, statement of agreed facts and agreed proposed orders,

(together “**Schedules**”).

5. Except the identity of the parties signing the Schedules, their contents are identical. The references to the “agreed facts” in Sections A and B of this Judgment are to those in the statements of agreed facts admitted by R2, R4-8 and R3 in their respective Schedule.

6. Pursuant to the Orders of Anthony Chan J dated 11 May and 23 July 2020, leave was given to the parties to dispose of the Petition by way of summary procedure and to fix a substantive hearing for the parties to make their respective submissions.

7. Prior to the substantive hearing, Rs indicated that they would not attend the hearing or make any submissions to the Court. Consequently, at the hearing on 15 December 2020, only the SFC appeared and was represented by Mr Jenkin Suen SC.

B. CONCERNS ON SFC’S APPROACH

8. At the hearing, this Court observed that the agreed facts contained a number of alternative “facts” said to have been admitted by Rs including:

(1) Rs “knowingly” overstated revenue and understated operating costs of the Company for the financial years 2015 and 2016 by instigating, permitting or participating in the Inflation Scheme. Rs admitted, accepted and agreed that they were “the instigators and/or mastermind” and had “knowledge” of the Inflation Scheme^[1].

(2) Without prejudice to §(1) above, Rs “at least acquiesced and/or turned a blind eye” to the same Inflation Scheme. Rs admitted, accepted and agreed that they “at least acquiesced and/or turned a blind eye” to the Inflation Scheme^[2].

(3) Without prejudice to §§(1) and (2) above, Rs “at least acted negligently” by failing to uncover the material misstatements, thereby failing to disclose the true financial position of the Company to its shareholders. Rs admitted, accepted and agreed that they “(at least) acted negligently and/or in breach of the duty of care

and diligence owed to the Company by failing to uncover the same”[3].

9. It is well established that under *Carecraft* procedure, the Court is not entitled to make findings upon materials other than the agreed facts (*SFC v Ho Yik Kin Norman*, HCMP 3392/2013, 9 October 2014, per Godfrey Lam J, §2). The obvious problem posed by the agreed facts is whether in deciding the appropriate length of disqualification, the Court should take into account the more serious conduct (where Rs are said to have the *actual* knowledge, and were the instigators and/or masterminds, of the Inflation Scheme) or the less serious conduct (where Rs are said to have acquiesced in the Inflation Scheme) or still the lesser serious conduct (where Rs are said to have acted negligently in failing to uncover the Inflation Scheme). Mr Suen submits that the Court should take into account the more serious admission and ignore the other less serious alternative admissions. I am unable to see the basis of his submission as it can equally be said that the Court should take into account the less serious admissions and ignore the more serious alternative admission. In the absence of Rs, it is simply not possible to ascertain whether the stance adopted by Mr Suen is one which is agreeable to Rs.

10. As regards the length of disqualification, the same “facts” had been admitted by each Rs (including their positions as “Senior Officers” of the Company and their roles in respect of the Inflation Scheme), but the periods of disqualification proposed by the SFC were very different: being 12 years for R2-4 and 10 years for R5-8. When this Court enquired the reasons for the different proposed periods, Mr Suen submitted that the only difference between R2-4 and R5-8 was their positions in the Company. Mr Suen contended that Rs had accepted the periods of disqualification proposed by the SFC by signing the Schedules and not attending the hearing. I disagreed. In the Schedules, Rs only agreed that it would be appropriate for disqualification order “for such period as this Court might determine”. There was nothing in the Schedules or the correspondence between the SFC and Rs which suggested that Rs had agreed with the periods of disqualification proposed by the SFC.

11. The other concern was the absence of any submission as to whether there were any mitigating factors relevant to Rs. Mr Suen submitted that it was up to Rs to put forward any mitigating factors they wished to advance and the SFC should not be required to do so even if the SFC was admittedly aware of such factors. I disagreed.

12. The SFC, as the regulator discharging an important function in the public interest, was expected to act fairly in proceedings commenced by it. It is incumbent upon the SFC to inform the Court matters within its knowledge insofar as they are relevant to the length of disqualification. These include whether Rs have been cooperative with the SFC at the outset, whether they have assisted the SFC in the provision of information and documents

during the investigation and whether they readily admitted the allegations as soon as they had received the Petition. Indeed, it would be in the public interest for the SFC to advance such factors for the purpose of *Carecraft* procedure, as it would provide an incentive to the respondents to cooperate with the SFC at an early stage. It would also save costs and time for the parties. I note that this has been the approach adopted by the Competition Commission when dealing with enforcement proceedings by way of *Carecraft* procedure (see *Competition Commission v Kam Kwong Engineering Company Limited & ors* [2020] 4 HKLRD 61; *Competition Commission v Quantr Limited & anor* [2020] 5 HKLRD 528).

13. In light of the above concerns, Mr Suen asked for an adjournment of 12 weeks to allow the SFC to revise the agreed facts and, thereafter, obtain Rs' agreement on such revised facts. The Petition was adjourned for 9 weeks and directions were given for the applications to be determined on paper.

C. DISCUSSION

C1. Revised Schedules

14. On 10 February 2021, the SFC lodged its supplemental submissions together with the revised Schedules dated 3 February 2021 in respect of R2/R4, R3, and R5-8 respectively (collectively "**Revised Schedules**") which supersede the Schedules. The Revised Schedules, with the revised agreed facts ("**Agreed Facts**"), are appended to this Judgment. The material changes in the Revised Schedules are as follows:

- (1) the deletion of the inconsistent admissions as regards acquiescence, turning a blind eye and negligence in respect of all Rs; and
- (2) the deletion of references to R5-8's role as instigator and/or mastermind of the Inflation Scheme.

15. In addition, R3 and R5-8 have by their letters to the SFC dated 31 December 2020 and 29 December 2020 respectively put forward various mitigating factors for consideration by the Court. Having considered Rs' position, the SFC proposes to seek disqualification order of the following revised duration:

- (1) 11 years in respect of R2 and R4;
- (2) 11 years in respect of R3; and
- (3) 9 years in respect of R5 to R8.

C2. Applicable principles

16. Section 214(1) and (2) of the SFO provide as follows:

“214. Remedies in cases of unfair prejudice, etc. to interests of members of listed corporations, etc.

(1) Where, in relation to a corporation which is or was listed, it appears to the Commission that at any relevant time the business or affairs of the corporation have been conducted in a manner—

- (a) oppressive to its members or any part of its members;
- (b) involving defalcation, fraud, misfeasance or other misconduct towards it or its members or any part of its members;
- (c) resulting in its members or any part of its members not having been given all the information with respect to its business or affairs that they might reasonably expect; or
- (d) unfairly prejudicial to its members or any part of its members,

the Commission may, subject to subsection (3), by petition apply to the Court of First Instance for an order under this section.

(2) If, on an application under this section, the Court of First Instance is of the opinion that the business or affairs of a corporation have been conducted in a manner described in subsection (1)(a), (b), (c) or (d), whether through conduct consisting of an isolated act or a series of acts or any failure to act, the Court may—

- (a) make an order restraining the carrying out, or requiring the carrying out, of any act or acts;
- (b) order that the corporation shall bring in its name such proceedings as the Court considers appropriate against such persons, and on such terms, as may be specified in the order;
- (c) unless the corporation is an authorized financial institution, appoint a receiver or manager of the whole or any part of the property or business of the corporation and may specify the powers and duties of the receiver or manager and fix his remuneration;
- (d) order that a person wholly or partly responsible for the business or affairs of the corporation having been so conducted shall not, without the leave of the Court—

- (i) be, or continue to be, a director, liquidator, or receiver or manager of the property or business, of the corporation or any other corporation; or

- (ii) in any way, whether directly or indirectly, be concerned, or take part, in the management of the corporation or any other corporation,

- for such period (not exceeding 15 years) as may be specified in the order;

- (e) make any other order it considers appropriate, whether for regulating the conduct of the business or affairs of the corporation in future, or for the purchase of the shares of any members of the corporation by other members of the corporation or by the corporation (and, in the case of a purchase by the corporation, for the reduction accordingly of the corporation's capital), or otherwise.”

17. Under s 214 of the SFO, the conduct complained of must be the business or affairs of the listed company and those of the subsidiaries insofar as they were directed by or under the

control of the listed company (*Securities and Futures Commission v Fung Chiu* [2009] 6 HKC 423, §§19-20, per Chu J (as she then was)).

18. The Court must be satisfied, based on the agreed facts, that the business or affairs of the company have in fact been conducted in a manner that contravened one of the limbs in s 214(1) of the SFO and, if so, determine the order to be made (*Re Riverhill Holdings Ltd* [2007] 4 HKLRD 46, §7, per Kwan J (as she then was)).

19. The SFC relies on s 214(1)(b), (c) and (d) of the SFO. I consider these limbs in turn:

(1) Section 214(1)(b) is concerned with “defalcation, fraud, misfeasance or other misconduct” towards the listed company or its members. “Defalcation” and “misfeasance” are both defined in s1, Part 1 of Schedule to the SFO, with the former being defined as “misapplication, including misappropriation, of any property”, while the latter as “the performance of an otherwise lawful act in a wrongful manner”. It is well established that breach of duties *qua* directors and officers constitute misfeasance.

(2) Section 214(1)(c) concerns with “members not having been given all the information with respect to its business or affairs that they might reasonably expect”. This covers situations where the listed company is required to publish periodic financial statements and announcements under the listing rules, the SFO or the Companies Ordinance (Cap 622), as members are entitled to expect the listed company to provide complete and accurate information in respect of such matters. Indeed, this is something which the directors invariably confirm in the announcements and the financial statements published by the listed company.

(3) Section 214(1)(d) looks at the effect of the conduct complained of by the SFC, which has to be “unfairly prejudicial to its members or any part of its members”. Under this limb, the conduct in question does not have to be wrongful *per se*. It is sufficient if the conduct is shown to be unfairly prejudicial to the listed company’s members or part of its members.

20. As regards the period of disqualification, the Court takes into account the two-fold objectives serve by a disqualification order: to protect the public against the future conduct of the respondent, and as a general deterrence (*SFC v Fung Chiu*, §55). Generally, the Court adopts the 3 brackets of disqualification period laid down by the English Court of Appeal in *Re Sevenoaks Stationers Ltd* [1991] Ch 164^[4]:

(1) the top bracket of over 10 years for particularly serious cases (i.e. 11 to 15

years, being the maximum period of disqualification);

(2) the middle bracket of 6 to 10 years for serious cases which do not merit the top bracket;and

(3) the minimum bracket of 2 to 5 years for less serious cases.

21. Further, the Court will have regard to all relevant circumstances including the nature and seriousness of the conduct complained of, the structure and nature of the business of the company, the interests of the shareholders, creditors and employees, the risks to others from the continuation of the respondents as company directors, the training, experience, skill and competence of the respondents, the honesty and competence of respondents, the hardship to respondents and their personal and commercial interests, their appreciation that future breaches could result in future proceedings and other mitigating factors (*Re First China Financial Network Holdings Ltd* [2015] 5 HKLRD 530, §9, per Anthony Chan J; *Hanergy Thin Film Power Group Limited*, §17, per Anderson Chow J; *Re Styland Holdings Ltd* [2011] 1 HKLRD 96, §§6-8, per Thomas Au J (as he then was); *SFC v Yeung Kui Wong & ors*, HCMP 1742/2009, 1 March 2011, per Reyes J).

C3. *Contravention of s 214(1)(b), (c) and (d)*

22. On the basis of the Agreed Facts, this Court is satisfied thatthat:

(1) The material misstatements in the key financial information of the Company in respect of the 6 Results Announcements are the business and affairs of the Company within the meaning of s 214(1) of theSFO. The misstatements were very substantial in that they covered a period of 2 years and had the effect of overstating the profits of the Company by 5 to 2,189 times and concealing the fact that the Company had suffered huge losses of over \$340 million in the 9 months ended 30 September 2015 and 2016.

(2) Rs knowinglyparticipated in the Inflation Scheme.

(3) The business or affairs of the Company were conducted by Rs in a manner:

(a) involving fraud and misfeasance towards the Company and its members within the meaning of s 214(1)(b) of the SFO;

(b) resulting in the members not having been given the true and complete information with respect to its business and affairs of the Company in particular, its revenue, expenses and operating results which they might reasonably expect within the meaning of s 214(1)(c) of the

SFO; and

(c) unfairly prejudicial to its members as they were entitled to be provided with true and complete financial information with respect to the Company's business and operating results, within the meaning of s 214(1)(d) of the SFO.

23. I turn to the period of disqualification in respect of each Rs.

C4. R2 and R4

24. Until their resignation with effect from 25 June 2018, R2 was the Chairman and Executive Director of the Company, while R4 was its Chief Financial officer, Executive Director and Deputy General Manager. R2 and R4 admit that:

- (1) they occupied important positions in the Company and had substantial control and knowledge over the finance of the Company;
- (2) they had ample incentive to inflate the performance of the Company as R2 controlled at least 33.29% of the issued shares in the Company; and he alongside with R4 were senior officers entitled to receive substantial remuneration from the Company; and
- (3) they were the instigators and/or mastermind of the Inflation Scheme, and that such Scheme was carried out in accordance with their instructions, directions and consent.

25. Mr Suen relies on the following authorities in support of his contention that where the respondent's conduct was fraudulent or involved dishonesty, the case would fall into the top bracket:

- (1) In *Re Styland Holdings Ltd (No 2)* Barma J held that mismanagement and failures to comply with the listing rules were serious misconduct, but not so serious as to fall within the top bracket; however the fact that the 1st and 2nd respondents received substantial sums took the case into the top bracket (§133).
- (2) In *SFC v Yeung Chung Lung & Ors*, HCMP 205/2013, 17 February 2017, the Court considered the false statement and embezzlement of funds warranted disqualification for a period of 12 years (§§106-107).
- (3) In *SFC v Wang Jian Hua & Ors*, HCMP 745/2013, 30 May 2016, the Court considered the gravity of the conduct of the 1st respondent *prima facie* falls within

the top bracket (§4) but imposed a disqualification period of 10 years after considering mitigating factors.

26. Mr Suen contends that while the present case does not involve embezzlement of the Company's funds, it is a case concerning dishonest orchestration of the Inflation Scheme which involved misrepresentations having been made to the banks, customers and the investing public dealing with the Company. The dishonest and fraudulent conduct on the part of R2 and R4 clearly falls within the top bracket. Moreover, having regard to (1) the magnitude of the overstatement of the profits of the Company, (2) the recurrence of overstatements in the first 3 quarters of 2016 (following similar misstatements in 2015), and (3) the dishonest conduct and role of R2 and R4 (being the instigators and mastermind of the Inflation Scheme), the Court should adopt a starting point of 12 to 13 years (i.e. the middle of the top bracket).

27. On the other hand, there are mitigating factors in favour of R2 and R4 in that they have cooperated with the SFC at the outset, and have agreed to the facts and proposed orders for the purpose of *Carecraft* procedure, and to pay the SFC's costs. Taking into account these mitigating factors, the SFC is prepared to seek a disqualification order for a reduced period of 11 years.

28. In my judgment, while the conduct of R2 and R4 is dishonest and fraudulent, one cannot ignore the fact that whilst the Company was still under the management of, *inter alios*, R2 and R4, clarification announcements were issued on 30 March 2017, 10 April 2017 and 29 September 2017 to disclose the fact that there were misstatements of operating revenue and operating costs in the financial statements and to correct the results stated in the 6 Results Announcements. These clarification announcements had the effect of militating, if not putting an end to, the effect of the misstatements contained in the 6 Results Announcements and the mis-information received by the members.

29. It is also an important distinction that the misconduct complained of against R2 and R4 did not involve embezzlement of the Company's funds, which is a much more serious breach of duty on the part of the fiduciaries such as R2 and R4. On the basis of the Agreed Facts, the Company did not suffer any loss.

30. For these reasons, I consider that R2 and R4's misconduct, while very serious and falls within the top bracket, warrants a starting point of 11 years. Taking into account the mitigating factors identified by the SFC, the appropriate disqualification period in respect of R2 and R4 is 9 years.

C5. R3

31. R3 was the Deputy Chairman, Executive Director and General Manager of the Company and was in charge of the business and management of the Company until 14 August 2017. He also held some A shares and H shares in the Company. He admits that:

- (1) he occupied important positions in the Company and was in charge of the business and management of the Company;
- (2) he was the instigator and/or mastermind of the Inflation Scheme, and that such scheme was carried out in accordance with his instructions, directions and consent;
- (3) he had ample incentive to inflate the performance of the Company as a shareholder and senior officer receiving substantial remuneration;
- (4) he directed the fraudulent overstatement of the profits of the Company and was directly responsible for each false record complained of in the 1st CSRC Judgment; and
- (5) the disclosure of false information was illegal, and was undertaken to maintain the projects of the Company.

32. In his email to the SFC on 31 December 2020, R3 provided a statement for the purpose of mitigation and advanced the following matters by way of mitigation.

33. First, R3 contends that the Inflation Scheme was made in circumstances where (a) the poor market conditions and tighter credit restrictions affected the liquidity of the Company; (b) the new investment project was in critical trial operation period and requiring large amounts of capital; and (c) the need to maintain the Company's credit and financing based on performance forecast. I agree with Mr Suen that these factors only point to the motives behind Rs perpetrating the Inflation Scheme. They are not mitigating factors for reducing the period of disqualification.

34. Second, to ensure that the Company would be able to maintain its financing, at the request of the financier, R3 (and his wife) provided personal guarantee, and he also sold 7.5 million A shares in the Company and lent the proceeds to the Company for its use without charging any interest. All these were done with a view to keep the Company afloat. In his further email to the SFC dated 16 January 2021, R3 emphasises that he has worked hard to contribute to the development of the Company and the interests of shareholders, as a result of which he has sustained long-term illness.

35. Mr Suen does not dispute the above matters, but submits that they do not assist R3 given that:

(1) R3 remains the owner of 30,608,000 A shares and 9,060,400 H shares in the Company and, therefore, stands to benefit from the increase in the share price; and

(2) in *Re Styland Holdings Ltd (No 2)*, Barma J did not consider that the dishonest misconduct could be mitigated by the respondents' efforts to build up the group, or by the fact that the group had remained generally profitable (§133). The same observation applies to R3.

36. I am inclined to agree with R3 that the matters he relies on are relevant mitigating factors as they go to show that he acted within his means to advance the interests of the Company (and, indirectly, the interests of the members) even though he was under no obligation to do so. Where, as here, it is said against a respondent that his conduct is unfairly prejudicial to the members, it seems to me that it must be a relevant consideration that the same respondent has undertaken steps to advance the interests of the members particularly when such steps were taken during the same period.

37. Third, R3 relies on the Company's appointment of an independent external auditor to conduct an internal control review as a material mitigating factor. As Mr Suen points out, the appointment was done pursuant to the sanctions imposed by the Stock Exchange or the Court's order in these proceedings, they were not initiated by R3.

38. The discussion set out in §§26 to 29 above applies equally to R3. R3's misconduct, which is very serious, warrants a starting point of 11 years. Taking into account the mitigating factors identified by the SFC and those discussed in §36 above, the appropriate disqualification period in respect of R3 is 8 years.

C6. R5-8

39. R5 was the Executive Director (and acting Chairman since 25 June 2018) until he retired from office on 21 December 2018. R6 was the secretary of the board of directors until 8 February 2018 and Deputy General Manager until 21 December 2018. R7 was the Finance Manager while R8 was the Deputy Finance Manager.

40. R5-8 admit that:

(1) as senior officers receiving substantial remuneration, they had ample incentive to overstate the profits and business performance of the Company; and

(2) they knowingly took part in making false adjustments to financial information to turn around losses into profits.

41. By letters dated 29 December 2020, R5-8 contend that the appropriate disqualification

period should be 3 to 5 years as they were employees of the Company. Reliance is placed on *SFC v Yeung Chung Lung & ors*, HCMP 205/2013, 17 February 2017, *SFC v Shum Ka Sang Charlie & anor*, HCMP 1014/2008, 22 May 2009, *SFC v Wong Kam Leong & ors*, HCMP 667/2018, 22 April 2020, *Re Styland Holdings Ltd (No 2)* and *SFC v Wang Jian Hua & ors*, HCMP 745/2013, 30 May 2016.

42. Mr Suen submits that these cases are distinguishable or do not assist them in that:

(1) In *Yeung Chung Lung*, the Court imposed disqualification orders of 12 years (for 1st respondent) and 8 years, taking into account the 1st respondent's additional misconduct of embezzling funds (§106). The complaint against the respondents is that they must have known about the falsification scheme, but made every effort to prevent the true facts from coming to light (§§38, 95, 104-105). By contrast, R5-8 admit that they knowingly permitted or participated in the Inflation Scheme at the outset, such that the conduct should fall within the top bracket, and the sanction should exceed 8 years.

(2) In *Shum Ka Sang Charlie*, the 1st and 2nd respondents occupied significant management positions and the wrongdoing involved falsification of transactions and records and significant overstatement of financial position. However, the 1st and 2nd respondents only admitted "reckless or negligent breach" of duties (§§12, 13). It was *not* a case of dishonesty and there was no documentary evidence to suggest that the Company's directors or key management personnel were involved in or had knowledge of the falsification of accounting profits (§19). On these bases Kwan J agreed that the case fell within the middle bracket (§20).

(3) In *Wong Kam Leong*, the evidence mainly points to negligence or neglect of duties (§52).

(4) In *Wang Jian Hua*, the Court imposed disqualification order of 10 years (1st respondent) and 6 years without any discount as they only admitted the misconduct shortly before trial. The Court considered the gravity of the conduct of the 1st respondent *prima facie* falls within the top bracket (§4), whilst the position of the 2nd and 3rd respondents is distinguishable as they were guilty of omission rather than commission (§8). Moreover, the Court took into account the fact that the respondents had ceased to be directors for over 6 years and the impugned transaction did not go through such that the company suffered no loss (at§5).

43. I have taken into account the cases relied on by R5-8 and the periods of disqualification imposed by the Court in respect of the misconduct in question. Although the facts of those

cases are not the same as the present case, they are instructive in providing guidance on the length of the disqualification period by reference to the gravity of the misconduct and the involvement of the respondents in question.

44. Mr Suen submits that it is misconceived to suggest that R5-8 took part in the Inflation Scheme as mere employees given that they “occupied significant management positions, and the public shareholders entrusted them to fully discharge their duties and responsibilities honestly”. The dishonest and fraudulent conduct of R5-8, said Mr Suen, should fall within the top bracket. Given that R5-8 were not instigators and/or mastermind of the Inflation Scheme, the Court should adopt a starting point of 11 years, being the lower end of the top bracket.

45. As with the other Rs, the SFC accepts that, as mitigating factors, R5-8 have cooperated with the SFC at the outset, particularly by agreeing to the facts and proposed orders for the purpose of *Carecraft* procedure, and have agreed to pay the SFC’s costs. Thus, whilst the conduct of R5-8 warrants disqualification in the top bracket, the SFC is prepared to seek disqualification order for a reduced duration of 9 years, taking into account relevant mitigating factors.

46. I note that only R5 was an Executive Director. R6-8 were not directors of the Company. The duties owed by R6-8, and the degree of control they exercised over the Company were less extensive than those owed by R5 (and R2-4). While R5-8 admit that they knowingly participated in the Inflation Scheme, they were not the instigators or masterminds of the Inflation Scheme.

47. The discussion set out in §§26 to 29 above applies equally to R5-8. Having considered the gravity of their misconduct, their positions held in the Company and their role in the Inflation Scheme, I consider that the starting point for R5 is 10 years while the starting point for R6-8 is 9 years. Taking into account the mitigating factors identified by the SFC, the appropriate disqualification period in respect of R5 is 8 years, while the disqualification period in respect of R6-8 is 7 years.

D. CONCLUSION

48. I make an order of disqualification against Rs for the following periods: (1) 9 years in respect of R2 and R4; (2) 8 years in respect of R3; (3) 8 years in respect of R5; and (4) 7 years in respect of R6-8.

49. As this Court observed at the hearing on 15 December 2020, it was wholly unnecessary and a waste of time and costs for the SFC to have prepared 12 hearing bundles of which 10 bundles contained exhibits which would not be referred to for the purpose of *Carecraft*

procedure. When this was raised with Mr Suen, he was unable to proffer any explanation as to why the exhibits had to be included given that the Court is not entitled to make findings upon materials other than the agreed facts. It seems to me that Rs should not be required to pay the costs incurred of the preparation of the 10 bundles of exhibits which were incurred by the SFC unnecessarily.

50. Rs agree to pay the costs of the SFC in these proceedings or such portion thereof as the Court thinks appropriate, to be taxed if not agreed with certificate for counsel. I therefore order Rs to pay the costs of the proceedings insofar as they relate to them, but not the costs occasioned by the preparation of the bundles of exhibits, to be taxed if not agreed with certificate for counsel.

(Linda Chan)
Judge of the Court of First Instance
High Court

Mr Jenkin Suen SC, instructed by Securities and Futures Commission, for the petitioner

The 2nd - 8th respondents were not represented and absent

Appendices: The Revised Schedules

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5th Respondent

ZHAO HONG FENG (趙洪峰)

6th Respondent

DING ZHI SHUI (丁志水)

7th Respondent

YANG JUN QIU (楊俊秋)

8th Respondent

**SCHEDULE FOR *CARECRAFT* PROCEDURE IN RESPECT OF THE
2nd AND 4th RESPONDENTS**

PART I - INTRODUCTION

1. On 26 July 2019, the Securities and Futures Commission (the “**Petitioner**”) presented a petition (the “**Petition**”) pursuant to sections 214(1)(b), (c) and (d) of the Securities and Futures Ordinance (Cap. 571) (the “**SFO**”) seeking:

(1) An order pursuant to section 214(2)(a) or (d) of the SFO that the 2nd to 8th Respondents shall not, for such period as the Court might determine, without leave of the Court:

(a) be, or continue to be, a director, liquidator, or receiver or manager of the property or business, of any listed or unlisted company in Hong Kong including Shandong Molong Petroleum Machinery Company Limited (the “**Company**”) or any of its subsidiaries and affiliates; and

(b) in any way directly or indirectly be concerned, or take part, in the management of any listed or unlisted company in Hong Kong including the Company or any of its subsidiaries and affiliates.

(2) An order pursuant to section 214(2)(a) or (e) of the SFO directing the Company to:

(a) reconstitute its Audit Committee with independent members or professionals;

(b) appoint an independent external auditor acceptable to the Petitioner to review and prepare a report on its internal control and financial reporting procedures so as to ensure that the Company complies with all relevant rules and regulations in Hong Kong and minimise the risk of recurrence of the misconduct complained of in the Petition; and

(c) publish and implement the suggested measures as may be advised in the report by such independent external auditor.

A. Purpose

2. Subject to the approval of this Court, the Petitioner and the 2nd and 4th Respondents have agreed to dispose of these proceedings against each of the 2nd and 4th Respondents by way of the summary procedure (the “**Summary Procedure**”) sanctioned in the case of *Re Carecraft Construction Co. Ltd.* [1994] 1 WLR 172 and as adopted by this Court in a number of cases in respect of proceedings under section 214 of the SFO.

3. This Schedule is produced in order to provide this Court, for the purpose of disposing of these proceedings against the 2nd and 4th Respondents by way of the Summary Procedure, with the core facts that are not disputed in relation to allegations relied upon by the Petitioner.

4. The facts set out in this Schedule are not disputed between the Petitioner and each of the 2nd and 4th Respondents on the basis that the case against these Respondents will be dealt with by the Court by way of the Summary Procedure. If the Court for any reason is of the view that these proceedings shall not be dealt with by the Summary Procedure or that a full hearing is appropriate, no admission or concession by either the Petitioner or any of the 2nd and 4th Respondents and none of the proposed orders referred to below or liability to pay costs shall be referred to or relied upon by any of the parties at any subsequent hearing without the prior written consent of the Petitioner and each of the 2nd and 4th Respondents.

5. For the purpose of resolving these proceedings against each of the 2nd and 4th Respondents by way of the Summary Procedure, and by reference to the facts set out in Part II of this Schedule which each of the 2nd and 4th Respondents admit and accept, each of the 2nd and 4th Respondents accept that during the relevant period, the business and affairs of the Company have been conducted in a manner described in section 214(1)(b) to (d) SFO, namely:-

- (1) involving defalcation, misfeasance or misconduct towards the Company, its members or any part of its members;
- (2) resulting in its members not having been given all the information with respect to the Company's business or affairs that they might reasonably expect; and/or
- (3) unfairly prejudicial to its members or any part of its members.

B. Unopposed Orders

6. On the basis of the facts set out in Part II of this Schedule, the Petitioner and each of the 2nd and 4th Respondents agree, and the 2nd and 4th Respondents are prepared to accept, that it would be appropriate for the orders set out at paragraph 47 below to be made against it.

7. If pursuant to this Schedule, this Court disposes of these proceedings summarily, each of the 2nd and 4th Respondents agrees that there should additionally be an order that they do pay the costs of the Petitioner in these proceedings, or such portion thereof as the Court thinks appropriate, to be taxed if not agreed with certificate for counsel.

8. In the event that this Court makes any order sought against the 2nd and 4th Respondents by reference to this Schedule, the Petitioner and each of the 2nd and 4th Respondents agree that this Schedule be annexed to this Court's judgment and will jointly seek a direction to that effect.

9. Furthermore, without prejudice to all of the Petitioner's rights, the Petitioner specifically reserves the right to (a) disclose this Schedule to third parties where it appears proper to do so in the public interest, including, but not limited to, making use of the Schedule for the purpose of any press release issued in respect of these proceedings, and (b) refer to this Schedule for purposes ancillary to, connected with and/or arising out of these proceedings.

PART II - STATEMENT OF AGREED FACTS

A. The Company and its Management

10. The Company is a Sino-foreign joint stock company incorporated in the People's Republic of China ("**PRC**"), listed on the Hong Kong Stock Exchange ("**HK Exchange**") (stock code: 568) and the Shenzhen Stock Exchange ("**SZ Exchange**") (stock code: 2490). The Company was publicly listed on the Growth Enterprise Market of HK Exchange on 15 April 2004, and changed its listing to the Main Board on 7 February 2007. It has been listed on the SZ Exchange since 21 October 2010.

11. The Company and its subsidiaries (the "**Group**") are principally engaged in the manufacture and sales of pipe products, pumping equipment and petroleum machinery in the PRC.

12. Mr Zhang En Rong (張恩榮) ("**ER Zhang**") was at all material times the controlling shareholder of the Company, holding at least 33.29% of its shares, prior to the disposal of his 3.76% stake on 13 January 2017.

13. Mr Zhang Yun San (張雲三) ("**YS Zhang**"), the son of ER Zhang, was also at all material times a shareholder of the Company. Before YS Zhang disposed of the 7,500,000 A shares in the Company on 23 November 2016, he held 30,608,000 A shares and 9,060,400 H shares of the Company.

14. At all material times, the senior management of the Company comprised (amongst others):

(1) ER Zhang, Chairman and Executive Director of the Company until he resigned with effect from 25 June 2018. He had substantial and overall control over matters concerning the Group's finances and had intimate knowledge of the same. In particular, he had knowledge of the Company's revenue, costs and profits, which were the most basic and fundamental measures of the Company's performance;

(2) YS Zhang, Deputy Chairman, Executive Director and General Manager of the Company until he resigned with effect from 14 August 2017. He was in charge of

the business and management of the Company;

(3) Mr Yang Jin (楊晉) (“**Yang Jin**”), Chief Financial Officer (“**CFO**”), Executive Director and Deputy General Manager of the Company until he resigned with effect from 25 June 2018. He was in charge of the finance of the Company including supervision and preparation of financial statements;

(4) Mr Guo Huan Ran (國煥然) (“**Guo**”), Executive Director of the Company (and the acting Chairman of the Company since 25 June 2018) until he retired from office with effect from 21 December 2018;

(5) Mr Zhao Hong Feng (趙洪峰) (“**Zhao**”), Secretary of the board of directors of the Company (the “**Board**”) until his cessation to hold such position with effect from 8 February 2018 and Deputy General Manager of the Company until his cessation to hold such position with effect from 21 December 2018;

(6) Mr Ding Zhi Shui (丁志水) (“**Ding**”), Finance Manager of the Company; and

(7) Ms Yang Jun Qiu (楊俊秋) (“**JQ Yang**”), Deputy Finance Manager of the Company

(collectively the “**Senior Officers**”).

15. At all material times, the Audit Committee of the Company comprised of:

(1) Mr Qin Xue Chang, Chairman of the audit committee and independent director;

(2) Ms Wang Chun Hua, an independent non-executive director until 27 June 2016;

(3) Mr John Paul Cameron, an independent non-executive director until 27 June 2016;

(4) Mr Ji Yan Song, an independent non-executive director since 29 June 2016; and

(5) Ms Quan Yu Hua, an independent non-executive director since 29 June 2016.

16. At all material times, ShineWing Certified Public Accountants Limited was the external auditor of the Group.

B. Material Overstatement of Profits

B1. Representation of the Company’s finances in 2015 and 2016

17. In 2015 and 2016, the Company published the following quarterly and half-yearly results announcements for the first three quarters of 2015 and 2016 (collectively, the “**6 Results Announcements**”):

- (1) Announcement dated 24 April 2015 for the 1st quarter of 2015 (“**2015 Q1 Report**”) with expected net profit for the 6 months ended 30 June 2015 at RMB 9.23 million to RMB 12 million;
- (2) Announcement dated 28 August 2015 for the 6 months ended 30 June 2015 (“**2015 Interim Report**”) with total profit at RMB 6.51 million and net loss at 0.99 million;
- (3) Announcement dated 30 October 2015 for the 3rd quarter of 2015 (“**2015 Q3 Report**”) with expected net profit for the year of 2015 at RMB 4.05 million to RMB 14.16 million;
- (4) Announcement dated 28 April 2016 for the 1st quarter of 2016 (“**2016 Q1 Report**”) with expected net profit for the 6 months ended 30 June 2016 at RMB 5.16 million to RMB 7.22 million;
- (5) Announcement dated 19 August 2016 for the 6 months ended 30 June 2016 (“**2016 Interim Report**”) with total loss at RMB 2.92 million and net loss at 10.49 million; and
- (6) Announcement dated 26 October 2016 for the 3rd quarter of 2016 (“**2016 Q3 Report**”) with expected net profit for the year of 2016 at RMB 6 million to RMB 12 million.

18. Each of the 6 Results Announcements contained the usual major accounting data such as operating revenue and expenses, and net profit etc., all of which were stated to be unaudited by the Company’s auditors.

19. Each of the 6 Results Announcements was discussed and approved by the Board, as evidenced by the relevant board minutes.

B2. Revision of the Company’s profit forecast and results in 2016 and 2017

20. In early 2016 and early 2017, the Company published the following announcements to revise the profit forecast and results:

- (1) By announcement dated 29 January 2016 (“**2015 Forecast Revision**”), the Company revised the forecast for 2015 from profit of RMB 4.05 million to RMB

14.16 million to loss of RMB 190 million to RMB 270 million;

(2) By annual results announcement dated 30 March 2016 (“**2015 Annual Results**”), the Company disclosed that the loss attributable to equity holders of the Company amounted to RMB 259.57 million in 2015 (as compared with a profit of RMB 20.23 million in 2014);

(3) By two announcements dated 3 February 2017 (“**2016 Forecast Revision**”), the Company revised the forecast for 2016 from profit of RMB 6 million to RMB 12 million to loss of RMB 480 million to RMB 630 million; and

(4) By annual results announcement dated 30 March 2017 (“**2016 Annual Results**”), the Company disclosed that the net loss attributable to the owners of the Company amounted to RMB 612.48 million in 2016 (as compared with the net loss of RMB 259.57 million in 2015).

21. The Company also stated in clarification announcements that the 6 Results Announcements contained inaccurate items in revenue recognition, revenue measurement and operating cost structure, and changes were required to correct the information therein, including:

(1) Clarification announcements dated 30 March 2017 and 29 September 2017 to correct the 2016 Q1 Report, the 2016 Interim Report and the 2016 Q3 Report (“**2016 Results Clarifications**”); and

(2) Clarification announcement dated 29 September 2017 to amend the 2015 Q1 Report, the 2015 Interim Report and the 2015 Q3 Report (“**2015 Results Clarification**”).

22. On 10 April 2017, the Company issued another clarification announcement which contained the following extract of the independent auditor’s report on the Group’s annual financial statements for the year ended 31 December 2016:

“For the first three quarters in 2016, the Company did not implement effective internal control policy and procedure on part of *operating revenue recognition and measurement*, as well as the *operating cost settlement*. The aforesaid material defect has resulted in misstatement of operating revenue and operating cost in the financial statements.” [emphasis added]

B3. *Material Overstatement of Profits*

23. Notwithstanding the relatively healthy financial position as purportedly portrayed, it transpired in the 2015 Results Clarification and the 2016 Results Clarifications that the 6 Results Announcements for 2015 and 2016 were in fact materially false, due *inter alia* to the

fact that the revenue and profits of the Company had been substantially inflated or overstated, whilst the operating costs of the Company had been substantially understated.

24. Fictitious or false entries on the operating revenues and/or operating costs of the Company had been created with the effect that the business operations of the Company appeared more successful than they were in fact, which in turn resulted in the inflation or overstatement of the profits of the Company.

25. The discrepancies between the false financial positions of the Company and/or the Group portrayed in the 6 Results Announcements and the actual financial position of the same are reflected in the changes and amendments made to the figures via the 2015 and 2016 Results Clarifications. Without being exhaustive, the key discrepancies include the following:

(1) Discrepancies for 2015:-

	Original (RMB)	Revised (RMB)	Discrepancy
2015 Q1 Report			
Operating revenue	567,637,950.76	543,523,096.84	24,114,853.92 -4.25%
Net profit / loss	4,592,299.53	-19,455,397.21	24,047,696.74 -523.65%
Net profit /loss after extraordinary gains / losses	2,314,467.96	-49,844,431.08	52,158,899.04 -2,253.60%
2015 Interim Report			
Operating revenue	1,097,649,636.91	1,024,459,949.26	73,189,687.65 -6.67%
Net profit / loss	10,313,286.91	-71,827,174.01	82,140,460.92 -796.45%
Net profit /loss after extraordinary gains / losses	-9,827,977.66	-91,968,438.58	82,140,460.92 -835.78%
2015 Q3 Report			
Operating revenue	1,362,879,020.14	1,341,201,727.34	21,677,292.80 -1.59%
Operating cost	1,076,543,630.68	1,160,057,025.28	83,513,394.60 7.75%
Net profit / loss (3 months)	2,405,037.84	-20,645,188.64	23,050,226.48 -958.41%

Net profit / loss (9 months)	12,718,324.75	-92,472,362.65	105,190,687.40- 827.08%
Net profit /loss after extraordinary gains / losses (3 months)	2,054,831.31	-20,995,395.16	23,050,226.47 -1,121.76%
Net profit /loss after extraordinary gains / losses (9 months)	-7,773,146.34	-112,963,833.74	105,190,687.40 -1,353.26%

(2) Discrepancies for 2016:-

	Original (RMB)	Revised (RMB)	Discrepancy (RMB / %)
2016 Q1 Report			
Operating revenue	425,168,219.17	383,768,219.17	41,400,000.00 -9.74%
Operating cost	379,594,870.10	399,594,870.10	20,000,000.00 5.27%
Net profit / loss	3,112,210.78	-58,287,789.22	61,400,000.00 -1,972.87%
Net profit /loss deducting non-recurring profit / loss	-4,532,487.27	-65,932,487.27	61,400,000.00 -1,354.66%
2016 Interim Report			
Operating revenue	871,031,873.22	771,031,873.22	100,000,000.00 -11.48%
Operating cost	770,746,262.83	828,762,708.04	58,016,445.21 7.53%
Net profit / loss	6,039,585.20	-146,276,860.01	152,316,445.21 -2,521.97%
Net profit /loss after extraordinary gains or losses	-1,965,200.44	-154,281,645.65	152,316,445.21 -7,750.68%
2016 Q3 Report			
Operating revenue	294,685,580.51	334,192,841.82	39,507,261.31 13.41%
Operating cost	255,382,764.85	373,189,171.16	117,806,406.31 46.13%
Net profit / loss (3 months)	2,303,876.43	-72,695,268.57	74,999,145.00 -3,255.34%

Net profit / loss (9 months)	8,343,461.63	-218,972,128.58	227,315,590.21 -2,724.48%
Net profit /loss deducting non-recurring profit / loss (3 months)	1,861,357.34	-73,137,787.66	74,999,145.00 -4,029.27%
Net profit /loss deducting non-recurring profit / loss (9 months)	-103,843.10	-227,419,433.31	227,315,590.21 -218,902.93%

26. The above discrepancies resulted in corresponding inflation or overstatement of the profits in the 6 Results Announcements in 2015 and 2016, which were substantial:

- (1) The range of overstatement of profits was between -523.65% (about 5 times) and -218,902.93% (about 2,189 times).
- (2) The material misstatement of key financial information was not a one-off incident. Even though the substantial misstatements in 2015 were revealed, at the latest, on 29 January 2016 when the 2015 Forecast Revision was issued, substantial misstatements continued to occur on 3 more occasions in 2016.

27. In the circumstances, the 6 Results Announcements were false and misleading.

C. INVESTIGATIONS AGAINST THE COMPANY

28. Various investigations have been carried out against the Company by the China Securities Regulatory Commission (“CSRC”), the SZ Exchange and the Petitioner respectively in relation to the overstatement of the Company’s financial position for the first three quarters of each of 2015 and 2016.

29. *First*, the CSRC carried out investigations against the Company. In summary:

- (1) On 8 February 2017, the Company issued an announcement regarding the receipt by ER Zhang and YS Zhang of investigation notices from the CSRC.
- (2) On 21 March 2017, the Company issued an announcement regarding its receipt of an investigation notice from the CSRC.
- (3) On 15 May 2017, the Company issued an announcement regarding its receipt of the prior notification of administrative penalty from the CSRC. Among others, such notice set out the factual premises in respect of suspected breach of law by the Company, including the following:
 - (a) To window dress the financial data in its quarterly and interim reports, the Company had overstated its net profit since 2015 through

increasing the unit selling prices recorded in lending statements to overstate estimated revenues and understate selling costs; and

(b) Particulars of the overstated revenue and the understated costs in each of the 6 Results Announcements.

(4) On the same day, the Company issued another announcement regarding the receipt by ER Zhang and YS Zhang of the prior notification of administrative penalty from the CSRC regarding ER Zhang's suspected failure to make information disclosure on the reduction in his holdings in the A shares of the Company, and ER Zhang and YS Zhang's suspected insider trading of A shares of the Company.

(5) On 25 September 2017, the Company issued an announcement regarding its receipt of the Judgment of Administrative Penalty from the CSRC (the "**1st CSRC Judgment**") in relation to the overstatement of financial figures in the 6 Results Announcements. Among others, the 1st CSRC Judgment (and the announcement in relation thereto) set out the following:

(a) The factual premises referred to in sub-paragraph (3) above;

(b) The respective positions adopted by the Senior Officers; and

(c) CSRC's conclusions including that (i) regardless of the purpose of the conduct in question in this case, it did not affect the fact that the Company has violated the relevant regulations; and (ii) the truth, accuracy and completeness of the information of listed companies were dependent on the due diligence of all directors, supervisors and senior management who should bear legal responsibility for the information disclosure.

(6) On the same day, the Company issued another announcement regarding the receipt by ER Zhang and YS Zhang of the Judgment of Administrative Penalty from the CSRC (the "**2nd CSRC Judgment**") in relation to ER Zhang's failure of information disclosure, and ER Zhang and YS Zhang's insider trading of A shares of the Company. Among others, the 2nd CSRC Judgment (and the announcement in relation thereto) similarly set out the factual premises relied upon, the respective positions adopted by ER Zhang and YS Zhang, and the CSRC's conclusions.

30. *Second*, the SZ Exchange also carried out investigations against the Company. In gist:

(1) On 15 February 2017, the Company issued an announcement regarding its receipt of an inquiry from the SZ Exchange on 6 February 2017 and its replies to the same. Among other things, the Company admitted that both ER Zhang and YS Zhang had reduced their shareholding in the Company prior to the 2016 Forecast Revision on 3 February 2017.

(2) On 2 June 2017, the Company issued an announcement regarding its response to an inquiry letter from the SZ Exchange concerning its 2016 annual report, including its response as to the reasons behind the material defects in respect of financial reporting.

(3) On 16 January 2018, the Company issued an announcement regarding its receipt of public censure by the SZ Exchange for various violations of the Stock Listing Rules of the SZ Exchange, including material accounting errors in respect of major financial information for the first three quarters of 2015 and 2016 and material deficiency in internal control on the accounting and disclosure of such information.

31. *Third*, in parallel with the foregoing, the Petitioner commenced an investigation against the Company. In gist:

(1) During around June 2017 to June 2018, pursuant to section 183 of the SFO, the Petitioner requested the Company to provide information about the overstatement of financial figures for the first three quarters in 2015 and 2016.

(2) The Company replied and explained the overstatement as follows:

(a) The Company's financial figures for each of the first three quarters in 2015 and 2016 were adjusted by considering the circumstances surrounding the Company's operations. These figures (in particular revenue figures) were essentially temporary estimates based on market conditions and expectations of customers' demand at the relevant time.

(b) The financial figures in question were the result of wrong judgments on the market and expectations of customers' demand at the relevant time.

(c) The wrong judgments were made by YS Zhang (former Executive Director and General Manager) and Yang Jin (former Executive Director and Deputy General Manager), and the financial figures were adjusted by Ding (Finance Manager), JQ Yang (Deputy Finance Manager) and Mr

Liu Hong Tao (former Finance officer).

(3) The SFC also interviewed the Senior Officers of the Company with the assistance of the CSRC.

(4) Without being exhaustive, during the interviews:

(a) Yang Jin admitted that he and YS Zhang had agreed to and arranged the adjustment of financial data so that the relevant periodic reports would show that the Company was making profit as opposed to incurring loss; and

(b) Ding and JQ Yang admitted to adjusting the financial data to show a certain level of profit under the instructions of Yang Jin.

D. ROLE OF THE 2nd AND 4th RESPONDENTS

32. Each of the 2nd and 4th Respondents accepted and agreed that they knowingly overstated revenue and understated operating costs of the Company for the financial years of 2015 and 2016 so as to achieve a substantial inflation and overstatement of the overall profits of the Company (the “**Inflation Scheme**”), by instigating, permitting or participating in the Inflation Scheme, as particularised in Section D2 below.

D1. The 2nd and 4th Respondents’ Duties to the Company

33. Each of the 2nd and 4th Respondents admitted, accepted and agreed that they each owed, *inter alia*, the following duties to the Company in common law and/or in equity:

(1) To act honestly and in good faith and to act in the best interests of the Company, including but not limited to:

(a) Not directing, approving, allowing or acquiescing the Company to make:

(i) statements or announcements to its public shareholders or the public generally which he knows to be (or turns a blind eye to the fact that they are) misleading or false;

(ii) statements or declarations to the Company’s auditors and regulatory authorities including the HK Exchange that he knows to be (or turns a blind eye to the fact that they are) misleading or false.

(b) Not acting for any improper purpose in the exercise of his powers and the discharge of his duties.

(c) A duty to act with care, skill and diligence reasonably expected of a person of their knowledge and experience in the performance of their functions and their management of the Company's affairs;

(d) Collectively and individually, a continuing duty to acquire and maintain a sufficient knowledge and understanding of the Company's business to enable them properly to discharge their duties as directors or senior officers of the Company; and

(e) Where they have delegated some of the managerial or financial responsibilities to their subordinates or other fellow officers, a duty to supervise the discharge of the delegated functions.

(2) To comply with the Company's bye-laws and the relevant laws and regulations concerning the management of the Company.

34. Further, each of the 2nd and 4th Respondents admitted, accepted and agreed that as the Company is listed on the Main Board of the HK Exchange, they as directors of the Company at the material times gave an undertaking to comply with and be bound by the Listing Rules of the HK Exchange, including Rule 3.08, which provides that every director must, in the performance of his duties as a director, *inter alia*:

(1) Act honestly and in good faith in the interests of the company as a whole;

(2) Act for proper purpose;

(3) Avoid actual and potential conflicts of interest and duty; and

(4) Follow up anything untoward that comes to his attention.

35. Furthermore, pursuant to Section 465 of the Companies Ordinance (Cap. 622), each of the 2nd and 4th Respondents admitted, accepted and agreed that they as directors of the Company, also owed a duty to exercise reasonable care, skill and diligence that would be exercised by a person with (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company and (b) the general knowledge, skill and experience that the director has.

D2. The 2 and 4 Respondents instigated, permitted or participated in the Inflation Scheme

36. Each of the 2nd and 4th Respondents admitted, accepted and agreed that they, in breach of their duties to the Company, were the instigators and/or mastermind of the Inflation Scheme, which was carried out in accordance with their instructions, directions and consent, and they had knowledge of the same at all material times, as shown by the following (non-exhaustive) indicators:

- (1) The substantial magnitude of the overstatement of the profits of the Company during the first three quarters of 2015 and 2016;
- (2) The substantial overstatements being the result of an intentional choice to adjust the operating revenue and the operating cost of the Company; and/or
- (3) The recurrence of overstatements in the first three quarters of 2016, notwithstanding the Company's announcement in January 2016 of the substantial revision of the results forecast for 2015.

D2.1. Yang Jin

37. The 4th Respondent admitted, accepted and agreed that he was the instigator and/or mastermind of the Inflation Scheme, or otherwise permitted or participated in the same.

38. *First*, the 4th Respondent admitted, accepted and agreed that he made admissions or statements during the interviews conducted by the CSRC for the SFC (and/or representations by the Company) that he directed the fraudulent overstatement of the profits of the Company. In particular:

- (1) Yang Jin admitted that he was directly responsible for each false record complained of in the 1st CSRC Judgement.
- (2) Yang Jin agreed that the disclosure of false information was illegal. He explained that if the actual losses were disclosed, this would lead to withdrawal of capital by lending banks, and cripple the pioneering projects which the Company invested in (with the resultant risk that the Group may not continue as a listed entity or going concern). He also admitted that the Group's financial condition was unsatisfactory at the material time.
- (3) Furthermore, Yang Jin admitted to requesting Ding and JQ Yang to make false adjustments to financial information to turn around losses into profits, upon

authorisation by YS Zhang.

39. *Second*, the 4th Respondent admitted, accepted and agreed that he occupied an important position in the Company, giving him knowledge of the Company's affairs and rendering him in a position to instigate the misstatements of the key financial information of the Company. Specifically, he was the CFO and Executive Director of the Company, in charge of the finance of the Company including supervision and preparation of financial statements.

40. *Third*, the 4th Respondent admitted, accepted and agreed that he had ample incentive to inflate the performance of the Company as shareholder and/or senior officers receiving substantial remuneration. Specifically, according to the Annual Reports, Yang Jin received RMB344,600 in 2015 and RMB351,600 in 2016.

41. *Fourth*, the 4th Respondent admitted, accepted and agreed that the discrepancies between the profits stated in the 6 Results Announcements and the subsequent amendments were very substantial (ranging between -523.65% and -218,902.93% – see Section B above), and that it is inherently improbable that he could have remained ignorant of the misstatement of financial information of the Company in the first three quarters of 2016.

D2.2. ER Zhang

42. The 2nd Respondent admitted, accepted and agreed that he was the instigator and/or mastermind of the Inflation Scheme, or otherwise permitted or participated in the same.

43. *First*, the 2nd Respondent admitted, accepted and agreed that amongst all the Senior Officers, he stood to benefit the most financially from the Inflation Scheme:

(1) At all material times, ER Zhang was the controlling shareholder of the Company holding at least 33.29% of its shares, prior to the disposal of his 3.76% stake on 13 January 2017;

(2) On the other hand, none of the other Senior Officers of the Company (except his son, YS Zhang) held any material shareholdings in the Company;

(3) The financial position and thus the share price of the Company were invariably influenced and enhanced by the Inflation Scheme, from which ER Zhang undoubtedly stood to benefit by virtue of his substantial shareholding in the Company; and

(4) The above is fortified by the fact that ER Zhang sold 30,000,000 A shares of

the Company on 13 January 2017, shortly before the issuance of the 2016 Forecast Revision on 3 February 2017.

44. *Second*, the 2nd Respondent admitted, accepted and agreed he held important positions in the Company. Apart from being the controlling shareholder, ER Zhang was the Chairman and Executive Director of the Company. The 2nd Respondent admitted, accepted and agreed that he had substantial and overall control over matters concerning the Group's finances and had intimate knowledge of the same. In particular, he had or ought to have knowledge of the Company's revenue, costs and profits, which were the most basic and fundamental measure of the Company's performance.

45. *Third*, the 2nd Respondent admitted, accepted and agreed that the discrepancies between the profits stated in the 6 Results Announcements and the subsequent amendments were very substantial, and it is inherently improbable that he could have remained ignorant of the misstatement of financial information of the Company in the first three quarters of 2016 since the 2015 Forecast Revision was announced on 29 January 2016.

E. LIABILITY

46. By reason of the matters above, the business or affairs of the Company were conducted by the 2nd and 4th Respondents in a manner:

- (1) involving defalcation, misfeasance or other misconduct towards the Company, its members or any part of its members by the fraudulent misrepresentation of the Company's key financial information;
- (2) resulting in its members not having been given all the information with respect to its business or affairs that they might reasonably expect, such as the true position of the Company's revenue, costs and profits (or losses); and/or
- (3) unfairly prejudicial to their members or part of their members, who were induced to buy shares or otherwise maintain their shareholding in the Company in reliance of false accounting information.

PART III – AGREED PROPOSED ORDERS

47. On the basis of the agreed facts set out in Part II above, the Petitioner and each of the 2nd and 4th Respondents agree and submit that it would be appropriate for orders to be made against each of the 2nd and 4th Respondents under sections 214(2)(a) and (d) of the SFO, under which they shall not, for such period as this Court might determine, without leave of

the Court:

(1) be, or continue to be, a director, liquidator, or receiver or manager of the property or business, of any listed or unlisted corporation in Hong Kong including the Company or any of its subsidiaries and affiliates; and

(2) in any way directly or indirectly be concerned, or take part, in the management of any listed or unlisted corporation in Hong Kong including the Company or any of its subsidiaries and affiliates.

48. If, pursuant to this Schedule, this Court disposes of these proceedings summarily, each of the 2nd and 4th Respondents agrees that there should additionally be an order that the 2nd and 4th Respondents do pay the costs of the Petitioner in these proceedings, or such portion thereof as the Court thinks appropriate, to be taxed if not agreed with certificate for counsel.

Dated this day of 2021

Securities and Futures Commission

Petitioner

Signed by

for and on behalf of the Petitioner

Zhang En Rong (張恩榮)

2nd Respondent

Yang Jin (楊晉)

4th Respondent

HCMP 1094/2019

IN THE HIGH COURT OF THE
HONG KONG SPECIAL ADMINISTRATIVE REGION
COURT OF FIRST INSTANCE
MISCELLANEOUS PROCEEDINGS NO. 1094 OF 2019

IN THE MATTER OF SHANDONG
MOLONG PETROLEUM MACHINERY
COMPANY LIMITED

and

IN THE MATTER OF SECTION 214 OF
THE SECURITIES AND FUTURES
ORDINANCE, CAP. 571

BETWEEN

SECURITIES AND FUTURES
COMMISSION

Petitioner

And

SHANDONG MOLONG PETROLEUM
MACHINERY COMPANY LIMITED

1st Respondent

ZHANG EN RONG (張恩榮)

2nd Respondent

ZHANG YUN SAN (張雲三)

3rd Respondent

YANG JIN (楊晉)

4th Respondent

GUO HUAN RAN (國煥然)

5th Respondent

ZHAO HONG FENG (趙洪峰)

6th Respondent

DING ZHI SHUI (丁志水)

7th Respondent

YANG JUN QIU (楊俊秋)

8th Respondent

**SCHEDULE FOR CARECRAFT PROCEDURE
IN RESPECT OF THE 2nd AND 4th RESPONDENTS**

Dated the 3rd day of February 2021

Securities and Futures Commission

The Petitioner

54/F, One Island East,

18 Westlands Road

Quarry Bay, Hong Kong

Tel: 2231 1222

Fax: 2521 7884

Ref: 122/LG/1000/030

HCMP 1094/2019

IN THE HIGH COURT OF THE
HONG KONG SPECIAL ADMINISTRATIVE REGION
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BETWEEN

SECURITIES AND FUTURES
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Petitioner

and

SHANDONG MOLONG PETROLEUM
MACHINERY COMPANY LIMITED

1st Respondent

ZHANG EN RONG (張恩榮)

2nd Respondent

ZHANG YUN SAN (張雲三)

3rd Respondent

YANG JIN (楊晉)

4th Respondent

GUO HUAN RAN (國煥然)

5th Respondent

ZHAO HONG FENG (趙洪峰)

6th Respondent

DING ZHI SHUI (丁志水)

7th Respondent

YANG JUN QIU (楊俊秋)

8th Respondent

**SCHEDULE FOR CARECRAFT PROCEDURE IN RESPECT OF THE
3rd RESPONDENT**

PART I - INTRODUCTION

1. On 26 July 2019, the Securities and Futures Commission (the “**Petitioner**”) presented a petition (the “**Petition**”) pursuant to sections 214(1)(b), (c) and (d) of the Securities and Futures Ordinance (Cap. 571) (the “**SFO**”) seeking:

(1) An order pursuant to section 214(2)(a) or (d) of the SFO that the 3rd Respondent shall not, for such period as the Court might determine, without leave of the Court:

(a) be, or continue to be, a director, liquidator, or receiver or manager of the property or business, of any listed or unlisted company in Hong Kong including Shandong Molong Petroleum Machinery Company Limited (the “**Company**”) or any of its subsidiaries and affiliates; and

(b) in any way directly or indirectly be concerned, or take part, in the management of any listed or unlisted company in Hong Kong including the Company or any of its subsidiaries and affiliates.

(2) An order pursuant to section 214(2)(a) or (e) of the SFO directing the Company to:

(a) reconstitute its Audit Committee with independent members or professionals;

(b) appoint an independent external auditor acceptable to the Petitioner to review and prepare a report on its internal control and financial reporting procedures so as to ensure that the Company complies with all relevant rules and regulations in Hong Kong and minimise the risk of recurrence of the misconduct complained of in the Petition; and

(c) publish and implement the suggested measures as may be advised in the report by such independent external auditor.

A. Purpose

2. Subject to the approval of this Court, the Petitioner and the 3rd Respondent have agreed to dispose of these proceedings against the 3rd Respondent by way of the summary procedure (the “**Summary Procedure**”) sanctioned in the case of *Re Carecraft Construction Co. Ltd.* [1994] 1 WLR 172 and as adopted by this Court in a number of cases in respect of proceedings under section 214 of the SFO.

3. This Schedule is produced in order to provide this Court, for the purpose of disposing of these proceedings against the 3rd Respondent by way of the Summary Procedure, with the core facts that are not disputed in relation to allegations relied upon by the Petitioner.

4. The facts set out in this Schedule are not disputed between the Petitioner and the 3rd Respondent on the basis that the case against him will be dealt with by the Court by way of the Summary Procedure. If the Court for any reason is of the view that these proceedings shall not be dealt with by the Summary Procedure or that a full hearing is appropriate, no admission or concession by either the Petitioner or the 3rd Respondent and none of the proposed orders referred to below or liability to pay costs shall be referred to or relied upon by either party at any subsequent hearing without the prior written consent of the Petitioner and the 3rd Respondent.

5. For the purpose of resolving these proceedings against the 3rd Respondent by way of the Summary Procedure, and by reference to the facts set out in Part II of this Schedule which the 3rd Respondent admits and accepts, the 3rd Respondent accepts that during the relevant period, the business and affairs of the Company have been conducted in a manner described in section 214(1)(b) to (d) SFO, namely:-

- (1) involving defalcation, misfeasance or misconduct towards the Company, its members or any part of its members;
- (2) resulting in its members not having been given all the information with respect to the Company's business or affairs that they might reasonably expect; and/or
- (3) unfairly prejudicial to its members or any part of its members.

B. Unopposed Orders

6. On the basis of the facts set out in Part II of this Schedule, the Petitioner and the 3rd Respondent agree, and the 3rd Respondent is prepared to accept, that it would be appropriate for the orders set out at paragraph 43 below to be made against it.

7. If pursuant to this Schedule, this Court disposes of these proceedings summarily, the 3rd Respondent agrees that there should additionally be an order that he does pay the costs of the Petitioner in these proceedings, or such portion thereof as the Court thinks appropriate, to be taxed if not agreed with certificate for counsel.

8. In the event that this Court makes any order sought against the 3rd Respondent by reference to this Schedule, the Petitioner and the 3rd Respondent agree that this Schedule be annexed to this Court's judgment and will jointly seek a direction to that effect.

9. Furthermore, without prejudice to all of the Petitioner's rights, the Petitioner specifically reserves the right to (a) disclose this Schedule to third parties where it appears proper to do so in the public interest, including, but not limited to, making use of the Schedule for the purpose of any press release issued in respect of these proceedings, and (b) refer to this Schedule for purposes ancillary to, connected with and/or arising out of these proceedings.

PART II - STATEMENT OF AGREED FACTS

A. The Company and its Management

10. The Company is a Sino-foreign joint stock company incorporated in the People's Republic of China ("PRC"), listed on the Hong Kong Stock Exchange ("HK Exchange")

(stock code: 568) and the Shenzhen Stock Exchange (“**SZ Exchange**”) (stock code: 2490). The Company was publicly listed on the Growth Enterprise Market of HK Exchange on 15 April 2004, and changed its listing to the Main Board on 7 February 2007. It has been listed on the SZ Exchange since 21 October 2010.

11. The Company and its subsidiaries (the “**Group**”) are principally engaged in the manufacture and sales of pipe products, pumping equipment and petroleum machinery in the PRC.

12. Mr Zhang En Rong (張恩榮) (“**ER Zhang**”) was at all material times the controlling shareholder of the Company, holding at least 33.29% of its shares, prior to the disposal of his 3.76% stake on 13 January 2017.

13. Mr Zhang Yun San (張雲三) (“**YS Zhang**”) (i.e. the 3rd Respondent herein), the son of ER Zhang, was also at all material times a shareholder of the Company. Before YS Zhang disposed of the 7,500,000 A shares in the Company on 23 November 2016, he held 30,608,000 A shares and 9,060,400 H shares of the Company.

14. At all material times, the senior management of the Company comprised (amongst others):

(1) ER Zhang, Chairman and Executive Director of the Company until he resigned with effect from 25 June 2018. He had substantial and overall control over matters concerning the Group’s finances and had intimate knowledge of the same. In particular, he had knowledge of the Company’s revenue, costs and profits, which were the most basic and fundamental measures of the Company’s performance;

(2) YS Zhang, Deputy Chairman, Executive Director and General Manager of the Company until he resigned with effect from 14 August 2017. He was in charge of the business and management of the Company;

(3) Mr Yang Jin (楊晉) (“**Yang Jin**”), Chief Financial Officer (“**CFO**”), Executive Director and Deputy General Manager of the Company until he resigned with effect from 25 June 2018. He was in charge of the finance of the Company including supervision and preparation of financial statements;

(4) Mr Guo Huan Ran (國煥然) (“**Guo**”), Executive Director of the Company (and the acting Chairman of the Company since 25 June 2018) until he retired from office with effect from 21 December 2018;

(5) Mr Zhao Hong Feng (趙洪峰) (“**Zhao**”), Secretary of the board of directors of the Company (the “**Board**”) until his cessation to hold such position with effect

from 8 February 2018 and Deputy General Manager of the Company until his cessation to hold such position with effect from 21 December 2018;

(6) Mr Ding Zhi Shui (丁志水) (“**Ding**”), Finance Manager of the Company; and

(7) Ms Yang Jun Qiu (楊俊秋) (“**JQ Yang**”), Deputy Finance Manager of the Company

(collectively the “**Senior Officers**”).

15. At all material times, the Audit Committee of the Company comprised of:

(1) Mr Qin Xue Chang, Chairman of the audit committee and independent director;

(2) Ms Wang Chun Hua, an independent non-executive director until 27 June 2016;

(3) Mr John Paul Cameron, an independent non-executive director until 27 June 2016;

(4) Mr Ji Yan Song, an independent non-executive director since 29 June 2016; and

(5) Ms Quan Yu Hua, an independent non-executive director since 29 June 2016.

16. At all material times, ShineWing Certified Public Accountants Limited was the external auditor of the Group.

B. Material Overstatement of Profits

B1. Representation of the Company’s finances in 2015 and 2016

17. In 2015 and 2016, the Company published the following quarterly and half-yearly results announcements for the first three quarters of 2015 and 2016 (collectively, the “**6 Results Announcements**”):

(1) Announcement dated 24 April 2015 for the 1st quarter of 2015 (“**2015 Q1 Report**”) with expected net profit for the 6 months ended 30 June 2015 at RMB 9.23 million to RMB 12 million;

(2) Announcement dated 28 August 2015 for the 6 months ended 30 June 2015 (“**2015 Interim Report**”) with total profit at RMB 6.51 million and net loss at 0.99 million;

(3) Announcement dated 30 October 2015 for the 3rd quarter of 2015 (“**2015 Q3 Report**”) with expected net profit for the year of 2015 at RMB 4.05 million to RMB 14.16 million;

(4) Announcement dated 28 April 2016 for the 1st quarter of 2016 (“**2016 Q1 Report**”) with expected net profit for the 6 months ended 30 June 2016 at RMB 5.16 million to RMB 7.22 million;

(5) Announcement dated 19 August 2016 for the 6 months ended 30 June 2016 (“**2016 Interim Report**”) with total loss at RMB 2.92 million and net loss at 10.49 million; and

(6) Announcement dated 26 October 2016 for the 3rd quarter of 2016 (“**2016 Q3 Report**”) with expected net profit for the year of 2016 at RMB 6 million to RMB 12 million.

18. Each of the 6 Results Announcements contained the usual major accounting data such as operating revenue and expenses, and net profit etc., all of which were stated to be unaudited by the Company’s auditors.

19. Each of the 6 Results Announcements was discussed and approved by the Board, as evidenced by the relevant board minutes.

B2. Revision of the Company’s profit forecast and results in 2016 and 2017

20. In early 2016 and early 2017, the Company published the following announcements to revise the profit forecast and results:

(1) By announcement dated 29 January 2016 (“**2015 Forecast Revision**”), the Company revised the forecast for 2015 from profit of RMB 4.05 million to RMB 14.16 million to loss of RMB 190 million to RMB 270 million;

(2) By annual results announcement dated 30 March 2016 (“**2015 Annual Results**”), the Company disclosed that the loss attributable to equity holders of the Company amounted to RMB 259.57 million in 2015 (as compared with a profit of RMB 20.23 million in 2014);

(3) By two announcements dated 3 February 2017 (“**2016 Forecast Revision**”), the Company revised the forecast for 2016 from profit of RMB 6 million to RMB 12 million to loss of RMB 480 million to RMB 630 million; and

(4) By annual results announcement dated 30 March 2017 (“**2016 Annual**

Results”), the Company disclosed that the net loss attributable to the owners of the Company amounted to RMB 612.48 million in 2016 (as compared with the net loss of RMB 259.57 million in 2015).

21. The Company also stated in clarification announcements that the 6 Results Announcements contained inaccurate items in revenue recognition, revenue measurement and operating cost structure, and changes were required to correct the information therein, including:

(1) Clarification announcements dated 30 March 2017 and 29 September 2017 to correct the 2016 Q1 Report, the 2016 Interim Report and the 2016 Q3 Report (“**2016 Results Clarifications**”); and

(2) Clarification announcement dated 29 September 2017 to amend the 2015 Q1 Report, the 2015 Interim Report and the 2015 Q3 Report (“**2015 Results Clarification**”).

22. On 10 April 2017, the Company issued another clarification announcement which contained the following extract of the independent auditor’s report on the Group’s annual financial statements for the year ended 31 December 2016:

“For the first three quarters in 2016, the Company did not implement effective internal control policy and procedure on part of *operating revenue recognition and measurement*, as well as the *operating cost settlement*. The aforesaid material defect has resulted in misstatement of operating revenue and operating cost in the financial statements.” [emphasis added]

B3. Material Overstatement of Profits

23. Notwithstanding the relatively healthy financial position as purportedly portrayed, it transpired in the 2015 Results Clarification and the 2016 Results Clarifications that the 6 Results Announcements for 2015 and 2016 were in fact materially false, due *inter alia* to the fact that the revenue and profits of the Company had been substantially inflated or overstated, whilst the operating costs of the Company had been substantially understated.

24. Fictitious or false entries on the operating revenues and/or operating costs of the Company had been created with the effect that the business operations of the Company appeared more successful than they were in fact, which in turn resulted in the inflation or overstatement of the profits of the Company.

25. The discrepancies between the false financial positions of the Company and/or the

Group portrayed in the 6 Results Announcements and the actual financial position of the same are reflected in the changes and amendments made to the figures via the 2015 and 2016 Results Clarifications. Without being exhaustive, the key discrepancies include the following:

(1) Discrepancies for 2015:-

	Original (RMB)	Revised (RMB)	Discrepancy
2015 Q1 Report			
Operating revenue	567,637,950.76	543,523,096.84	24,114,853.92 -4.25%
Net profit / loss	4,592,299.53	-19,455,397.21	24,047,696.74 -523.65%
Net profit /loss after extraordinary gains / losses	2,314,467.96	-49,844,431.08	52,158,899.04 -2,253.60%
2015 Interim Report			
Operating revenue	1,097,649,636.91	1,024,459,949.26	73,189,687.65 -6.67%
Net profit / loss	10,313,286.91	-71,827,174.01	82,140,460.92 -796.45%
Net profit /loss after extraordinary gains / losses	-9,827,977.66	-91,968,438.58	82,140,460.92 -835.78%
2015 Q3 Report			
Operating revenue	1,362,879,020.14	1,341,201,727.34	21,677,292.80 -1.59%
Operating cost	1,076,543,630.68	1,160,057,025.28	83,513,394.60 7.75%
Net profit / loss (3 months)	2,405,037.84	-20,645,188.64	23,050,226.48 -958.41%
Net profit / loss (9 months)	12,718,324.75	-92,472,362.65	105,190,687.40 -827.08%
Net profit /loss after extraordinary gains / losses (3 months)	2,054,831.31	-20,995,395.16	23,050,226.47 -1,121.76%
Net profit /loss after extraordinary gains / losses (9 months)	-7,773,146.34	-112,963,833.74	105,190,687.40 -1,353.26%

(2) Discrepancies for 2016:-

	Original (RMB)	Revised (RMB)	Discrepancy (RMB / %)
2016 Q1 Report			
Operating revenue	425,168,219.17	383,768,219.17	41,400,000.00 -9.74%
Operating cost	379,594,870.10	399,594,870.10	20,000,000.00 5.27%
Net profit / loss	3,112,210.78	-58,287,789.22	61,400,000.00 -1,972.87%
Net profit /loss deducting non-recurring profit / loss	-4,532,487.27	-65,932,487.27	61,400,000.00 -1,354.66%
2016 Interim Report			
Operating revenue	871,031,873.22	771,031,873.22	100,000,000.00 -11.48%
Operating cost	770,746,262.83	828,762,708.04	58,016,445.21 7.53%
Net profit / loss	6,039,585.20	-146,276,860.01	152,316,445.21 -2,521.97%
Net profit /loss after extraordinary gains or losses	-1,965,200.44	-154,281,645.65	152,316,445.21 -7,750.68%
2016 Q3 Report			
Operating revenue	294,685,580.51	334,192,841.82	39,507,261.31 13.41%
Operating cost	255,382,764.85	373,189,171.16	117,806,406.31 46.13%
Net profit / loss (3 months)	2,303,876.43	-72,695,268.57	74,999,145.00 -3,255.34%
Net profit / loss (9 months)	8,343,461.63	-218,972,128.58	227,315,590.21 -2,724.48%
Net profit /loss deducting non-recurring profit / loss (3 months)	1,861,357.34	-73,137,787.66	74,999,145.00 -4,029.27%
Net profit /loss deducting non-recurring profit / loss (9 months)	-103,843.10	-227,419,433.31	227,315,590.21 -218,902.93%

26. The above discrepancies resulted in corresponding inflation or overstatement of the profits in the 6 Results Announcements in 2015 and 2016, which were substantial:

(1) The range of overstatement of profits was between -523.65% (about 5 times) and -218,902.93% (about 2,189 times).

(2) The material misstatement of key financial information was not a one-off incident. Even though the substantial misstatements in 2015 were revealed, at the latest, on 29 January 2016 when the 2015 Forecast Revision was issued, substantial misstatements continued to occur on 3 more occasions in 2016.

27. In the circumstances, the 6 Results Announcements were false and misleading.

C. INVESTIGATIONS AGAINST THE COMPANY

28. Various investigations have been carried out against the Company by the China Securities Regulatory Commission (“CSRC”), the SZ Exchange and the Petitioner respectively in relation to the overstatement of the Company’s financial position for the first three quarters of each of 2015 and 2016.

29. *First*, the CSRC carried out investigations against the Company. In summary:

(1) On 8 February 2017, the Company issued an announcement regarding the receipt by ER Zhang and YS Zhang of investigation notices from the CSRC.

(2) On 21 March 2017, the Company issued an announcement regarding its receipt of an investigation notice from the CSRC.

(3) On 15 May 2017, the Company issued an announcement regarding its receipt of the prior notification of administrative penalty from the CSRC. Among others, such notice set out the factual premises in respect of suspected breach of law by the Company, including the following:

(a) To window dress the financial data in its quarterly and interim reports, the Company had overstated its net profit since 2015 through increasing the unit selling prices recorded in lending statements to overstate estimated revenues and understate selling costs; and

(b) Particulars of the overstated revenue and the understated costs in each of the 6 Results Announcements.

(4) On the same day, the Company issued another announcement regarding the receipt by ER Zhang and YS Zhang of the prior notification of administrative penalty from the CSRC regarding ER Zhang’s suspected failure to make information disclosure on the reduction in his holdings in the A shares of the

Company, and ER Zhang and YS Zhang's suspected insider trading of A shares of the Company.

(5) On 25 September 2017, the Company issued an announcement regarding its receipt of the Judgment of Administrative Penalty from the CSRC (the "**1st CSRC Judgment**") in relation to the overstatement of financial figures in the 6 Results Announcements. Among others, the 1st CSRC Judgment (and the announcement in relation thereto) set out the following:

- (a) The factual premises referred to in sub-paragraph (3) above;
- (b) The respective positions adopted by the Senior Officers; and
- (c) CSRC's conclusions including that (i) regardless of the purpose of the conduct in question in this case, it did not affect the fact that the Company has violated the relevant regulations; and (ii) the truth, accuracy and completeness of the information of listed companies were dependent on the due diligence of all directors, supervisors and senior management who should bear legal responsibility for the information disclosure.

(6) On the same day, the Company issued another announcement regarding the receipt by ER Zhang and YS Zhang of the Judgment of Administrative Penalty from the CSRC (the "**2nd CSRC Judgment**") in relation to ER Zhang's failure of information disclosure, and ER Zhang and YS Zhang's insider trading of A shares of the Company. Among others, the 2nd CSRC Judgment (and the announcement in relation thereto) similarly set out the factual premises relied upon, the respective positions adopted by ER Zhang and YS Zhang, and the CSRC's conclusions.

30. *Second*, the SZ Exchange also carried out investigations against the Company. In gist:

(1) On 15 February 2017, the Company issued an announcement regarding its receipt of an inquiry from the SZ Exchange on 6 February 2017 and its replies to the same. Among other things, the Company admitted that both ER Zhang and YS Zhang had reduced their shareholding in the Company prior to the 2016 Forecast Revision on 3 February 2017.

(2) On 2 June 2017, the Company issued an announcement regarding its response to an inquiry letter from the SZ Exchange concerning its 2016 annual report, including its response as to the reasons behind the material defects in respect of

financial reporting.

(3) On 16 January 2018, the Company issued an announcement regarding its receipt of public censure by the SZ Exchange for various violations of the Stock Listing Rules of the SZ Exchange, including material accounting errors in respect of major financial information for the first three quarters of 2015 and 2016 and material deficiency in internal control on the accounting and disclosure of such information.

31. *Third*, in parallel with the foregoing, the Petitioner commenced an investigation against the Company. In gist:

(1) During around June 2017 to June 2018, pursuant to section 183 of the SFO, the Petitioner requested the Company to provide information about the overstatement of financial figures for the first three quarters in 2015 and 2016.

(2) The Company replied and explained the overstatement as follows:

(a) The Company's financial figures for each of the first three quarters in 2015 and 2016 were adjusted by considering the circumstances surrounding the Company's operations. These figures (in particular revenue figures) were essentially temporary estimates based on market conditions and expectations of customers' demand at the relevant time.

(b) The financial figures in question were the result of wrong judgments on the market and expectations of customers' demand at the relevant time.

(c) The wrong judgments were made by YS Zhang (former Executive Director and General Manager) and Yang Jin (former Executive Director and Deputy General Manager), and the financial figures were adjusted by Ding (Finance Manager), JQ Yang (Deputy Finance Manager) and Mr Liu Hong Tao (former Finance officer).

(d) Before the annual year-end audit the Company has itself audited and revised its financial data according to the actual development of its business, which ensured the accuracy and authenticity of its annual financial figures.

(3) The SFC also interviewed the Senior Officers of the Company with the assistance of the CSRC.

(4) Without being exhaustive, during the interviews:

(a) Yang Jin admitted that he and YS Zhang had agreed to and arranged the adjustment of financial data so that the relevant periodic reports would show that the Company was making profit as opposed to incurring loss; and

(b) Ding and JQ Yang admitted to adjusting the financial data to show a certain level of profit under the instructions of Yang Jin.

D. ROLE OF THE SENIOR OFFICERS (INCLUDING THE 3RD RESPONDENT)

32. The 3rd Respondent accepted and agreed that the Senior Officers of the Company, including the 3rd Respondent, knowingly overstated revenue and understated operating costs of the Company for the financial years of 2015 and 2016 so as to achieve a substantial inflation and overstatement of the overall profits of the Company (the “**Inflation Scheme**”), by instigating, permitting or participating in the Inflation Scheme, as particularised in Section D2 below.

D1. The Senior Officers’ (including the 3rd Respondent’s) Duties to the Company

33. The 3rd Respondent admitted, accepted and agreed that the Senior Officers of the Company, including himself, each owed, *inter alia*, the following duties to the Company in common law and/or in equity:

(1) To act honestly and in good faith and to act in the best interests of the Company, including but not limited to:

(a) Not directing, approving, allowing or acquiescing the Company to make:

(i) statements or announcements to its public shareholders or the public generally which he knows to be (or turns a blind eye to the fact that they are) misleading or false;

(ii) statements or declarations to the Company’s auditors and regulatory authorities including the HK Exchange that he knows to be (or turns a blind eye to the fact that they are) misleading or false;

(b) Not acting for any improper purpose in the exercise of his powers

and the discharge of his duties;

(c) A duty to act with care, skill and diligence reasonably expected of a person of their knowledge and experience in the performance of their functions and their management of the Company's affairs;

(d) Collectively and individually, a continuing duty to acquire and maintain a sufficient knowledge and understanding of the Company's business to enable them properly to discharge their duties as directors or senior officers of the Company; and

(e) Where they have delegated some of the managerial or financial responsibilities to their subordinates or other fellow officers, a duty to supervise the discharge of the delegated functions.

(2) To comply with the Company's bye-laws and the relevant laws and regulations concerning the management of the Company.

34. Further, the 3rd Respondent admitted, accepted and agreed that as the Company is listed on the Main Board of the HK Exchange, the 3rd Respondent as a director of the Company at the material times gave an undertaking to comply with and be bound by the Listing Rules of the HK Exchange, including Rule 3.08, which provides that every director must, in the performance of his duties as a director, *inter alia*:

(1) Act honestly and in good faith in the interests of the company as a whole;

(2) Act for proper purpose;

(3) Avoid actual and potential conflicts of interest and duty; and

(4) Follow up anything untoward that comes to his attention.

35. Furthermore, pursuant to Section 465 of the Companies Ordinance (Cap. 622), the 3rd Respondent admitted, accepted and agreed that as a director of the Company, he also owed a duty to exercise reasonable care, skill and diligence that would be exercised by a person with (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company and (b) the general knowledge, skill and experience that the director has.

D2. The Senior Officers (including the 3rd Respondent) instigated, permitted or participated in the Inflation Scheme

36. The 3rd Respondent admitted, accepted and agreed that the Senior Officers (including himself), in breach of their duties to the Company, were the instigators and/or mastermind of the Inflation Scheme, which was carried out in accordance with the Senior Officers' instructions, directions and consent, and they had knowledge of the same at all material times, as shown by the following (non-exhaustive) indicators:

- (1) The substantial magnitude of the overstatement of the profits of the Company during the first three quarters of 2015 and 2016;
- (2) The substantial overstatements being the result of an intentional choice to adjust the operating revenue and the operating cost of the Company; and/or
- (3) The recurrence of overstatements in the first three quarters of 2016, notwithstanding the Company's announcement in January 2016 of the substantial revision of the results forecast for 2015.

D2.1. YS Zhang (the 3rd Respondent)

37. The 3rd Respondent admitted, accepted and agreed that he was the instigator and/or mastermind of the Inflation Scheme, or otherwise permitted or participated in the same.

38. *First*, the 3rd Respondent admitted, accepted and agreed that he made admissions or statements during the interviews conducted by the CSRC for the SFC (and/or representations by the Company) that he directed the fraudulent overstatement of the profits of the Company. In particular:

- (1) he admitted that he was directly responsible for each false record complained of in the 1st CSRC Judgement.
- (2) he agreed that the disclosure of false information was illegal. He explained that if the actual losses were disclosed, this would cripple the projects which the Company invested in (with the resultant risk that the Group may not continue as a listed entity or going concern). He also admitted that the Group's financial condition was unsatisfactory at the material time.

39. *Second*, the 3rd Respondent admitted, accepted and agreed that he occupied an important position in the Company, giving him knowledge of the Company's affairs and rendering him in a position to instigate the misstatements of the key financial information of the Company. Specifically, he was the Vice Chairman, Executive Director and General Manager of the Company, in charge of the business and management of the Company.

40. *Third*, the 3rd Respondent admitted, accepted and agreed that he had ample incentive to inflate the performance of the Company as a shareholder and senior officer receiving substantial remuneration. Specifically:

(1) The 3rd Respondent was at all material times a shareholder of the Company. Before the 3rd Respondent disposed of the 7,500,000 A shares, he held 30,608,000 A shares and 9,060,400 H shares of the Company. The 3rd Respondent therefore stood to benefit directly from the overstatement of profits of the Company as it would affect the share price of the Company. This is reinforced by his sale of 7,500,000 A shares in the Company on 23 November 2016, before the issuance of the 2016 Forecast Revision on 3 February 2017; and

(2) According to the Annual Reports, the total remuneration received by the 3rd Respondent was RMB607,700 in 2015 and RMB603,300 in 2016.

41. *Fourth*, the 3rd Respondent admitted, accepted and agreed that the discrepancies between the profits stated in the 6 Results Announcements and the subsequent amendments were very substantial (ranging between -523.65% and -218,902.93% – see Section B above), and that it is inherently improbable that he could have remained ignorant of the misstatement of financial information of the Company in the first three quarters of 2016.

E. LIABILITY

42. By reason of the matters above, the business or affairs of the Company were conducted by the 3rd Respondent in a manner:

(1) involving defalcation, misfeasance or other misconduct towards the Company, its members or any part of its members by the fraudulent misrepresentation of the Company's key financial information;

(2) resulting in its members not having been given all the information with respect to its business or affairs that they might reasonably expect, such as the true position of the Company's revenue, costs and profits (or losses); and/or

(3) unfairly prejudicial to their members or part of their members, who were induced to buy shares or otherwise maintain their shareholding in the Company in reliance of false accounting information.

PART III – AGREED PROPOSED ORDERS

43. On the basis of the agreed facts set out in Part II above, the Petitioner and the 3rd

Respondent agree and submit that it would be appropriate for orders to be made against him under sections 214(2)(a) and (d) of the SFO, under which he shall not, for such period as this Court might determine, without leave of the Court:

- (1) be, or continue to be, a director, liquidator, or receiver or manager of the property or business, of any listed or unlisted corporation in Hong Kong including the Company or any of its subsidiaries and affiliates; and
- (2) in any way directly or indirectly be concerned, or take part, in the management of any listed or unlisted corporation in Hong Kong including the Company or any of its subsidiaries and affiliates.

44. If, pursuant to this Schedule, this Court disposes of these proceedings summarily, the 3rd Respondent agrees that there should additionally be an order that the 3rd Respondent do pay the costs of the Petitioner in these proceedings, or such portion thereof as the Court thinks appropriate, to be taxed if not agreed with certificate for counsel.

Dated this day of 202

Securities and Futures Commission

Petitioner

Signed by

for and on behalf of the Petitioner

Zhang Yun San (張雲三)

3rd Respondent

HCMP 1094/2019

IN THE HIGH COURT OF THE
HONG KONG SPECIAL ADMINISTRATIVE REGION
COURT OF FIRST INSTANCE
MISCELLANEOUS PROCEEDINGS NO. 1094 OF 2019

IN THE MATTER OF SHANDONG
MOLONG PETROLEUM MACHINERY
COMPANY LIMITED

and

IN THE MATTER OF SECTION 214 OF
THE SECURITIES AND FUTURES
ORDINANCE, CAP. 571

BETWEEN

SECURITIES AND FUTURES
COMMISSION

Petitioner

And

SHANDONG MOLONG PETROLEUM
MACHINERY COMPANY LIMITED

1st Respondent

ZHANG EN RONG (張恩榮)

2nd Respondent

ZHANG YUN SAN (張雲三)

3rd Respondent

YANG JIN (楊晉)

4th Respondent

GUO HUAN RAN (國煥然)

5th Respondent

ZHAO HONG FENG (趙洪峰)

6th Respondent

DING ZHI SHUI (丁志水)

7th Respondent

YANG JUN QIU (楊俊秋)

8th Respondent

**SCHEDULE FOR CARECRAFT PROCEDURE
IN RESPECT OF THE 3RD RESPONDENT**

Dated the 3rd day of February 2021

Securities and Futures Commission

The Petitioner

54/F, One Island East,
18 Westlands Road
Quarry Bay, Hong Kong
Tel: 2231 1222
Fax: 2521 7884
Ref: 122/LG/1000/0304

HCMP 1094/2019

IN THE HIGH COURT OF THE
HONG KONG SPECIAL ADMINISTRATIVE REGION
COURT OF FIRST INSTANCE
MISCELLANEOUS PROCEEDINGS NO. 1094 OF 2019

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IN THE MATTER OF SECTION 214 OF
THE SECURITIES AND FUTURES
ORDINANCE, CAP. 571

BETWEEN

SECURITIES AND FUTURES
COMMISSION

Petitioner

and

SHANDONG MOLONG PETROLEUM
MACHINERY COMPANY LIMITED

1st Respondent

ZHANG EN RONG (張恩榮)

2nd Respondent

ZHANG YUN SAN (張雲三)	3 rd Respondent
YANG JIN (楊晉)	4 th Respondent
GUO HUAN RAN (國煥然)	5 th Respondent
ZHAO HONG FENG (趙洪峰)	6 th Respondent
DING ZHI SHUI (丁志水)	7 th Respondent
YANG JUN QIU (楊俊秋)	8 th Respondent

**SCHEDULE FOR *CARECRAFT* PROCEDURE IN RESPECT OF THE
5th TO 8TH RESPONDENTS**

PART I - INTRODUCTION

1. On 26 July 2019, the Securities and Futures Commission (the “**Petitioner**”) presented a petition (the “**Petition**”) pursuant to sections 214(1)(b), (c) and (d) of the Securities and Futures Ordinance (Cap. 571) (the “**SFO**”) seeking:

(1) An order pursuant to section 214(2)(a) or (d) of the SFO that the 2nd to 8th Respondents shall not, for such period as the Court might determine, without leave of the Court:

(a) be, or continue to be, a director, liquidator, or receiver or manager of the property or business, of any listed or unlisted company in Hong Kong including Shandong Molong Petroleum Machinery Company Limited (the “**Company**”) or any of its subsidiaries and affiliates; and

(b) in any way directly or indirectly be concerned, or take part, in the management of any listed or unlisted company in Hong Kong including the Company or any of its subsidiaries and affiliates.

(2) An order pursuant to section 214(2)(a) or (e) of the SFO directing the Company to:

(a) reconstitute its Audit Committee with independent members or professionals;

(b) appoint an independent external auditor acceptable to the Petitioner to review and prepare a report on its internal control and financial reporting procedures so as to ensure that the Company complies with all relevant rules and regulations in Hong Kong and minimise the risk of recurrence of the misconduct complained of in the Petition; and

(c) publish and implement the suggested measures as may be advised in the report by such independent external auditor.

A. Purpose

2. Subject to the approval of this Court, the Petitioner and the 5th to 8th Respondents have agreed to dispose of these proceedings against each of the 5th to 8th Respondents by way of the summary procedure (the “**Summary Procedure**”) sanctioned in the case of *Re Carecraft Construction Co. Ltd.* [1994] 1 WLR 172 and as adopted by this Court in a number of cases in respect of proceedings under section 214 of the SFO.

3. This Schedule is produced in order to provide this Court, for the purpose of disposing of these proceedings against the 5th to 8th Respondents by way of the Summary Procedure, with the core facts that are not disputed in relation to allegations relied upon by the Petitioner.

4. The facts set out in this Schedule are not disputed between the Petitioner and each of the 5th to 8th Respondents on the basis that the case against these Respondents will be dealt with by the Court by way of the Summary Procedure. If the Court for any reason is of the view that these proceedings shall not be dealt with by the Summary Procedure or that a full hearing is appropriate, no admission or concession by either the Petitioner or any of the 5th to 8th Respondents and none of the proposed orders referred to below or liability to pay costs shall be referred to or relied upon by any of the parties at any subsequent hearing without the prior written consent of the Petitioner and each of the 5th to 8th Respondents.

5. For the purpose of resolving these proceedings against each of the 5th to 8th Respondents by way of the Summary Procedure, and by reference to the facts set out in Part II of this Schedule which each of the 5th to 8th Respondents admit and accept, each of the 5th to 8th Respondents accept that during the relevant period, the business and affairs of the Company have been conducted in a manner described in section 214(1)(b) to (d) SFO, namely:-

- (1) involving defalcation, misfeasance or misconduct towards the Company, its members or any part of its members;
- (2) resulting in its members not having been given all the information with respect to the Company's business or affairs that they might reasonably expect; and/or
- (3) unfairly prejudicial to its members or any part of its members.

B. Unopposed Orders

6. On the basis of the facts set out in Part II of this Schedule, the Petitioner and each of the 5th to 8th Respondents agree, and the 5th to 8th Respondents are prepared to accept, that it would be appropriate for the orders set out at paragraph 46 below to be made against it.

7. If pursuant to this Schedule, this Court disposes of these proceedings summarily, each of the 5th to 8th Respondents agrees that there should additionally be an order that they do pay the costs of the Petitioner in these proceedings, or such portion thereof as the Court thinks appropriate, to be taxed if not agreed with certificate for counsel.

8. In the event that this Court makes any order sought against the 5th to 8th Respondents by reference to this Schedule, the Petitioner and each of the 5th to 8th Respondents agree that this Schedule be annexed to this Court's judgment and will jointly seek a direction to that effect.

9. Furthermore, without prejudice to all of the Petitioner's rights, the Petitioner specifically reserves the right to (a) disclose this Schedule to third parties where it appears proper to do so in the public interest, including, but not limited to, making use of the Schedule for the purpose of any press release issued in respect of these proceedings, and (b) refer to this Schedule for purposes ancillary to, connected with and/or arising out of these proceedings.

PART II - STATEMENT OF AGREED FACTS

A. The Company and its Management

10. The Company is a Sino-foreign joint stock company incorporated in the People's Republic of China ("**PRC**"), listed on the Hong Kong Stock Exchange ("**HK Exchange**") (stock code: 568) and the Shenzhen Stock Exchange ("**SZ Exchange**") (stock code: 2490). The Company was publicly listed on the Growth Enterprise Market of HK Exchange on 15 April 2004, and changed its listing to the Main Board on 7 February 2007. It has been listed on the SZ Exchange since 21 October 2010.

11. The Company and its subsidiaries (the "**Group**") are principally engaged in the

manufacture and sales of pipe products, pumping equipment and petroleum machinery in the PRC.

12. Mr Zhang En Rong (張恩榮) (“**ER Zhang**”) was at all material times the controlling shareholder of the Company, holding at least 33.29% of its shares, prior to the disposal of his 3.76% stake on 13 January 2017.

13. Mr Zhang Yun San (張雲三) (“**YS Zhang**”), the son of ER Zhang, was also at all material times a shareholder of the Company. Before YS Zhang disposed of the 7,500,000 A shares in the Company on 23 November 2016, he held 30,608,000 A shares and 9,060,400 H shares of the Company.

14. At all material times, the senior management of the Company comprised (amongst others):

(1) ER Zhang, Chairman and Executive Director of the Company until he resigned with effect from 25 June 2018. He had substantial and overall control over matters concerning the Group’s finances and had intimate knowledge of the same. In particular, he had knowledge of the Company’s revenue, costs and profits, which were the most basic and fundamental measures of the Company’s performance;

(2) YS Zhang, Deputy Chairman, Executive Director and General Manager of the Company until he resigned with effect from 14 August 2017. He was in charge of the business and management of the Company;

(3) Mr Yang Jin (楊晉) (“**Yang Jin**”), Chief Financial Officer (“**CFO**”), Executive Director and Deputy General Manager of the Company until he resigned with effect from 25 June 2018. He was in charge of the finance of the Company including supervision and preparation of financial statements;

(4) Mr Guo Huan Ran (國煥然) (“**Guo**”), Executive Director of the Company (and the acting Chairman of the Company since 25 June 2018) until he retired from office with effect from 21 December 2018;

(5) Mr Zhao Hong Feng (趙洪峰) (“**Zhao**”), Secretary of the board of directors of the Company (the “**Board**”) until his cessation to hold such position with effect from 8 February 2018 and Deputy General Manager of the Company until his cessation to hold such position with effect from 21 December 2018;

(6) Mr Ding Zhi Shui (丁志水) (“**Ding**”), Finance Manager of the Company; and

(7) Ms Yang Jun Qiu (楊俊秋) (“**JQ Yang**”), Deputy Finance Manager of the Company

(collectively the “**Senior Officers**”).

15. At all material times, the Audit Committee of the Company comprised of:

(1) Mr Qin Xue Chang, Chairman of the audit committee and independent director;

(2) Ms Wang Chun Hua, an independent non-executive director until 27 June 2016;

(3) Mr John Paul Cameron, an independent non-executive director until 27 June 2016;

(4) Mr Ji Yan Song, an independent non-executive director since 29 June 2016;
and

(5) Ms Quan Yu Hua, an independent non-executive director since 29 June 2016.

16. At all material times, ShineWing Certified Public Accountants Limited was the external auditor of the Group.

B. Material Overstatement of Profits

B1. Representation of the Company’s finances in 2015 and 2016

17. In 2015 and 2016, the Company published the following quarterly and half-yearly results announcements for the first three quarters of 2015 and 2016 (collectively, the “**6 Results Announcements**”):

(1) Announcement dated 24 April 2015 for the 1st quarter of 2015 (“**2015 Q1 Report**”) with expected net profit for the 6 months ended 30 June 2015 at RMB 9.23 million to RMB 12 million;

(2) Announcement dated 28 August 2015 for the 6 months ended 30 June 2015 (“**2015 Interim Report**”) with total profit at RMB 6.51 million and net loss at 0.99 million;

(3) Announcement dated 30 October 2015 for the 3rd quarter of 2015 (“**2015 Q3 Report**”) with expected net profit for the year of 2015 at RMB 4.05 million to RMB 14.16 million;

(4) Announcement dated 28 April 2016 for the 1st quarter of 2016 (“**2016 Q1 Report**”) with expected net profit for the 6 months ended 30 June 2016 at RMB

5.16 million to RMB 7.22 million;

(5) Announcement dated 19 August 2016 for the 6 months ended 30 June 2016 (“**2016 Interim Report**”) with total loss at RMB 2.92 million and net loss at 10.49 million; and

(6) Announcement dated 26 October 2016 for the 3rd quarter of 2016 (“**2016 Q3 Report**”) with expected net profit for the year of 2016 at RMB 6 million to RMB 12 million.

18. Each of the 6 Results Announcements contained the usual major accounting data such as operating revenue and expenses, and net profit etc., all of which were stated to be unaudited by the Company’s auditors.

19. Each of the 6 Results Announcements was discussed and approved by the Board, as evidenced by the relevant board minutes.

B2. Revision of the Company’s profit forecast and results in 2016 and 2017

20. In early 2016 and early 2017, the Company published the following announcements to revise the profit forecast and results:

(1) By announcement dated 29 January 2016 (“**2015 Forecast Revision**”), the Company revised the forecast for 2015 from profit of RMB 4.05 million to RMB 14.16 million to loss of RMB 190 million to RMB 270 million;

(2) By annual results announcement dated 30 March 2016 (“**2015 Annual Results**”), the Company disclosed that the loss attributable to equity holders of the Company amounted to RMB 259.57 million in 2015 (as compared with a profit of RMB 20.23 million in 2014);

(3) By two announcements dated 3 February 2017 (“**2016 Forecast Revision**”), the Company revised the forecast for 2016 from profit of RMB 6 million to RMB 12 million to loss of RMB 480 million to RMB 630 million; and

(4) By annual results announcement dated 30 March 2017 (“**2016 Annual Results**”), the Company disclosed that the net loss attributable to the owners of the Company amounted to RMB 612.48 million in 2016 (as compared with the net loss of RMB 259.57 million in 2015).

21. The Company also stated in clarification announcements that the 6 Results Announcements contained inaccurate items in revenue recognition, revenue measurement

and operating cost structure, and changes were required to correct the information therein, including:

- (1) Clarification announcements dated 30 March 2017 and 29 September 2017 to correct the 2016 Q1 Report, the 2016 Interim Report and the 2016 Q3 Report (“**2016 Results Clarifications**”); and
- (2) Clarification announcement dated 29 September 2017 to amend the 2015 Q1 Report, the 2015 Interim Report and the 2015 Q3 Report (“**2015 Results Clarification**”).

22. On 10 April 2017, the Company issued another clarification announcement which contained the following extract of the independent auditor’s report on the Group’s annual financial statements for the year ended 31 December 2016:

“For the first three quarters in 2016, the Company did not implement effective internal control policy and procedure on part of *operating revenue recognition and measurement*, as well as the *operating cost settlement*. The aforesaid material defect has resulted in misstatement of operating revenue and operating cost in the financial statements.” [emphasis added]

B3. *Material Overstatement of Profits*

23. Notwithstanding the relatively healthy financial position as purportedly portrayed, it transpired in the 2015 Results Clarification and the 2016 Results Clarifications that the 6 Results Announcements for 2015 and 2016 were in fact materially false, due *inter alia* to the fact that the revenue and profits of the Company had been substantially inflated or overstated, whilst the operating costs of the Company had been substantially understated.

24. Fictitious or false entries on the operating revenues and/or operating costs of the Company had been created with the effect that the business operations of the Company appeared more successful than they were in fact, which in turn resulted in the inflation or overstatement of the profits of the Company.

25. The discrepancies between the false financial positions of the Company and/or the Group portrayed in the 6 Results Announcements and the actual financial position of the same are reflected in the changes and amendments made to the figures via the 2015 and 2016 Results Clarifications. Without being exhaustive, the key discrepancies include the following:

- (1) Discrepancies for 2015:-

	Original (RMB)	Revised (RMB)	Discrepancy
2015 Q1 Report			
Operating revenue	567,637,950.76	543,523,096.84	24,114,853.92 -4.25%
Net profit / loss	4,592,299.53	-19,455,397.21	24,047,696.74 -523.65%
Net profit /loss after extraordinary gains / losses	2,314,467.96	-49,844,431.08	52,158,899.04 -2,253.60%
2015 Interim Report			
Operating revenue	1,097,649,636.91	1,024,459,949.26	73,189,687.65 -6.67%
Net profit / loss	10,313,286.91	-71,827,174.01	82,140,460.92 -796.45%
Net profit /loss after extraordinary gains / losses	-9,827,977.66	-91,968,438.58	82,140,460.92 -835.78%
2015 Q3 Report			
Operating revenue	1,362,879,020.14	1,341,201,727.34	21,677,292.80 -1.59%
Operating cost	1,076,543,630.68	1,160,057,025.28	83,513,394.60 7.75%
Net profit / loss (3 months)	2,405,037.84	-20,645,188.64	23,050,226.48 -958.41%
Net profit / loss (9 months)	12,718,324.75	-92,472,362.65	105,190,687.40 -827.08%
Net profit /loss after extraordinary gains / losses (3 months)	2,054,831.31	-20,995,395.16	23,050,226.47 -1,121.76%
Net profit /loss after extraordinary gains / losses (9 months)	-7,773,146.34	-112,963,833.74	105,190,687.40 -1,353.26%

(2) Discrepancies for 2016:-

	Original (RMB)	Revised (RMB)	Discrepancy (RMB / %)
2016 Q1 Report			
Operating revenue	425,168,219.17	383,768,219.17	41,400,000.00 -9.74%

Operating cost	379,594,870.10	399,594,870.10	20,000,000.00 5.27%
Net profit / loss	3,112,210.78	-58,287,789.22	61,400,000.00 -1,972.87%
Net profit /loss deducting non-recurring profit / loss	-4,532,487.27	-65,932,487.27	61,400,000.00 -1,354.66%
2016 Interim Report			
Operating revenue	871,031,873.22	771,031,873.22	100,000,000.00 -11.48%
Operating cost	770,746,262.83	828,762,708.04	58,016,445.21 7.53%
Net profit / loss	6,039,585.20	-146,276,860.01	152,316,445.21 -2,521.97%
Net profit /loss after extraordinary gains or losses	-1,965,200.44	-154,281,645.65	152,316,445.21 -7,750.68%
2016 Q3 Report			
Operating revenue	294,685,580.51	334,192,841.82	39,507,261.31 13.41%
Operating cost	255,382,764.85	373,189,171.16	117,806,406.31 46.13%
Net profit / loss (3 months)	2,303,876.43	-72,695,268.57	74,999,145.00 -3,255.34%
Net profit / loss (9 months)	8,343,461.63	-218,972,128.58	227,315,590.21 -2,724.48%
Net profit /loss deducting non-recurring profit / loss (3 months)	1,861,357.34	-73,137,787.66	74,999,145.00 -4,029.27%
Net profit /loss deducting non-recurring profit / loss (9 months)	-103,843.10	-227,419,433.31	227,315,590.21 -218,902.93%

26. The above discrepancies resulted in corresponding inflation or overstatement of the profits in the 6 Results Announcements in 2015 and 2016, which were substantial:

- (1) The range of overstatement of profits was between -523.65% (about 5 times) and -218,902.93% (about 2,189 times).
- (2) The material misstatement of key financial information was not a one-off incident. Even though the substantial misstatements in 2015 were revealed, at the

latest, on 29 January 2016 when the 2015 Forecast Revision was issued, substantial misstatements continued to occur on 3 more occasions in 2016.

27. In the circumstances, the 6 Results Announcements were false and misleading.

C. INVESTIGATIONS AGAINST THE COMPANY

28. Various investigations have been carried out against the Company by the China Securities Regulatory Commission (“CSRC”), the SZ Exchange and the Petitioner respectively in relation to the overstatement of the Company’s financial position for the first three quarters of each of 2015 and 2016.

29. *First*, the CSRC carried out investigations against the Company. In summary:

(1) On 8 February 2017, the Company issued an announcement regarding the receipt by ER Zhang and YS Zhang of investigation notices from the CSRC.

(2) On 21 March 2017, the Company issued an announcement regarding its receipt of an investigation notice from the CSRC.

(3) On 15 May 2017, the Company issued an announcement regarding its receipt of the prior notification of administrative penalty from the CSRC. Among others, such notice set out the factual premises in respect of suspected breach of law by the Company, including the following:

(a) To window dress the financial data in its quarterly and interim reports, the Company had overstated its net profit since 2015 through increasing the unit selling prices recorded in lending statements to overstate estimated revenues and understate selling costs; and

(b) Particulars of the overstated revenue and the understated costs in each of the 6 Results Announcements.

(4) On the same day, the Company issued another announcement regarding the receipt by ER Zhang and YS Zhang of the prior notification of administrative penalty from the CSRC regarding ER Zhang’s suspected failure to make information disclosure on the reduction in his holdings in the A shares of the Company, and ER Zhang and YS Zhang’s suspected insider trading of A shares of the Company.

(5) On 25 September 2017, the Company issued an announcement regarding its receipt of the Judgment of Administrative Penalty from the CSRC (the “1st CSRC

Judgment”) in relation to the overstatement of financial figures in the 6 Results Announcements. Among others, the 1st CSRC Judgment (and the announcement in relation thereto) set out the following:

- (a) The factual premises referred to in sub-paragraph (3) above;
- (b) The respective positions adopted by the Senior Officers; and
- (c) CSRC’s conclusions including that (i) regardless of the purpose of the conduct in question in this case, it did not affect the fact that the Company has violated the relevant regulations; and (ii) the truth, accuracy and completeness of the information of listed companies were dependent on the due diligence of all directors, supervisors and senior management who should bear legal responsibility for the information disclosure.

(6) On the same day, the Company issued another announcement regarding the receipt by ER Zhang and YS Zhang of the Judgment of Administrative Penalty from the CSRC (the “**2nd CSRC Judgment**”) in relation to ER Zhang’s failure of information disclosure, and ER Zhang and YS Zhang’s insider trading of A shares of the Company. Among others, the 2nd CSRC Judgment (and the announcement in relation thereto) similarly set out the factual premises relied upon, the respective positions adopted by ER Zhang and YS Zhang, and the CSRC’s conclusions.

30. *Second*, the SZ Exchange also carried out investigations against the Company. In gist:

(1) On 15 February 2017, the Company issued an announcement regarding its receipt of an inquiry from the SZ Exchange on 6 February 2017 and its replies to the same. Among other things, the Company admitted that both ER Zhang and YS Zhang had reduced their shareholding in the Company prior to the 2016 Forecast Revision on 3 February 2017.

(2) On 2 June 2017, the Company issued an announcement regarding its response to an inquiry letter from the SZ Exchange concerning its 2016 annual report, including its response as to the reasons behind the material defects in respect of financial reporting.

(3) On 16 January 2018, the Company issued an announcement regarding its receipt of public censure by the SZ Exchange for various violations of the Stock Listing Rules of the SZ Exchange, including material accounting errors in respect

of major financial information for the first three quarters of 2015 and 2016 and material deficiency in internal control on the accounting and disclosure of such information.

31. *Third*, in parallel with the foregoing, the Petitioner commenced an investigation against the Company. In gist:

(1) During around June 2017 to June 2018, pursuant to section 183 of the SFO, the Petitioner requested the Company to provide information about the overstatement of financial figures for the first three quarters in 2015 and 2016.

(2) The Company replied and explained the overstatement as follows:

(a) The Company's financial figures for each of the first three quarters in 2015 and 2016 were adjusted by considering the circumstances surrounding the Company's operations. These figures (in particular revenue figures) were essentially temporary estimates based on market conditions and expectations of customers' demand at the relevant time.

(b) The financial figures in question were the result of wrong judgments on the market and expectations of customers' demand at the relevant time.

(c) The wrong judgments were made by YS Zhang (former Executive Director and General Manager) and Yang Jin (former Executive Director and Deputy General Manager), and the financial figures were adjusted by Ding (Finance Manager), JQ Yang (Deputy Finance Manager) and Mr Liu Hong Tao (former Finance officer).

(d) Before the annual year-end audit the Company has itself audited and revised its financial data according to the actual development of its business, which ensured the accuracy and authenticity of its annual financial figures.

(3) The SFC also interviewed the Senior Officers of the Company with the assistance of the CSRC.

(4) Without being exhaustive, during the interviews, Ding and JQ Yang admitted to adjusting the financial data to show a certain level of profit under the instructions of Yang Jin.

D. ROLE OF THE 5th TO 8th RESPONDENTS

32. Each of the 5th to 8th Respondents accepted and agreed that they knowingly overstated revenue and understated operating costs of the Company for the financial years of 2015 and 2016 so as to achieve a substantial inflation and overstatement of the overall profits of the Company (the “**Inflation Scheme**”), by permitting or participating in the Inflation Scheme, as particularised in Section D2 below.

D1. The 5th to 8th Respondents’ Duties to the Company

33. Each of the 5th to 8th Respondents admitted, accepted and agreed that they each owed, *inter alia*, the following duties to the Company in common law and/or in equity:

(1) To act honestly and in good faith and to act in the best interests of the Company, including but not limited to:

(a) Not directing, approving, allowing or acquiescing the Company to make:

(i) statements or announcements to its public shareholders or the public generally which he knows to be (or turns a blind eye to the fact that they are) misleading or false;

(ii) statements or declarations to the Company’s auditors and regulatory authorities including the HK Exchange that he knows to be (or turns a blind eye to the fact that they are) misleading or false.

(b) Not acting for any improper purpose in the exercise of his powers and the discharge of his duties.

(c) A duty to act with care, skill and diligence reasonably expected of a person of their knowledge and experience in the performance of their functions and their management of the Company’s affairs;

(d) Collectively and individually, a continuing duty to acquire and maintain a sufficient knowledge and understanding of the Company’s business to enable them properly to discharge their duties as directors or senior officers of the Company; and

(e) Where they have delegated some of the managerial or financial responsibilities to their subordinates or other fellow officers, a duty to supervise the discharge of the delegated functions.

(2) To comply with the Company's bye-laws and the relevant laws and regulations concerning the management of the Company.

34. Further, each of the 5th to 8th Respondents admitted, accepted and agreed that as the Company is listed on the Main Board of the HK Exchange, Guo (the 5th Respondent) as a director of the Company at the material times gave an undertaking to comply with and be bound by the Listing Rules of the HK Exchange, including Rule 3.08, which provides that every director must, in the performance of his duties as a director, *inter alia*:

- (1) Act honestly and in good faith in the interests of the company as a whole;
- (2) Act for proper purpose;
- (3) Avoid actual and potential conflicts of interest and duty; and
- (4) Follow up anything untoward that comes to his attention.

35. Furthermore, pursuant to Section 465 of the Companies Ordinance (Cap. 622), each of the 5th to 8th Respondents admitted, accepted and agreed that Guo (the 5th Respondent) as a director of the Company, also owed a duty to exercise reasonable care, skill and diligence that would be exercised by a person with (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company and (b) the general knowledge, skill and experience that the director has.

D2. The 5th to 8th Respondents permitted or participated in the Inflation Scheme

36. Each of the 5th to 8th Respondents admitted, accepted and agreed that they, in breach of their duties to the Company, permitted or participated in the Inflation Scheme, and they had knowledge of the same at all material times, as shown by the following (non-exhaustive) indicators:

- (1) The substantial magnitude of the overstatement of the profits of the Company during the first three quarters of 2015 and 2016;
- (2) The substantial overstatements being the result of an intentional choice to adjust the operating revenue and the operating cost of the Company; and/or
- (3) The recurrence of overstatements in the first three quarters of 2016, notwithstanding the Company's announcement in January 2016 of the substantial revision of the results forecast for 2015.

D2.1. Guo and Zhao

37. The 5th and 6th Respondents admitted, accepted and agreed that they permitted or participated in the Inflation Scheme.

38. *First*, the 5th and 6th Respondents admitted, accepted and agreed that they held important positions in the Company, giving them knowledge of the Company's affairs. Specifically:

- (1) Guo was the Executive Director of the Company; and
- (2) Zhao was the secretary of the Board and the Deputy General Manager of the Company.

39. *Second*, the 5th and 6th Respondents admitted, accepted and agreed that the discrepancies between the profits stated in the 6 Results Announcements and the subsequent amendments were very substantial, and it is inherently improbable that they could have remained ignorant of the misstatement of financial information of the Company in the first three quarters of 2016 since the 2015 Forecast Revision was announced on 29 January 2016.

40. *Third*, the 5th and 6th Respondents admitted, accepted and agreed that they had ample incentive to overstate profits and business performance of the Company as senior officers receiving substantial remuneration. According to the Annual Reports, the total remuneration received by Guo was RMB415,500 in 2015 and RMB413,200 in 2016, whilst Zhao received RMB146,000 in 2015 and RMB130,800 in 2016.

D2.2. Ding and JQ Yang

41. The 7th and 8th Respondents admitted, accepted and agreed that they permitted or participated in the Inflation Scheme.

42. *First*, the 7th and 8th Respondents admitted, accepted and agreed that they held important positions in the Company, giving them first-hand knowledge of the Company's financial information and rendering them in a position to make adjustments to the Company's financial figures. Specifically:

- (1) Ding was the Finance Manager of the Company; and
- (2) JQ Yang was the Deputy Finance Manager of the Company.

43. *Second*, the 7th and 8th Respondents admitted, accepted and agreed that Yang Jin had

requested Ding and JQ Yang to make false adjustments to financial information to turn around losses into profits, upon authorisation by YS Zhang.

44. *Third*, the 7th and 8th Respondents admitted, accepted and agreed that during the interviews conducted by the CSRC for the SFC, Ding and JQ Yang admitted that:

- (1) They adjusted the financial figures of the Company under the instructions of Yang Jin in order to show a certain amount of profit;
- (2) They were inflating the profits of the Company by way of false adjustment of revenue and costs and, specifically, through increasing the unit selling prices to overstate estimated revenue;
- (3) Although both of them claimed to have allegedly expressed to Yang Jin their discomfort with such actions, they repeated such manoeuvres for the first three quarters of 2016; and
- (4) Their actions were illegal, regardless of the instructions received or the commercial reasons behind the instructions.

E. LIABILITY

45. By reason of the matters above, the business or affairs of the Company were conducted by the 5th to 8th Respondents in a manner:

- (1) involving defalcation, misfeasance or other misconduct towards the Company, its members or any part of its members by the fraudulent misrepresentation of the Company's key financial information;
- (2) resulting in its members not having been given all the information with respect to its business or affairs that they might reasonably expect, such as the true position of the Company's revenue, costs and profits (or losses); and/or
- (3) unfairly prejudicial to their members or part of their members, who were induced to buy shares or otherwise maintain their shareholding in the Company in reliance of false accounting information.

PART III – AGREED PROPOSED ORDERS

46. On the basis of the agreed facts set out in Part II above, the Petitioner and each of the 5th to 8th Respondents agree and submit that it would be appropriate for orders to be made against each of the 5th to 8th Respondents under sections 214(2)(a) and (d) of the SFO, under

which they shall not, for such period as this Court might determine, without leave of the Court:

- (1) be, or continue to be, a director, liquidator, or receiver or manager of the property or business, of any listed or unlisted corporation in Hong Kong including the Company or any of its subsidiaries and affiliates; and
- (2) in any way directly or indirectly be concerned, or take part, in the management of any listed or unlisted corporation in Hong Kong including the Company or any of its subsidiaries and affiliates.

47. If, pursuant to this Schedule, this Court disposes of these proceedings summarily, each of the 5th to 8th Respondents agrees that there should additionally be an order that the 5th to 8th Respondents do pay the costs of the Petitioner in these proceedings, or such portion thereof as the Court thinks appropriate, to be taxed if not agreed with certificate for counsel.

Dated this day of 2021

Securities and Futures Commission
Petitioner
Signed by
for and on behalf of the Petitioner

Guo Huan Ran (國煥然)
5th Respondent

Zhao Hong Feng (趙洪峰)
6th Respondent

Ding Zhi Shui (丁志水)
7th Respondent

Yang Jun Qiu (楊俊秋)

8th Respondent

HCMP 1094/2019

IN THE HIGH COURT OF THE
HONG KONG SPECIAL ADMINISTRATIVE REGION
COURT OF FIRST INSTANCE
MISCELLANEOUS PROCEEDINGS NO. 1094 OF 2019

IN THE MATTER OF SHANDONG
MOLONG PETROLEUM MACHINERY
COMPANY LIMITED

and

IN THE MATTER OF SECTION 214 OF
THE SECURITIES AND FUTURES
ORDINANCE, CAP. 571

BETWEEN

SECURITIES AND FUTURES
COMMISSION

Petitioner

And

SHANDONG MOLONG PETROLEUM
MACHINERY COMPANY LIMITED

1st Respondent

ZHANG EN RONG (張恩榮)

2nd Respondent

ZHANG YUN SAN (張雲三)

3rd Respondent

YANG JIN (楊晉)

4th Respondent

GUO HUAN RAN (國煥然)

5th Respondent

ZHAO HONG FENG (趙洪峰)

6th Respondent

DING ZHI SHUI (丁志水)

7th Respondent

YANG JUN QIU (楊俊秋)

8th Respondent

**SCHEDULE FOR CARECRAFT PROCEDURE
IN RESPECT OF THE 5th TO 8th RESPONDENTS**

Dated the 3rd day of February 2021

Securities and Futures Commission

The Petitioner

54/F, One Island East,

18 Westlands Road

Quarry Bay, Hong Kong

Tel: 2231 1222

Fax: 2521 7884

Ref: 122/LG/1000/0304

[\[1\]](#) §§32(1), 36-53 of Schedules

[\[2\]](#) §§32(2), 54 of Schedules

[\[3\]](#) §32(3), 55-58 of Schedules

[\[4\]](#) See for eg, *SFC v Fung Chiu; Re Styland Holdings Ltd (No 2)* [2012] 2 HKLRD 325; *Re Hanergy Thin Film Power Group Limited*, HCMP 166/2017, 4 September 2017, §16