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HD **Governance a thorn in side of friendship**

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WHEN Tony Abbott gave his first speech in **China** as Australian Prime Minister last week he borrowed the famous words of its reformist leader Deng Xiaoping to create his own aphorism.

“To get rich is indeed glorious — but to be a true friend is sublime,” he told the audience of **China**’s top political and **business** figures.

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In conclusion, the Prime Minister said, “we don’t just visit because we need to, but because we want to. Our region and our world need peace and understanding based on international law and mutual respect.” Just how **business** manages this “glorious” friendship with **China** — maintaining the balancing act between getting rich and the rule of law — was not a subject the Prime Minister chose to dwell upon.

But as Australia hurtles toward a free-trade agreement with **China**, the governance records and investment practices of **Chinese** companies in Australia will not be a subject either **business** or our political leadership will be able to ignore. Concerns about the governance practices of **Chinese** companies in Australia are widespread, although to voice these concerns is often seen as anathema to the investment opportunity.

The Weekend Australian has spoken to several Australian-based directors and bankers who have been burnt by **Chinese** companies either investing or listing here, but would not speak on the record for fear of being labelled anti-**Chinese** and missing out on investment opportunities.

One who did speak up was Wayne Morgan, a former non-executive director of ASX-listed Sino Australia Oil and Gas.

Morgan was brought on two years ago by Sino to aid in what was the largest listing by a **Chinese company** on the ASX last year. He and fellow director Andrew Faulkner were removed as directors by the **Chinese** drilling services **company** after chairman and majority shareholder Continued on Page 22 Continued from Page 21 Shao Tianpeng attempted to move $7.5 **million** into a **Chinese** bank account the day after the **company** listed on the ASX in December last year.

According to a letter of complaint to ASIC from two of the **company**’s sacked Australian directors, Wayne Johnson and Andrew Faulkner, the pair were seriously concerned about the money transfer contracts allegedly not disclosed in the prospectus, which would have left the **company** with just $170,000 in its accounts, as well allegedly unexplained related party transactions.

Last week in the Federal Court ASIC maintained a freezing order over the HSBC account. Trading in Sino shares has been halted by the ASX, amid concerns over the failure to lodge last year’s accounts.

Though not state-owned, Sino was a **company** founded with the support of the government of Daqing, the oil-rich city of the northeast, which is “incubating” hundreds of companies in the region, and reportedly has plans to list up to 30 more companies on the ASX.

Morgan told The Weekend Australian **Chinese** companies “are not aware of, don’t fully understand or choose to ignore” Australian governance requirements, especially in regard to directors duties.

“I don’t think they fully understand the obligations,: he says. “And frankly they have more of a view that they can run their company as they did before but it’s just listed now. When in reality their obligations are to all shareholders.

“It’s been said to me: ‘Hey we’re the major shareholders and we get to do what we want to do.’ ” While aware of the “linguistic and cultural barriers” the Chinese face, he has no doubt that differences between sophisticated Chinese investors and those from the regions also play a part. “In a lot of regional locations you will have people who haven’t had a lot of experience even working in the Chinese corporate environment.

“We’ve got the government saying we’re open for business with China. Well, we are and we want to. But there has to be some kind of guidelines acknowledged by both China and Australia that they have to conform with our ASIC regulations for starters.” Long-term China-based executive and company director Clinton Dines puts it down to inexperience in international investing and says Chinese companies are on a steep learning curve about how things are done offshore.

“You have got to remember that they got their domestic house in order (by) the first decade of this era but effectively since 1949 they have been isolated from the world,’’ Dines says.

“So you have got to expect missteps.’’ He points out that within China, state companies have been steadily observing and adapting Western governance principles, moving, for example, from executive directors of companies in stages through to a majority of independent non-executive directors over the past decade.

“The trend line is extremely clear,’’ Dines says. “There is a process going on here, it is not going on by accident.’’ Nonetheless there have been some big missteps. The story of Hanlong, which was to become one of the largest Chinese mining investors in Australia, is the most colourful in the recent history of inbound investment.

Liu Han, the global head and founder of Chinese miner the Hanlong Group, now sits in a court dock in the central Chinese province of Hubei, accused of running a brutal organised crime syndicate and facing a potential death sentence.

The charges against one of China’s one-time wealthiest businessmen, his brother Liu Wei and 34 other members of the “mafia style” gang detail alleged standover tactics, bribes to officials and the murder of business rivals.

Liu Han was a regular visitor to Australia on trips to scout investment opportunities for Hanlong.

Spending up in casinos and meeting senior resources executives, he spearheaded the bid for Hanlong to become a majority shareholder in ASX-listed Moly Group and Sundance Resources.

The latter failed when ASIC where alerted to what became Australia’s largest insider trading investigation.

A leadership group at the company, including Australian operations boss Steven Xiao and current Moly Group chairman Nelson Cheng, were found to have invested in an insider trader syndicate that was making money from Hanlong’s takeover bids in Australia.

This plan included what ASIC claims was a fake takeover bid on uranium miner Bannerman Resources in July 2012 that allowed the executives to buy up Bannerman stock and dump it once the Hanlong offer pushed the price up. Hanlong would then withdraw the offer once the profit was made.

While the young vice-president of the group, Australian-based Calvin Zhu, was sentenced to 15 months’ jail, Steven Xiao fled to China and is fighting extradition after being tracked down by authorities in Hong Kong.

Two fellow members of the syndicate, Cheng and chief financial officer Simon Yang, have not been charged, but The Weekend Australian understands there is an ongoing ASIC investigation into Hanlong. Cheng replaced Liu Han on the board after his arrest in China.

Now acting Hanlong chief executive Kang Huan Jung — reportedly Liu’s “right and man” — also sits on the Moly board after being flown in by Liu when news of the initial insider trading investigation broke.

ASIC commissioner John Price said while there was not an ASIC surveillance team devoted to Chinese investment, there was an emerging miners and resources team based in Western Australia that “focus on that segment of the market”.

"Corporate governance standards can be difficult given you may have a geographically scattered board of directors — internal controls and risk-management issues for the same reason.

"How can you be sure that the assets that the company has are worth what people say they are worth or indeed even exist?" Geoff Nicol is part of the Australian Research Council's governance research team at University of Canberra, and he specialises in Chinese-Australian investment and corporate governance.

Nicol says that it is encouraging in the Sino case the Australian directors blew the whistle, but he is of no doubt a lot of Chinese companies' behaviour goes unreported for fear of losing current or future opportunities.

"In the case of Sino the Australian director made it clear that this was not acceptable, but I am sure that it is not always so," he says. "You will not find much enthusiasm for the view ... (the) problem is that people push for trade at any costs and there are a lot of vested interests.

"How we actually enforce director's duties in Australia is a serious issue. "Taken individually there might be smaller issues or one offs ... but we have to be mindful that if we want investment the law has to be complied with. I am starting to grow concerned." With the government indicating a range of restrictions on Chinese investment will be relaxed with a possible FTA, Nicol warns governance standards "will be chips in the bargaining of the FTA. I'm worried a lot of this will be eaten up in the FTA." David Williams, a partner in boutique investment firm Kidder Williams specialising in food and agriculture deals, says even the reputation of Chinese companies attempting to the right thing is "pretty appalling'' because of a combination of bad deal management, poor asset targeting and distrust on both sides.

"I welcome and encourage Chinese investment in food and agriculture but I fear they are not going about it in the right way and doing themselves no favours.

"The problem is that they do not use advisers. That is important in understanding how business is done here," Williams says.

Williams says the issue of intellectual property protection is a particular sore point as Chinese firms have been known to consult advisers who provide ideas for nothing in return.

"Investment bankers are largely suspicious about Chinese companies until they can be convinced their IP is safe and will be paid for." He says despite the hype around Chinese investment, the best deals in food and agriculture still are being done by the Japanese, while the Chinese are missing out or buying overpriced assets.

"Look at what is happening in dairy. Everyone one is talking about the Chinese interest in dairy, but many of the deals that are happening are Japanese ... but the Chinese are in greatest need of the product.

"The Japanese understand the industry and product flows, watch the assets closely, get good advice and get a deal done quickly ... meanwhile Chinese buyers are still kicking the tyres." However, Williams also accepts the Japanese use to be subject to similar criticism in the late 1980s and 90s.

"They bought overpriced assets and put their own people in charge and as a consequence lost a lot of money but now they have gotten much smarter."NEW CHINA SCANDAL P29

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