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Newsletter

Litigation & Dispute Resolution

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What's inside?

Court of Final Appeal holds that insider dealing of overseas listed securities is prohibited under section 300 of the Securities and Futures Ordinance

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In our **March 2016** and **December 2017** newsletters, we reported the respective Judgments of the Court of First Instance and the Court of Appeal in *The Securities and Futures Commission v Young Bik Fung & Others (HCMP 2575/2010; CACV 33/2016).*

Subsequently, the 2nd to 4th Defendants (Eric, Patsy and Stella respectively) made a final appeal to the Court of Final Appeal (CFA) to seek a judgment in their favour. By the CFA's Judgment on 31 October 2018, their appeal was dismissed.

In so doing, the CFA held that the phrase "transaction involving securities" in s.300 of the Securities and Futures Ordinance (SFO) is to be given a wide meaning, which is not confined to a single arrangement, and can also include a series of inter-related but discrete steps, such as purchases or sales of Taiwan listed Hsinchu Bank shares through the misuse of confidential insider information regarding the takeover plan of Standard Chartered Bank (SCB). In addition, the CFA held that insider dealing of overseas listed securities (excluding Hong Kong listed securities which will be caught and dealt with by the usual insider dealing provisions in the SFO) will be caught by s.300 of the SFO, provided "substantial activities constituting the crime" occurred within Hong Kong.

A reminder of the facts

As per our earlier newsletters, in this case, Betty (the 1st Defendant) was a solicitor seconded to SCB by her then employer in respect of SCB's takeover of Hsinchu Bank. During the secondment, she obtained inside information about SCB's intended tender offer for Hsinchu Bank shares. Based on the inside information, Betty and Eric (the 2nd Defendant, a solicitor, and Betty's friend) through Patsy (the 3rd Defendant, Eric's sister) acquired shares in Hsinchu Bank. Patsy also invested for Stella (the 4th Defendant, Eric's sister). All of them made profits as a result.

The SFC relied on s.300 instead of the insider dealing provision under s.291 of the SFO because Hsinchu Bank shares were overseas listed shares which are not covered by s.291. The SFC sought a declaration that s.300 was contravened in order for the Court to make remedial and disgorgement orders under s.213 against the Defendants.

The Court of First Instance (whose judgment was upheld by the Court of Appeal) found that the Defendants contravened s.300 by practising fraud and deception in transactions involving securities, and made disgorgement orders against them.

The appeal to the CFA

The propositions of the Defendants before the CFA were:

(a) First, that the words "a person shall not directly or indirectly, in a transaction involving securities" must be read to require that "person" – i.e. the defendant – to be *a party* to the "transaction" referred to.

(b) Secondly, that, since the only transactions that the Defendants (meaning Patsy and, through her as their agent, Eric, Betty and Stella) entered into were the contracts to purchase the Hsinchu Bank shares and then to sell them to SCB in accepting SCB's Tender Offer, the relevant transactions in the present case were those share dealing transactions, i.e. the purchase and then the sale of the shares, taken as separate transactions.

(c) Thirdly, that the fraud or deception also had to be "in the transaction", meaning, they had to be practised by the defendant on the counterparty to the relevant transaction. There transactions did not involve any fraud or deception practised on their counterparties.

The "counterparty" argument

The Defendants argued that the fraud or deception must be practiced on a counterparty to the transaction before it can be regarded as being "in a transaction". The deception practised against SCB was not employed or engaged in the transaction involving the purchase of Hsinchu Bank shares over the Taiwan Stock Exchange. The analogy was that if a person steals money to buy shares on an exchange, the fraud constituted by the theft is not a fraud in the securities transaction.

The CFA opined that s.300 of the SFO did not require the Defendants to be party to the transactions or that fraud must be practised on the counterparty, so long as their fraudulent or deceptive scheme is employed in connection with or in relation to the transaction. In any event, the CFA agreed with the Courts below that fraud was practiced on SCB both in respect of the misuse of the inside information and the tender of the shares to SCB.

Mr. Justice Spigelman NPJ also reviewed the legislative history of the Ordinance and found that reference to a counterparty ("transaction *with any other person*" in the predecessor provision) was removed when s.300 became law. The Defendants' arguments were writing back into the section the words which the legislature removed, which is not permissible.

The "transaction" argument

The Defendants argued that the purchase of the shares was a transaction and their sale when the tender was accepted was a separate transaction, and that it would strain the natural meaning of the word to cover preparatory steps antecedent to the dealing in securities such as the use or disclosure of the inside information, or the deposit of money into the trading account that was used to purchase the shares in question.

The CFA held that it is artificial to split the purchase and sale into two or more separate transactions. The word must be given a meaning that is required by the context of the section and such as would achieve its purpose. The word "transaction" has a wide meaning. The CFA referred to *HKSAR v Yeung Ka Sing Carson* (2016) 19 HKCFAR 279 in which the CFA said at paragraph 137 that "*[i]n making a judgment as to whether acts are so connected that they can fairly be regarded as forming part of the same transaction or criminal enterprise it is necessary to keep in mind the purpose for which the question is asked.*"

Mr. Justice Ribeiro PJ opined that the Defendants' scheme fell comfortably within s.300. The relevant "transaction involving securities" encompassed the misuse and disclosure of inside information regarding SCB's takeover; misuse of that information by purchasing the Hsinchu Bank shares with a view to selling them to SCB at a higher tender price; their acceptance of SCB's offer and their realisation of larger profits derived from their misuse of the inside information. These dealings formed a part of the overall transaction.

Mr. Justice Spigelman NPJ opined that "transaction" is not a word that can be confined to a single arrangement and it may and frequently does include a series of occurrences extending over a length of time. His Lordship said that conduct can involve "securities" and have occurred "in a transaction" if the events said to constitute the transaction consist of a series of inter-related, but discrete steps.

Application of s.300 to insider dealing of overseas listed securities

The CFA held that "securities" under s.300 is not confined to shares listed in Hong Kong. It would be in line with the purpose of the Ordinance and Hong Kong's position as an international financial centre that s.300 should cover insider dealing in shares listed in Taiwan, if substantial activities constituting the crime occurred within Hong Kong. However, to avoid s.300 also applying to the insider dealing of Hong Kong listed shares, the CFA said that s.300 excludes such insider dealing, which will be dealt with by the usual insider dealing provisions.

Commentary

The CFA's judgment is to be welcomed. The CFA said that it would be in keeping with the purpose of the SFO and Hong Kong's position as an international financial centre that provided substantial activities constituting the crime occurred in Hong Kong, s.300 should cover the insider dealing in shares listed overseas. It now confirms that notwithstanding that the shares are not Hong Kong listed, insider dealing of overseas listed securities is caught by s.300 of the SFO. Parties in Hong Kong who have inside information of overseas listed securities should be careful when dealing with the overseas listed securities and they should not think they are beyond the regulatory and enforcement reach of the law.

SFO s.213 remedy for aggrieved public investors against Person(s) Unknown in securities fraud

Connie Ma

In *Securities And Futures Commission v An Unknown Person Or Persons Purporting To Carry On A Securities And/Or Futures Trading Business Known As Cardell Ltd And/Or Cardell Co Ltd And Others* ([2018] HKCFI 2814; [2019] HKCU 37), the SFC successfully obtained compensation for aggrieved public investors under section 213 of the Securities and Futures Ordinance (Cap. 571) (SFO) against "person(s) unknown" responsible for a series of "boiler room frauds" across the internet since 2014.

A "boiler room fraud" is a common securities fraud where the fraudster purports to operate as a licensed securities or futures broker and offers to people, via websites, emails or cold-calls, to trade in securities or futures paid for by the victims but which in fact have not been executed in any recognised exchange.

Facts

Victims from Europe were solicited to invest in securities or futures contracts by person(s) unknown purporting to be carrying on securities and or/futures trading business under different companies operating in Hong Kong (the fraudsters). Victims then remitted funds into the bank accounts opened in Hong Kong under another set of company names. Victims later discovered that the contracts were a scam, but were unable to contact the fraudsters or recover monies from the fraudsters.

It transpired that the companies the fraudsters purported to be operating were not registered with the Companies Registry or Business Registration Office of the Inland Revenue Department and did not hold any business registration certificate. However, the companies under whose names the accounts were opened were existing companies incorporated in Hong Kong and the Republic of Seychelles (the Companies).

The SFC brought three separate actions against each group of people purporting to carry out business under the different company names and corresponding websites together with the Companies. The SFC brought the following claims:

Against person(s) unknown purporting to carry on securities and/or futures trading business under the different trading names concerned and corresponding websites:

- s.109(1) SFO: knowingly issuing advertisements in Hong Kong in which a person held himself out as being prepared to carry on regulated activities whilst unlicensed and unregistered.
- s.114(1)(b) SFO: holding out as carrying on businesses in regulated activities in Hong Kong whilst unlicensed and unregistered and without reasonable excuse.

Against the Companies:

- s.114(1)(b) SFO as above, as they allowed access to their bank accounts for settlement of regulated activities.
- "aiding and abetting" within the meaning of s.213(1)(ii), as the purpose of the remittances into their bank accounts was inconsistent with the purposes stated in the account opening documents. The account opening documents stated that the accounts were opened for trading purposes e.g. payment to suppliers.

Decision

Orders granted by the Court include:

(1) A restitution order under s.213(2)(b) of the SFO to distribute the amounts frozen in the bank accounts of the Companies to the victims on a pro rata basis i.e. by dividing the amount left in each of the bank accounts amongst the victims in proportion to the amount they respectively remitted into each of them.

(2) Order under s.213(2)(d) of the SFO for the appointment of an administrator to facilitate the distribution and consequential directions.

(3) Injunction order under s.213(2) against the person(s) unknown for carrying on a business/advertising itself as being prepared to carry on regulated activities including on all internet websites within its control; injunctions against the Companies from disposing of any of the funds in their bank accounts.

Commentary

The judgment reaffirmed the Court's "broad-brush approach" in granting s.213 civil remedies with the over-arching purpose of allowing the SFC as regulator to take action for the benefit of investors, who may otherwise be deterred by cost considerations from instituting legal proceedings individually to obtain redress for their relatively small losses. This follows the principles referred to in the preceding CFI case of *SFC v Qunxing Paper Holdings Ltd (No 2)* [2018] 1 HKLRD 1060 and landmark CFA case *Securities and Futures Commission v Tiger Asia Management LLC & Ors* [2013] 16 HKCFAR 324. S.213 and helps fill the gap for the lack of a class action regime in Hong Kong and provides more effective relief to investors than criminal proceedings in the Market Misconduct Tribunal.

Other powers of the SFC under s.213 include making:

- A freezing order
- A declaration that a contract is void/voidable
- Ancillary orders necessary for making of any orders under s.213

SFC v Qunxing Paper Holdings Ltd (No 2) further confirmed that the SFC's power to make an order to restore parties to a position prior to the transaction under s.213(2)(b) can be construed widely, to include an order against any person knowingly concerned in the contravention of the SFO despite not being a counterparty to the transaction.

Other occasions on which the SFC has sought s.213 remedies have concerned mostly insider dealing and price rigging.

Rules of the High Court and related case law highly relevant in competition tribunal hearings

Bryan Chan

Background

In the recent decision, *Competition Commission v W. Hing Construction Company Limited* [2018] 5 HKLRD 437 (the Decision), the Competition Tribunal (the Tribunal) applied case laws on procedural issues in High Court hearings to Tribunal hearings. The Decision is a good example showing that the Rules of the High Court (Cap. 4A) and related case law are highly relevant to proceedings in the Tribunal.

Background of the Decision

The Decision was made as a result of an interlocutory application brought in *Competition Commission v W. Hing Construction Company Limited* (CTEA 2/2017), the second enforcement action brought by the Competition Commission (the Commission) in the Tribunal.

The 4th Respondent applied to amend its Response and file three additional witness statements just one and a half months before trial. The defence given in the proposed amended Response was completely different to the defence in the original Response and the three witness statements were in support of the new defence.

The Tribunal dismissed the 4th Respondent's application on the grounds that the application did not have merit and that it was made at a very late stage.

Grounds for the Decision

In relation to the latter point, the Tribunal considered various cases concerning procedural issues in civil proceedings in the High Court, including *Topwell Corp Ltd v Kwan Kam Kee* [2014] 5 HKLRD 1 (a case where leave was granted for re-amendment of the defendant's defence despite delay), *Li Shiu To v Li Shiu Tsang and others* (unreported, HCA 416/2003, 14 August 2012) (a case where leave was granted for amendment of the Re-amended Statement of Claim, despite delay) and *Jose Miranda da Costa Junior & Anor v Lorenzo Yih, also known as Yu Chuan Yih & Ors* (unreported, HCA 156/2010, 28 April 2014) (a case where an application for leave to file further affidavits was dismissed).

After considering these cases, the Tribunal held that delay on its own may not be sufficient to justify a refusal of leave for amendment. However, it was in the interests of the whole community to conduct legal proceedings efficiently and an adjournment of the trial would seriously prejudice the parties involved in the litigation. In this case, having regard to the procedural history of the case and imminent trial date, if the application were granted, the Commission would be prejudiced and left with little time to consider and investigate the new defence put forward by the 4th Respondent. The trial may have to be delayed. Therefore, the 4th Respondent's application was rejected.

Despite the fact that the hearing was a Tribunal hearing, the principles and objectives in the cited cases should still be upheld. The Tribunal found support from s.144 of the Competition Ordinance, which enables the Tribunal to follow the practice and procedure of the Court of First Instance in the exercise of its civil jurisdiction. Rule 4 of the Competition Tribunal Rules (Cap. 619D) also incorporates the Rules of the High Court (Cap. 4A) to a significant extent.

Key messages

Procedures in Tribunal proceedings are, in a sense, simpler and more flexible than those in the High Court. For example, there is no acknowledgement of service and there is only one mode of commencing proceedings in the Tribunal. However, the simpler, more flexible nature of Tribunal proceedings does not mean that unexplained delays and late applications will be treated more leniently.

Further, where applicable, the Rules of the High Court (Cap. 4A) and relevant case laws will serve as a reference for dealing with procedural issues in Tribunal proceedings.

The final point to take away from the Decision is paragraph 28 thereof, where it is stated that "*There is also a broader public interest in these enforcement actions to see the proceedings being dealt with as expeditiously as is reasonably practicable. The outcome of Tribunal proceedings would well serve as guidance to other undertakings and persons in the regulation of their economic conduct*."

Recent publications

Reciprocal recognition and enforcement of judgments in civil and commercial matters

Scope of mutual legal assistance between the Mainland and Hong Kong broadens as jurisdictional concerns in cross border transactions are clarified

Companies (Amendment) (No.2) Ordinance 2018: Additional requirement to notify location of board records

Application of statutory secrecy obligations on licensed corporations

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