



Regulatory and compliance – Hong Kong

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Hong Kong's Court of Final Appeal rules on fraudulent or deceptive conduct in share dealings

Introduction

In another landmark case for the Securities and Futures Commission (SFC) in Hong Kong, the Court of Final Appeal has ruled on the ambit of section 300 of the Securities and Futures Ordinance (Cap. 571 – the Ordinance), and confirmed that it covers insider trading in shares listed outside Hong Kong.

Section 300 makes it an offence to do anything that is fraudulent or deceptive in a transaction involving shares and other regulated trades. Before these proceedings, there had been no reported case on section 300, although it was understood to apply to transactions involving overseas-listed securities. Hong Kong's highest court has now confirmed the wide nature of the offence and that it is not limited to dealings in securities listed on a "recognized stock exchange" in Hong Kong. The offence applies to any transaction involving shares and other securities wherever listed, including steps taken in Hong Kong towards insider dealing in overseas-listed shares.

In these circumstances, the SFC can be expected to commence more section 300 proceedings, especially where the impugned transactions are within the SFC's enforcement

priorities and involve conduct in Hong Kong but with respect to shares listed overseas.

Some key points

- Section 300 makes it an offence to engage in any conduct that is fraudulent or deceptive with respect to any transaction involving securities, futures contracts or leveraged foreign exchange trades. This is not limited to dealing in shares that are locally listed.
- A "transaction" for this purpose is widely construed. It can be one or more components of a share dealing with a view to making a profit or avoiding a loss (such as, the purchase, sale, or giving of instructions to an intermediary). Taken as a whole, these components can also constitute a transaction.
- The defendant does not need to be a party to the impugned transaction(s). It is enough that they use fraudulent or deceptive conduct in connection with a transaction; for example, the use of inside information to make a profit or avoid a loss.
- Where conduct amounts to insider dealing with respect to locally listed shares, an offender should be pursued for insider dealing (under section 291) and not for an offence under section 300.

Any comments or queries?

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- Conduct contrary to section 300, like insider dealing, is not victimless. The courts in Hong Kong appear to have little difficulty in finding that the victim is an identified counterparty or, more generally, the public at large.
- Conduct contrary to section 300 can be pursued by the prosecution authorities in Hong Kong in the criminal courts. A criminal conviction can carry a heavy custodial sentence. However, the SFC can also launch civil proceedings, pursuant to section 213 of the Ordinance, to seek (among other things) compensation for a counterparty or class of investors, injunctions, orders preventing dealings and to recover the SFC's significant legal costs.
- Section 300 does not have extra-territorial effect. It is enough that there is some connection with Hong Kong; for example, that the disclosure or misuse of inside information takes place in Hong Kong. The transaction, however, might be executed in Hong Kong or overseas.

SFC v Lee & Ors [2018] HKCFA 45

Background

In short, four individuals in Hong Kong participated in a scheme to purchase shares in a company listed on the Taiwan Stock Exchange before the company's acquisition by an international bank. One of the defendants (who was not a party to the appeal proceedings) had gained inside information regarding the takeover offer while working as a solicitor seconded to the bank. She (as a "tipper") informed one of the other defendants (as "tippee", also a lawyer) and the four of them raised funds to purchase the shares before the bank announced a public tender offer. One of them accepted the tender offer via a trading account in Hong Kong. The four individuals distributed the profits between them.

The defendants' conduct was eventually reported to the SFC. The defendants were not charged with a criminal offence. Rather, the SFC launched civil proceedings in the High Court, pursuant to section 213 of the Ordinance. It is important to stress that

these proceedings are civil in nature but the SFC can seek redress on the basis that a relevant provision of the Ordinance has been contravened by a defendant. In this case, the relevant section stated to have been contravened was section 300.

In the High Court (both at first instance and in the Court of Appeal) the defendants lost. One of the defendants did not participate in the appeal hearing before the Court of Appeal. The lower courts found that three of the defendants' conduct amounted to a contravention of section 300 of the Ordinance, while the other defendant had participated in the transaction. All four were ordered to disgorge their profit and pay the SFC' substantial legal costs.

Three of the defendants appealed to the Court of Final Appeal.

Issues

The issues in the appeal were complicated. In essence, the appellants sought to challenge the findings that they had participated in conduct that contravened section 300.

First, the appellants argued that section 300 required that they be "a party" to the transaction, whereas (so the argument went) they had allegedly only participated in aspects of it. Second, they argued that the alleged fraud or deception had to be part of the transaction itself and practised by the defendants on the counterparty – as opposed to their simply being involved in connection with an impugned transaction.

In essence, these appeal points (and related matters) raised technical issues in connection with the wording of section 300, which had not been tested before the courts in Hong Kong.

CFA Judgment

The appeal was unanimously dismissed, although the Court of Final Appeal's judgment is made up of four different judgments between the five judges.

On the first main issue, the court held that properly construed “in a transaction involving securities” meant “in connection with” or “in relation to”. There was no requirement that a defendant be a party to the transaction – it was enough that their fraudulent or deceptive conduct was used in connection with the transaction. Adopting a purposive approach to statutory interpretation and accounting for the legislative history of section 300, “involving” had a wide meaning (as befits a statutory provision designed to protect confidence in the markets).

The court was also dismissive of the appellants’ argument that their purchase and sale of the shares did not fall within section 300 because it would strain the natural meaning of the section if it extended to preparatory steps antecedent to the dealing. As one of the judges noted, it was not clear why this distinction mattered and a “transaction” could include a part of the share dealing or the whole transaction.

The court also considered that the defendants could, in any event, be said to be “parties” to share dealings and their scheme clearly came within section 300.

As regards the second main issue (on whom the fraud needs to be practised), the different judgments of the court reiterated that insider dealing in Hong Kong listed securities (punishable under section 291) and insider dealing in overseas-listed securities (punishable under section 300) are not victimless crimes. They constitute a fraud on the public and “cheating”. Further, the bank (as offeror of the tender for the shares in the Taiwanese company) had been a counterparty and a fraud or deception had been practised on it specifically.

There are other aspects to the judgments. Notably, section 300 is not a “catch all” provision. It catches specific conduct, albeit widely construed. Further, where conduct constitutes insider dealing (in locally listed shares) it should be pursued as such and not under section 300.

Comment

Overall, the judgments are not an easy read. The way the issues were argued was complicated. However, reduced to their basics, the Court of Final Appeal adopted an expansive approach to the interpretation of section 300, taking into account the mischief at which it is directed.

The outcome in the case is no surprise and was widely anticipated. The Court of Final Appeal has not traditionally been sympathetic to technical arguments that seek to get around the plain meaning of words used in a statutory provision that operates in the interest of the public and the integrity of the markets.

The SFC will be delighted with the result. Where a person plays a part in any transaction involving securities or regulated trades, and the disclosure or misuse of inside information occurs in Hong Kong, that person risks a criminal prosecution in Hong Kong or civil proceedings brought by the SFC under section 213, or both. The SFC has a record of using section 213 to good effect to pursue contraventions of the Ordinance. To date, some of those whom the SFC has pursued have had to pay significant compensation and heavy legal costs. On reflection, few such defendants can have thought that their transgressions were worthwhile. The SFC has forged a reputation as the lead market regulator in Hong Kong and its section 213 jurisdiction extends to market misconduct committed in Hong Kong involving transactions on overseas stock exchanges.

It will also not be lost on many that two of the defendants in this case are lawyers. They have been found to have participated in serious misconduct, albeit in the context of civil proceedings. One of the judgments (at paragraph 30) approves of the proposition that a fiduciary who misuses inside information for gain or to avoid loss, dishonestly misappropriates that information which makes the conduct fraudulent. Matters for these two defendants may not stop at the Court of Final Appeal.

The information provided in this article is intended to give general information only. It is not a complete statement of the law. It is not intended to be relied upon or to be a substitute for legal advice in relation to particular circumstances. Specific circumstances require specific advice.

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