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[online version](http://www.charltonslaw.com/sfc-to-step-up-oversight-of-corporate-conduct/)

# Hong Kong Law Update 213

## Introduction

The need for listed companies to make timely and accurate disclosure of price sensitive information under the statutory regime for disclosure of price sensitive (i.e. inside information) under Part XIVA of the Securities and Futures Ordinance is illustrated in a number of recent regulatory enforcement actions. In July 2013 PME Group Ltd was convicted of providing false or misleading information to the Stock Exchange of Hong Kong (the **Stock Exchange**) in breach of section 384 of the Securities and Futures Ordinance (**SFO**) and fined HK$60,000. While the case related to events which occurred before Part XIVA SFO came into force, the same set of facts would likely now found an action under Part XIVA which can result in fines of up to HK$8 million. The company’s director was however acquitted of making false or misleading announcements.

On 12 December 2013, the SFC obtained a court order under section 213 SFO against convicted insider dealer, Mr. Du Jun, to pay HK$23.9 million to 297 counterparties to his insider dealing transactions. Mr. Du Jun had already been sentenced to six years’ imprisonment and fined in connection with the insider dealing. On 20 December 2013, the SFC obtained court orders against Tiger Asia Management LLC and two of its senior officers to pay HK$45,266,610 to investors affected by their insider dealing in shares of two Hong Kong-listed banks. The cases illustrate the willingness of the Securities and Future Commission (**SFC**) to seek compensation for investors under section 213 SFO in market misconduct cases.

Orders under section 213 could also be sought for breach of any provision of the SFO and thus could be sought to compensate investors following a listed company’s breach of the statutory obligation to disclose price sensitive information. Section 213 proceedings are also being used by the SFC to obtain compensation for investors where materially false or misleading information is included in a new listing applicant’s IPO prospectus. Following its success in June 2012 in obtaining an order for Hontex International Holdings Company Limited to repurchase its IPO shares, the SFC is now seeking orders under section 213 that Qunxing Paper Holdings Company Limited’s public shareholders and warrant holders be restored to their positions before entering the transactions.

## 1. PME Group Director Acquitted of Making False or Misleading Announcements

The director of PME Group Ltd (**PME**), Ms Ivy Chan Shui Sheun, was acquitted by the Eastern Magistrates’ Court on 8 November 2013, on three counts of making false or misleading stock exchange announcements.

On 5 July 2013, the SFC commenced criminal proceedings against PME and its director, in relation to allegations that PME had provided false or misleading information to the Stock Exchange in contravention of section 384 of the SFO. It is an offence under section 384 for a person to provide to the Exchange information which is false or misleading in a material particular if the persons knows that, or is reckless as to whether, the information is materially false or misleading. Section 390 SFO further provides that where it is proved that a company has committed an offence under the SFO with the consent or connivance of a director of the company, or that the company’s offence is attributable to the recklessness of a director, the director will be guilty of the same offence. The maximum penalties that can be imposed by the Magistrates Court on conviction under section 384 are two years’ imprisonment and/or a HK$1 million fine.

In response to the Exchange’s enquiries into an increase of approximately 136% in the closing price of PME shares between the 11 and 28 February 2008, PME made three announcements, each confirming that it knew of no negotiations or agreements which were discloseable to the market and that its directors were not aware of any price sensitive matter. The SFC alleged that these announcements were false or misleading as PME was in fact taking steps to gain control of a private entity holding approximately 50% of another company listed on the Exchange with a market value of HK$145 million. The SFC alleged that this was a material acquisition for PME and should have been disclosed in response to the Exchange’s enquiries regarding the movement in the company’s share price.

PME pleaded guilty to the charges and was convicted in August 2013. It was fined HK$60,000 and ordered to pay the SFC’s costs of investigation.

PME’s director, Ms Ivy Chan Shui Sheun, pleaded not guilty to the charges. The magistrate at the Eastern Magistrates Court found that the directors relied on the company secretary to decide whether the acquisition was required to be disclosed. It was found that Ms Chan did not have the necessary criminal intent (i.e. knowledge that, or recklessness as to whether, the information in the announcements was false or misleading as to a material fact) to be guilty of the charges. According to the [SFC’s news release](http://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/enforcement-news/doc?refNo=13PR107) ([see archive](acquittal.pdf)), the SFC is reviewing the court’s decision with a view to lodging an appeal.

The case illustrates the importance of listed companies ensuring that timely and accurate disclosure is made to the market. While this case concerned misleading announcements published in response to Exchange enquiries regarding movements in the share price, facts similar to those in the PME case would probably now also be caught under new Part XIVA SFO. The acquisition of control of another Hong Kong listed company would in many cases constitute “inside information” which a listed company would be required to announce under the new regime as soon as reasonably practicable. Failure to make the announcement could result in a fine of up to HK8 million for the listed company and/or its directors. It is also possible that the SFC could seek an order under section 213 SFO for a listed company which has breached the obligation to disclose price sensitive (i.e. inside information) under section 307B SFO to compensate investors. Breach of the section 307B obligation will occur both where a listed company fails to disclose inside information and where it discloses information which is materially false or misleading and an officer of the company knows, or is reckless or negligent as to whether, the information is materially false or misleading.

## 2. Court Orders Insider Dealers to Compensate Investors under section 213 Securities and Futures Ordinance (SFO)

### Court orders Du Jun to pay HK$23.9 million to investors

On 12 December 2013, former Morgan Stanley Asia Limited managing director, Mr. Du Jun was ordered to pay HK$23.9 million to 297 investors in connection his insider dealing in shares of CITIC Resources Holdings Limited (**CITIC Resources**) in 2007. This was the first time that a court had made a restoration order under section 213 SFO in an insider dealing case.

The SFC commenced the section 213 proceedings in July 2007 and obtained interim orders freezing approximately HK$46 million on grounds that Mr. Du Jun was likely to transfer his assets out of Hong Kong which would frustrate any financial penalty or disgorgement order imposed if he was subsequently found guilty of insider dealing. The court found that it was empowered “to make an order to restrain the disposal of property where it appears to the SFC that a person had breached the provisions of the SFO and would come under a potential financial liability, whether this be the disgorging of profits or a penalty in a disciplinary action”.

The civil proceedings were delayed pending the outcome of parallel criminal proceedings for insider dealing under section 291 SFO. The District Court convicted Du Jun in September 2009 of ten counts of insider dealing and sentenced him to seven years imprisonment and a fine of HK$23,324,117. On appeal, the Court of Appeal upheld all the insider dealing convictions but reduced the term of imprisonment from seven to six years and the amount of the fine to HK$1.688 million. The Court of Appeal reduced the fine on the basis that its effect would be to deprive Du Jun’s trading counterparties of the amounts which might be available to them if the SFC were successful in the proceedings under section 213.[[1]](#footnote-29)

The December 2013 restoration order against Mr. Du Jun brings an end to the section 213 proceedings brought by the SFC. The amount ordered to be repaid was intended to restore Du Jun’s counterparties to the CITIC Resources share transactions to their pre-transaction positions through payment of the difference between the value of the shares on the day of the transaction (taking into account the inside information possessed by Du Jun) and the actual transaction price.

### Tiger Asia Management LLC ordered to pay HK$45,266,610 to investors

The court ordered Tiger Asia Management LLC (**Tiger Asia**), a New York-based asset management company, and two of its senior on 20 December 2013 to pay HK$45,266,610 to investors affected by their insider dealing in the shares of Bank of China Limited and China Construction Bank Corporation (**CCB**). This followed admissions for the purposes of the section 213 proceedings by Tiger Asia and the senior officers involved that they had contravened the insider dealing provisions of the SFO and manipulated the price of CCB shares. These parties have also made the same admissions of insider dealing and manipulation in separate proceedings commenced by the SFC in the Market Misconduct Tribunal (**MMT**). In those proceedings, the SFC is seeking orders prohibiting the parties involved from dealing in securities, futures contracts or leveraged foreign exchange contracts in Hong Kong without leave of the court for up to five years and cease and desist orders (which are orders not to engage in specified form(s) of market misconduct). The SFC is not pursuing criminal charges against the parties involved. This is due to the fact that the parties have already been prosecuted in the United States in respect of the same conduct and that the SFC has been advised that those proceedings would probably be classified as criminal proceedings under Hong Kong law, which would prevent the bringing of criminal proceedings in Hong Kong for the same conduct on the basis of double jeopardy.

The orders granted in the case, as in the Du Jun case, were restoration orders – orders requiring a person to take the steps specified by the court to restore the parties to their pre-transaction position. As in Du Jun, Tiger Asia and the senior officers involved were ordered to pay the counterparties to the insider dealing transactions the difference between the actual price of the transactions and the value of the shares, taking into account the inside information possessed by Tiger Asia, at the time.

### Section 213 SFO and implications

The above cases are indicative of the SFC’s increasing reliance on civil proceedings under section 213 SFO to compensate investors who have suffered loss as a result of market misconduct. In June 2012 court orders sought by the SFC under section 213 were granted ordering Hontex International Holdings Company Limited (**Hontex**) to repurchase its shares from investors who had subscribed for Hontex shares in its initial public offering (**IPO**) or purchased them in the secondary market. Hontex had acknowledged that its IPO prospectus contained materially false or misleading information and that it had contravened section 298 SFO, a market misconduct provision which prohibits the distribution of materially false or misleading information that is likely to induce another to subscribe for or purchase securities, if the person knows or is reckless as to whether the information is false or misleading.

Section 213 SFO allows the SFC to apply to the court for a broad range of remedies or injunctions where there has been a breach of:

* any provision of the SFO;
* the provisions of Parts II and XII of the Companies Ordinance relating to: (i) prospectuses; (ii) a corporation’s purchase of its own shares; and (iii) a corporation giving financial assistance for the acquisition of its own shares; and
* certain provisions of the anti-money laundering and counter-terrorist financing legislation.

The Court of Final Appeal’s decision in the Tiger Asia case affirmed the jurisdiction of the Court of First Instance to make orders under section 213 SFO completely independently of civil proceedings before the Market Misconduct Tribunal or criminal proceedings for market misconduct. Tiger Asia had unsuccessfully challenged the jurisdiction of the Court of First Instance to grant an order under section 213 without there having been a prior criminal conviction for, or MMT finding of, market misconduct. In the absence of a class action regime in Hong Kong, the SFC has shown that it is prepared to use section 213 to obtain compensation for investors, thereby achieving essentially the same remedy as is available in other jurisdictions in securities class actions. In the Tiger Asia case, the Court of Final Appeal stated that in section 213 proceedings, the SFC acts “as protector of the collective interests of the persons dealing in the market who have been injured by market misconduct”.

A wide range of remedies can be imposed under section 213. These include orders restraining or prohibiting the offending conduct, freezing orders prohibiting a person from disposing of certain property and orders appointing an administrator of a person’s property. The court can also order the payment of damages or an order requiring parties to the transaction to be restored to their pre-transaction position. As referred to above, the SFC can seek orders under section 213 not only in relation to market misconduct, but in relation to any breach of the SFO. The SFC could therefore seek remedies under section 213 for investors who suffer loss as a result of a listed corporation’s breach of the statutory obligation to disclose price sensitive information (called “inside information” under the SFO) as soon as is reasonably practicable under section 307B SFO.

As was seen in the Hontex case referred to above, the SFC will also rely on section 213 to obtain compensation for investors where a listed corporation’s IPO prospectus proves to contain statements that are materially false or misleading.

## 3. SFC Commences section 213 Proceedings against Qunxing Paper

The SFC also recently commenced proceedings under section 213 against Qunxing Paper Holdings Company Limited (**Qunxing**) alleging that materially false or misleading information was included in Qunxing’s IPO prospectus for its 2007 listing and the announcements of its annual results for the years 2007 to 2011. The court granted an interim order on 12 December 2013 freezing the total amount of assets raised by Qunxing from the investing public. The SFC is also seeking orders for Qunxing’s public shareholders and warrant holders to be restored to their positions before entering the transactions.

The SFC alleges that Qunxing has breached sections 277 and 298 SFO which are civil and criminal offences, respectively, committed where a person discloses or disseminates information that is materially false or misleading which is likely to induce another person to subscribe for securities and where the person knows that, or is reckless or (for the civil offence under section 277 only) negligent as to whether, the information is materially false or misleading. The SFC also alleges contravention of section 384 of the SFO which prohibits the giving of false or misleading information to the Stock Exchange or the SFC in any filing made under the SFO or Parts II and XII of the Companies Ordinance. Additionally, or alternatively, the SFC alleges breach of section 342F of the Companies Ordinance which imposes criminal liability on a person who “authorizes the issue” of a prospectus containing an untrue statement.

## 4. SFC to Step up Oversight of Corporate Conduct

Talking at a recent dinner, SFC Chairman Carlson Tong said that the SFC is going to be more proactive in overseeing the corporate conduct of listed companies which he said, “will mean more surveillance, analysis and enforcement work on its part and expanding a role it has already been performing under the inside information regime”.[[2]](#footnote-34) To this end the SFC has set up a dedicated corporate regulation team to review company announcements, circulars and reports and monitor press reports and analyst research. The new team will also conduct periodic reviews of companies and will focus particularly on those with a history of losses, frequent corporate restructuring or changes of auditors.

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1. HKSAR and Du Jun, In the High Court of the HKSAR Court of Appeal, Criminal Appeal No. 334 of 2009 at paragraph 167. [↑](#footnote-ref-29)
2. Mr. Carlson Tong’s speech “[Towards better corporate governance](http://www.sfc.hk/web/EN/files/ER/PDF/Speeches/Carlson%2020131212.pdf)” ([see archive](Carlson20131212.pdf)) at the Chamber of Hong Kong Listed Companies 11th anniversary gala dinner. [↑](#footnote-ref-34)