HKSAR v IPFUND Asset Management Limited and Sin Chung Yin DCCC 23/2015

Unofficial Translation: Reasons for verdict

Securities

161. The definition of "securities" was discussed in para 29-40 of the Defence Counsel submission.

The defendant referred to:-

(i) Part 1 of Schedule 1of the Securities and Futures Ordinance (Cap 571);
(ii) S29 of the Companies Ordinance (Cap 622);
(iii) Articles of Association of the shell companies which are used to hold Property Nos. 27-42;
(iv) Butterworths Hong Kong Company Law Handbook (14th edition) Para 95.02 (in Chinese
(v) Para 16 of the case briefs from prosecution;
(vi) Evidence given by PW1 under cross-examination;
(vii) Evidence given by PW2;
(viii) Exhibits P4 and P272;
(ix) Submissions by Perimeter Guidance Manual ("PERG") from Financial Conduct Authority ("FCA"), a relevant department in UK under the Securities and Futures Commission; and
(x) Relevant legal documents from UK (Appendix 9, PERG and extract from 2011 statutory instrument No.1062)

162. Part 1 of Schedule 1 of the Securities and Futures Ordinance referred to by the defendant:-

"securities means- …

(d) interests in any collective investment scheme;

…

but does not include- (i) shares or debentures of a company that is a private company within the meaning of s11 of the Companies Ordinance (Cap 622)"

According to s11 of the Companies Ordinance which is mentioned in Part 1 Schedule 1 of the Securities and Futures Ordinance, a company is a private company if:

"(a) its articles—

(i) restrict a member's right to transfer shares;

(ii) limit the number of members to 50; and Cap 622 - Companies Ordinance 8

(iii) prohibit any invitation to the public to subscribe for any shares or debentures of the company; and

(b) it is not a company limited by guarantee."

163. I considered the Articles of Association of shell companies which were used to hold Property Nos. 27-42 in Appendix 7. The Articles of Association of each shell company is as follows:-

*"**PRIVATE COMPANY***

3. The company shall be a private company and accordingly the following provisions shall have effect:-

(a) The number of Members for the time being of the Company (exclusive of persons who are in the employment of the Company, and of persons, who having been formerly in the employment of the Company were, while in such employment and having continued after the determination of such employment to be, Members of the Company) is not to exceed fifty, but where two or more persons hold one or more shares in the Company jointly, they shall, for the purposes of this paragraph, be treated as a single Member.

(b) Any invitation to the public to subscribe for any shares or debentures or debentures stock of the Company is hereby prohibited.

(c) The right of transfer of shares shall be restricted as hereinafter provided.

(d) The Company shall not have power to issue warrants to bearer."

164. Para 112.02 of *Butterworths Hong Kong Company Law Handbook* (18th edition) stipulates the following in relation to how to calculate the number of members of a company:-

"Upon the registration of the company, the founder members must be entered as members of the company's register of members. Subsequently, every other person who agrees to become a member and whose name is entered on the register of members will be a member: s 112(2). This provision applies to all types of companies. (Re New Smart Energy [2012]1 HKLRD 506, [2012] HKCU 2571). Until the company has registered a person as the new member of shares, that person will not be treated as a member. (CNT Resources Ltd v Lam (unreported, CACV 128/1985, 9 August 1985) (CA). So the beneficial owner of shares held in the name of a nominee is not a member."

165. From the above extract, we can see that even if the number of investors who participated in the property investment scheme in which the property is held by a shell company is more than 50, only investors whose names appear on the register of members would be treated as a member. Beneficial owners who enjoy shareholdings in the property as a nominee would not be treated as members of the company.

166. After considering the abovementioned documents, I agree with the Defence Counsel that the shell companies which were used to hold Property Nos. 27-42 were private companies under Part 1 of Schedule 1 of the Securities and Futures Ordinance and s11 of the Companies Ordinance.

167. From evidence given by PW1 and PW2 in para 33 of the Defence Counsel submission, it can be observed that:-

(a) Although not all investors signed the shareholders' agreement and declaration of trust, the shares of the shell companies were assigned to them according to their percentage interest;

(b) The original intent of the property investment scheme was to draft and sign a shareholder's agreement and declaration of trust for every shell company, but the investors would only sign the shareholder's agreement and declaration of trust for those properties which failed to complete a "confirmor sale", as the investors could expect those properties to be held for a longer period;

(c) Shareholder's agreements and declarations of trust were drafted for all properties which failed to achieve a confirmor sale, although not all investors signed the documents before the sale of the relevant property;

(d) Investors were asked to sign the shareholder's agreement and declaration of trust. D2 would hold the shares on behalf of the investors if they failed to sign the documents (see exhibit P272- an email sent by PW1 in the name of IPFUND to an investor, Lewis Fung. In the email, PW1 invited Fung to go to the office of IPFUND to sign the shareholder's agreement and declaration of trust. PW1 said "If you fail to sign the documents by the designated time, Dr. Ronald Sin will hold the shares on your behalf and no official documents regarding the above investment may be issued to you"); and

(e) In a letter sent by IPFUND to the Companies Registry, dated 23rd May 2012, which was signed by D2 (exhibit P4), IPFUND stated that "From 17 November 2010 until now, this company has provided administrative and consultancy services and managed a series of limited companies in Hong Kong and used them as vehicles to hold landed properties for trading. After it acquires the landed properties we would invite relatives and friends, including myself, to subscribe the shares of the vehicle company. If the properties can be sold, the profits will be shared among us."

168. Para 16 of the case brief of the opening statement from the prosecution described the reasons why the prosecution believed the property investment scheme (Property Nos. 27-42) was a collective investment scheme:-

"16. The prosecution pointed out that each of the 16 IPFUND property investment schemes constitutes a collective investment scheme under Part 1 of Schedule 1 of the Securities and Futures Ordinance (Cap 571) ("the Ordinance"). Interests in a "collective investment scheme" constitute "securities" as defined under the Ordinance. IPFUND's business operation during the relevant period constituted "dealing in securities" (i.e. Type 1 regulated activity under Part 1 of

Schedule 5 of the Ordinance). (See Appendix B for the Prosecution's interpretation of the Ordinance).

169. As aforementioned, the shell companies which were used to hold Property Nos. 27-42 were all private companies according to Part 1 of Schedule 1 of the Securities and Futures Ordinance and s11 of the Companies Ordinance.

170. The Prosecution said that the "regulated activity" carried out by IPFUND was "dealing in securities". In para 51 of Appendix B, the prosecution stated that when investors paid money or participated in the investment operated by IPFUND, IPFUND would allow investors to acquire an interest in the property investment scheme after signing an agreement with the investors. The entering into of this agreement constituted dealing in securities. The prosecution's position is unchanged.

171. The interest referred to by the prosecution in para 51 of Appendix B must refer to the interest enjoyed by investors by virtue of their shareholdings in the shell companies, i.e. shares of the shell companies, irrespective of whether the investors were:

(i) registered on the register of members and held the shares as members of the company; or

(ii) held the shareholding as nominees.

172. The definition of "securities" in Part 1 of Schedule 1 of the Securities and Futures Ordinance clearly stated that securities refers to interests in any collective investment scheme <u>but does not include</u> shares of a private company.

173. Thus, if (i) the shell companies which held the 16 property investments were all private companies; and (ii) the interests acquired by investors in the property investment scheme were all shares of the shell companies; the investment scheme operated by IPFUND would not constitute "dealing in securities" and thus would not amount to a "regulated activity" within s114(1)(a) of the Ordinance.

174. I agree with the analysis in relation to the need to exempt private companies from constituting collective investment schemes under para 35-59 of defendant's submission. I agree that if there is no exemption in relation to a "private company", every private company which holds a property would constitute a collective investment scheme. Dealing in the shares of such a private company would constitute an offence under s114 of the Ordinance. This could not be the legislative intent and objective of the Ordinance. I think the private company exemption in Part 1 of Schedule 1 of the Ordinance is already very clear. It is not necessary to look into the descriptions in Perimeter Guidance Manual ("PERG") by the Financial Conduct Authority ("**FCA**") or compare with relevant statutory instruments in UK.

Dealing in securities

175. In paras 41-49 of the Defence Counsel submission "F. Dealing in securities", it stated that (i) the prosecution failed to prove that IPFUND carried out dealing in securities and; (ii) D2 can rely on the exemption as "principal". It submitted that the "principal" exemption applies to IPFUND in paras 96-99.

176. As I ruled that the shell companies holding the 16 property investment schemes were all private companies and the interest acquired by the investors in the investment scheme was actually shares of the shell companies, the investment schemes operated by IPFUND did not amount to "dealing in securities". Thus, it is not necessary for me to consider the arguments in "F. Dealing in securities" in the defendant's submission. However, I will consider the relevant submission for the sake of completeness.

(i) Whether IPFUND carried out dealing in securities

177. I have to put aside the above ruling in relation to "exemption to private company" and "securities" when handling the discussion in paras 41-54 of the Defence Counsel submission.

178. Part 2 of Schedule 5 of the Securities and Futures Ordinance:-

"dealing in securities, in relation to a person, means making or offering to make an agreement with another person, or inducing or attempting to induce another person to enter into or to offer to enter into an agreement-

(a) for or with a view to acquiring, disposing of, subscribing for or underwriting securities; or

(b) the purpose or pretended purpose of which is to secure a profit to any of the parties from the yield of securities or by reference to fluctuations in the value of securities"

179. I agree with para 42 of the Defence Counsel submission that the operation of a collective investment scheme itself is not a regulated activity. "Dealing in securities" is a regulated activity and the meaning of "securities" under the Ordinance includes interests in a collective investment scheme.

180. I would adopt the above analysis in the "carrying a business" section. As aforementioned, I think the evidence clearly shows that IPFUND was involved in investment in the relevant time.

181. In relation to whether IPFUND reached an agreement with investors in relation to the interests acquired by them, I think "the reason that investors decided to participate in the investment scheme before IPFUND came into existence was because D2 was in charge of the scheme" is not relevant to the issue. This also applies to the similes related to the Chinese restaurant and tuition centre from the "whose business" section. I think the fact that investors paid for the investment as required and agreed to sacrifice 5% of the profit as administrative costs indicated that IPFUND reached an agreement with the investors in relation to their acquisition of interests through participation in the investment scheme. PW1's evidence given that she needed to obtain the defendant's consent before participating in the investment is even more irrelevant to the issue of whether or not there was an agreement between IPFUND and the

investors as the evidence in the present case clearly shows that D2 is the only decision-maker, shareholder and director of IPFUND.

182. In para 50 of the Defence Counsel submission, it is stated that "The prosecution has to prove two further crucial elements:

(1) the existence of a collective investment scheme; and

(2) the activities carried out constitute dealing in securities. Both elements require 2 of the abovementioned activities to be carried out in business."

183. In relation to the issue of "(1) the existence of a collective investment scheme", the definition of a collective investment scheme is:-

"(a) arrangements in respect of any property-

(i) under which the participating persons do not have day-to-day control over the management of the property, whether or not they have the right to be consulted or to give directions in respect of such management;

(ii) under which-

(A) the property is managed as a whole by or on behalf of the person operating the arrangements;

(B) the contributions of the participating persons and the profits or income from which payments are made to them are pooled; or

(C) the property is managed as a whole by or on behalf of the person operating the arrangements, and the contributions of the participating persons and the profits or income from which payments are made to them are pooled; and

(iii) the purpose or effect, or pretended purpose or effect, of which is to enable the participating persons, whether by acquiring any right, interest, title or benefit in the property or any part of the property or otherwise, to participate in or receive-

(A) profits, income or other returns represented to arise or to be likely to arise from the acquisition, holding, management or disposal of the property or any part of the property, or sums represented to be paid or to be likely to be paid out of any such profits, income or other returns; or

(B) a payment or other returns arising from the acquisition, holding or disposal of, the exercise of any right in, the redemption of, or the expiry of, any right, interest, title or benefit in the property or any part of the property; or…

but does not include-

(i) arrangements operated by a person otherwise than by way of business; …"

(Part 1 of Schedule 1 of the Securities and Futures Ordinance)

184. For this issue, I agree with the analysis in para 50 of the Prosecution's submission. Considering all the evidence of the case, all the 16 property investment schemes fulfill the requirements of collective investment schemes according to Part 1 Schedule 1 of the Securities and Futures Ordinance. I therefore rule that collective investment schemes exist at the relevant time.

185. The 16 property investment schemes are all arrangements related to property interests.

186. The investors did not have day-to-day control over the properties involved in the investment schemes.

187. IPFUND managed investors' interests in the properties through D2, PW1 and PW2. Investors' payments and the profits distributed to them were pooled.

188. The purpose of all the arrangements relating to the property investment scheme was to allow the investors to share the profits or returns generated from purchasing, holding, leasing, managing and/or selling the properties.

189. All the arrangements related to the property investment scheme were operated as a business.

190. Paras 16-28 of the Defence Counsel's closing statement states that the Prosecution failed to prove that IPFUND operated the investment scheme through the carrying on of a business.

191. Based on my above analysis of the issue of "carrying on a business", I think the evidence clearly indicates that IPFUND operated the 16 collective investment schemes (Property Nos. 27-42) by way of carrying on a business.

192. As abovementioned, I am of the view that the "exemption for private companies" applies to the shell companies holding the 16 property investments. Thus, investors' shareholdings in the shell companies did not constitute an interest in a collective investment scheme. They were also not "securities". Hence, the acquisition, disposition, underwriting and reaching agreement in relation to the shell companies did not constitute "dealing in securities".

193. Putting aside the conclusion that the 16 investment schemes did not amount to "dealing in securities", I would now like to deal with the issue of whether "dealing in securities" was carried on as a business.

194. I think "using shell companies to purchase properties, and then sharing the profits among investors in accordance with their percentage shareholding of the shell companies, for which IPFUND charges 5% as its administrative cost" is the core activity of the 16 property investment schemes run by IPFUND. Investors were looking for a return on investment. The purpose of IPFUND running the collective investment scheme was also to generate profit. Some of the

examples in the present case such as whether D2 chose not to charge administrative cost/charge a lower rate of administrative cost were clearly business decisions made by him for IPFUND.

In each of the investment schemes, investors would obtain a certain percentage shareholding in a shell company according to the amount invested. The arrangement did not occur irregularly or intermittently.

According to the declaration on the application form for business registration (exhibit P3), the business nature of IPFUND was "Asset Management". During cross-examination, D2 said "Asset Management" meant managing the property investment schemes. There were 16 property investment schemes involved in the present case. The above evidence showed that the property investment schemes were businesses of IPFUND. An important part of managing the property investment scheme was to arrange for a percentage of shell company shares to be acquired by the investors according to the amount they invested. The number of investment schemes and their continuing nature both indicate that "dealing in securities" was carried on in as a business.

195. Defence Counsel submitted that IPFUND did not reach any agreement with the investors. On the website of IPFUND, which is still in the process of being set up (exhibit 31), there was a description of IPFUND and its investors, which stated "IP FUND Asset Management Limited, a leading property investment consultancy service company. We provide individuals and corporate customers with a diverse range of investment packages".

IPFUND clearly views investors as their clients. There was clearly a contractual relationship between IPFUND and its clients. According to exhibit P31, the relevant agreements relate to the arrangement for investors' participation in the investment, i.e. the "investment package" referred to in exhibit P31.

196. As I indicated above, the fact that investors paid money and agreed to sacrifice 5% of the profit as administrative costs of IPFUND indicated that IPDUND and the investors had reached an agreement in relation to the investors' interests.

197. The fact that investment talks were hosted by D2, the only director and shareholder of IPFUND, and that he decided who could attend the talks, were irrelevant to the issue of whether "dealing in securities" was carried out as a business.

198. It is meaningless to compare the charging of administrative costs by IPFUND with the normal charging of transaction fees by securities brokers.

(iii) IPFUND and D2 acting as principal?

199. In para55-59 and 96-99 of the defendant's submission, it pointed out that both IPFUND and D2 were disposing of the securities as principal, according to the exemption in the definition of "dealing in securities" in the Ordinance:-

"except where the person-

(v) as principal-

(A) …; or

(B) … disposes of… securities"

200. For the prosecution's response, please refer to the prosecution's further submission at paras 20-22.

In relation to this issue, I have considered the evidence and submissions from both sides.

201. I agree with the Prosecution's analysis and distinguishing *Tullet & Tolyo International Securities Ltd v APC Securities Co. Ltd* [2001] 2 HKLRD 356. In *Tullet,* Tullet purchased bills in his own name in the hope of selling them at a profit: in the present case, property was also purchased with the aim of on-selling it at a profit. However, the provisional deposits were paid by D2 because he was the only director and decision-maker of IPFUND and IPFUND was the legal person responsible for the management of the property investment. The only purpose of the shell companies was to hold the purchased properties. Once the properties were sold, the registration of the shell companies would be cancelled. Moreover, D2 was not necessarily the shareholder/director of all shell companies. Taking into account these considerations, D2 was obviously not signing the provisional sale and purchase agreements and paying the provisional deposits as principal.

202. I believe D2 was acting as the agent of the investors participating in the property investment scheme when he represented the shell companies in signing the provisional sale and purchase agreements and paying the deposits. With respect to the payments of deposits by D2, there was a common understanding that D2 would be remunerated in full for the amount he paid later on. I think this is a significant distinction from the facts in *Tullet.*

203. Moreover, *Tullet* would be personally liable for the purchase of the bills while D2 and IPFUND would not be personally liable for the purchase of the properties. Only the shell companies used for holding the properties would be liable. I think these circumstances also clearly distinguished the present case from *Tullet*.

204. I do not agree with Defence Counsel's submission that IPFUND and D2 disposed of the securities as principal.

205. I agree with para 22 of the submission from the prosecution that the Securities and Futures Ordinance clearly stipulates that if an offence committed by a corporation is attributable to any recklessness on the part of any officer of the corporation, the officer will also be convicted of an offence. I also agree with the prosecution that although in the case of *HKSAR v Chu Wai Sun and others* [2008] 4 HKLRD 18, which is referred to by the defendant, the Court of Appeal held that "recklessness" did not constitute criminal liability in the same way as aiding and abetting, it is not relevant in considering the criminal liability of D2.

Criminal liability of D2

206. The criminal liability of D2 depends on whether IPFUND is convicted of charges 1 and 2: if IPFUND is acquitted of both charges, D2 must also be acquitted of charges 3 and 4.

Ruling

207. Based on the above interpretations and reasoning in relation to (i) "exemption for private companies"; (ii) "securities"; (iii) "dealing in securities"; and (iv) "regulated activities", I rule that:-

208. D1 is acquitted of charges 1 and 2.

209. D2's criminal liability must be founded IPFUND's conviction of charges 1 and 2; as D1 is acquitted of both charges, D2 is acquitted of charges 3 and 4.

Important

The above is an unofficial translation only of the Chinese version of the Reasons for Verdict which is available at http://legalref.judiciary.gov.hk/lrs/common/search/search_result_detail_frame.jsp?DIS=103729&QS=%2B&TP=RV. In the case of any inconsistency between the Chinese and English language versions, the Chinese version will prevail.