

Hong Kong Court of Appeal Expands SFC Powers to Seek Remedies for Insider Trading

March 13, 2012

In what is being seen as a landmark decision, the Hong Kong Court of Appeal has allowed an appeal by the Hong Kong Securities and Futures Commission (SFC) from the decision of a lower court that will permit the SFC to proceed to seek final remedial court orders imposing sanctions as a free standing remedy against Tiger Asia, a New York-based fund manager that has no presence in Hong Kong.

The SFC alleged that in January, 2009, Tiger Asia, a hedge fund based in New York, was invited by a placing agent, before the market opened, to participate in a proposed placement of shares in China Construction Bank (which is listed on the HKSE). Tiger Asia agreed to be "wall crossed," so that it could receive access to information provided by the placing agent that was confidential and price sensitive. Tiger Asia participated in the placing, and on the same day sold short the underlying stock before release of the issuer's public announcement of the placing. The following day Tiger Asia covered its short position out of the placement shares that it had purchased at a discount to the market price, yielding it a substantial profit.

The SFC alleged that these activities amounted to insider dealing and downward manipulation of the issuer's share price at the time of the short sales.

Further allegations of the same nature were later added by the SFC against Tiger Asia concerning share placements in Bank of China Limited that occurred at about the same time as the first placement, for which it also agreed to be "wall crossed." Tiger Asia has denied the allegations.

The SFC sought orders under the Hong Kong Securities and Futures Ordinance (SFO) to unwind the transactions entered into by Tiger Asia and to restore affected counterparties to their pre-transaction positions. The orders sought also included a freezing order against assets to ensure there were sufficient assets to satisfy any restoration orders that might be made by the court, and to prevent Tiger Asia and its senior officers from trading in listed securities and derivatives in Hong Kong in similar circumstances. This would be the first occasion that the SFC has sought a court order to exclude an entity from trading in the Hong Kong market.

The SFC argued that its exercise of these remedial powers should not be dependent on there being a pre-existing determination or finding of a contravention of Hong Kong's insider dealing and market manipulation laws by a criminal court or, in a civil context, by the Market Misconduct Tribunal (MMT). The provision of the SFO that the SFC sought to rely upon provides that where a person has contravened any relevant provision of the SFO, the Court has power to make orders that include an order to restore the parties to any transaction to the position in which they were before the transaction was entered into, and to declare a securities contract void.

As Tiger Asia and three of its senior officers who are alleged to have committed the offences are not in Hong Kong, a criminal prosecution may not be possible. Separately, a civil action before the MMT is likely to be a very lengthy process. However, the Court of Appeal accepted the SFC's arguments permitting the SFC to pursue a third route (i.e., separate from criminal or civil proceedings for insider dealing and other market misconduct offences) concerning conduct that the SFC alleges is market misconduct.

In giving its judgment, the court commented that the SFC's powers in the SFO to apply to the court for remedial orders provided "much needed ammunition to the [SFC] to protect investors. I do not agree that it is reasonable or desirable that investor protection under [the SFO] should come at the price of forgoing criminal prosecution." The SFC would still be required to show to the Court that Tiger Asia had contravened particular provisions of the SFO.

However, it can now do so as part of the proceedings for any remedial court orders sought, rather than having to wait for a determination in separate proceedings before a criminal court or the MMT before being able to seek such orders. The SFC has said that its case against Tiger Asia will proceed, and it is expected that it will seek freezing orders against assets.

Ramifications of Court's Decision

The ramifications of the court's decision are significant for any fund manager who trades in securities on the HKSE, wherever the fund manager may be located, as it dramatically broadens the SFC's powers. It raises the specter that a fund manager accused by the SFC of insider dealing or other market misconduct, albeit denied by the fund manager, could find itself the subject of remedial court orders despite there being no prior separate determination or finding by a criminal court or the MMT that such contravention had indeed occurred. It also means that the SFC can move much faster to obtain these types of orders. It is expected that the SFC will not be slow to make full use of these powers in the future.

This ruling is also notable given other recent and highly visible insider trading enforcement actions in the United States, the United Kingdom and other jurisdictions. In the UK, in a very similar recent case, the FSA imposed fines totaling approximately £7.1 million on David Einhorn and his hedge fund management company, Greenlight Capital Inc., for breaching insider dealing laws. The FSA alleged that Mr Einhorn had reduced his funds' holdings in Punch Taverns PLC from 13.3% to 8.98% after learning in a telephone call among a number of individuals, including the CEO of Punch Taverns, that Punch Taverns was at an advanced stage of the process towards the issuance of a significant amount of new equity. Immediately following the call, Mr Einhorn directed Greenlight traders to sell 11.65 million shares in Punch Taverns. The Punch Taverns equity issue was subsequently announced and the price of Punch Tavern's shares fell by 29.9%, meaning that a loss of £5.8 million was avoided by the Greenlight funds.