



Hong Kong Law

December 2014

SFC STARTS MARKET MISCONDUCT PROCEEDINGS OVER ALLEGED FALSE RESEARCH REPORT

The Securities and Futures Commission (**SFC**) has commenced proceedings against Mr. Andrew Left, a US citizen and head of Citron Research, for potential market misconduct involved in the publication of a research report in June 2012 alleging that Hong Kong-listed Mainland property developer, Evergrande Real Estate Group Limited (**Evergrande**), was insolvent and had consistently disclosed fraudulent information to the investing public.

Citron Research is a US-based publisher of research reports on listed companies. On 21st June, 2012, Left published a report on Citron Research's website¹ which contained negative information about Evergrande including the claims that it was insolvent and had consistently made fraudulent representations to its investors. This information was false.

Turnover of Evergrande stock was exceptionally high on 21st June. The share price reached a high of HK\$4.52 in the morning, but plunged to HK\$3.6, a 19.6% fall from the previous day's close, after release of the Citron report and finally closed at HK\$3.97 (a drop of 11.4% from the previous day's close).

According to the SFC, Left short sold 4.1 million Evergrande shares shortly before the report's release, which he then bought back making a notional profit of more than HK\$2.8 million, which amounted to approximately HK\$1.7 million in realised profit.

The SFC's notice to the Market Misconduct Tribunal² alleges that in publishing false information in relation to Evergrande, Left committed the civil market misconduct offence of disclosure of false or misleading information inducing transactions under section 277(1) of the Securities and Futures Ordinance (SFO). Section 277(1) makes it an offence (among others) to disclose or disseminate (or authorise or be concerned in the disclosure or dissemination of) information that is likely to induce others to buy or sell Hong Kong listed securities where:

- the information is false or misleading as to a material fact (or through the omission of a material fact); and
- the maker of the statement knows that the information is false or misleading, or is reckless or negligent as to whether the information is false or misleading.

Market Misconduct Tribunal Proceedings

The purpose of market misconduct proceedings before the Market Misconduct Tribunal is to determine:

- a) whether any market misconduct has taken place;
- b) the identity of every person involved in the market misconduct; and
- c) the amount of any profit gained or loss avoided as a result of the market misconduct.

¹ Citron Research www.citronresearch.com

² Issued on 15th December 2014

The MMT makes its findings on the civil standard of proof and thus needs to be satisfied on the balance of probabilities that a person has engaged in market misconduct.

At the end of any proceedings, the MMT may under Section 257(1) SFO impose the following sanctions on any person found to have committed market misconduct:

- a) *a disqualification order* – that a person shall not, without the leave of the Court of First Instance, be or continue to be a director, liquidator, or receiver or manager of the property or business, of a listed corporation or any other specified corporation or in any way, whether directly or indirectly, be concerned or take part in the management of a listed corporation or other specified corporation for up to 5 years;
- b) *a cold shoulder order* – that a person shall not, without the leave of the Court of First Instance, in Hong Kong, directly or indirectly, deal in any securities, futures contract or leveraged foreign exchange contract, or an interest in any of them or a collective investment scheme for up to 5 years;
- c) *a cease and desist order* – that the person must not again engage in any specified form of market misconduct;
- d) *a disgorgement order* – that the person pay to the Government an amount up to the amount of any profit gained or loss avoided as a result of the market misconduct;
- e) *Government costs order* – that the person pay to the Government its costs and expenses in relation to the proceedings and any investigation;
- f) *SFC costs order* – that the person pay the SFC's costs and expenses in relation to any investigation; and
- g) *disciplinary referral order* – that any body which may take disciplinary action against the person as one of its members be recommended to take such action against him.

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