



Hong Kong

April 2015

COURT OF FINAL APPEAL RULING: PACIFIC SUN ADVISORS AND ITS DIRECTOR ACQUITTED OF SFO OFFENCE RE. UNAUTHORISED ISSUE OF FUND ADVERTISEMENTS

On 20 March, 2015, the Hong Kong Court of Final Appeal (the **CFA**) ruled¹ in favour of Pacific Sun Advisors Limited (**Pacific Sun**) and its director and CEO, Mr. Andrew Mantel. The CFA affirmed the Magistrates' Court's original 2013 verdict acquitting Pacific Sun and Mr. Mantel of the offence of issuing unauthorised advertisements to the public to acquire interests in a fund, which had been overturned by the Court of First Instance (**CFI**) on appeal by the SFC.

The CFA's ruling hinged on the proper interpretation of the exemption under section 103(3)(k) SFO for certain investment products, including funds (i.e. collective investment schemes), "that are or are intended to be disposed of only to professional investors" from the prohibition on issuing unauthorised advertisements or invitations to the public to subscribe for investment products under Section 103(1) of the Securities and Futures Ordinance (the **SFO**). The CFA held that Pacific Sun and Mr. Mantel could rely on the exemption as they could demonstrate that the fund was intended to be offered only to professional investors notwithstanding that the advertisements did not state that only professional investors were eligible to invest in the fund. The CFA rejected the CFI's findings that:

- the exemption under section 103(3)(k) applies only where it can be seen from the advertisement or invitation that the investment products are available only to professional investors; and
- Pacific Sun's screening of investors to ensure that all investors in the fund were professional investors was irrelevant in determining whether the exemption applied.

The SFC's press release² published following the CFA ruling noted its effect of allowing advertisements for CIS that may not be suitable for retail investors to be issued to the general public, notwithstanding that the CIS will only be sold to professional investors. The SFC is considering the decision to determine whether section 103 SFO requires amendment.

Background

Pacific Sun and its Chief Executive Officer, Mr. Mantel, are licensed by the SFC to conduct Type 4 (advising on securities) and Type 9 (asset management) regulated activities.

In November 2011, Pacific Sun sent e-mails and published documents on its website announcing the launch of a fund, the Pacific Sun Greater China Equities Fund (the **Fund**), a collective investment scheme (**CIS**). Both sides agreed

¹ Judgment of the Court of Final Appeal in Final Appeal No. 11 of 2014 (Criminal) between the Securities and Futures Commission and Pacific Sun Advisors Ltd. and Andrew Pieter Mantel which is available at http://legalref.judiciary.gov.hk/lrs/common/search/search_result_detail_frame.jsp?DIS=97598&QS=%2B&TP=JU.

² Securities and Futures Commission. "Court of Final Appeal allows appeal of Pacific Sun Advisors Limited and its director". 20 March 2015. Available at: <http://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=15PR26>.

that these documents constituted advertisements for a CIS issued to the public for which SFC authorisation had not been obtained. The CIS was intended to be available only to professional investors, but this was not expressly stated in the advertisements. The SFC charged Pacific Sun and Mr. Mantel with the offence of issuing unauthorised advertisements under section 103(1), which, inter alia, prohibits the issue of invitations or advertisements to the public to invest in a CIS without SFC authorisation.

Magistrate's Decision in favour of Pacific Sun

The Magistrate acquitted Pacific Sun and Mr. Mantel on two bases:

1. First, based on the disclaimers included in the advertisements and Pacific Sun's screening procedures to ensure that the Fund was made available only to professional investors, the Magistrate held that he could not conclude beyond reasonable doubt that the advertisement contained an invitation to the public to invest in the Fund. Instead, he found that it constituted an invitation to the public to seek further information if required.
2. Secondly, the Magistrate found that the Fund was or was intended to be available solely to professional investors and was not one for investment by the general public, so that the exemption in section 103(3)(k) applied. Pacific Sun could rely on the section 103(3)(k) exemption by demonstrating its intention to dispose of the investment only to professional investors; this intention did not need to be stated expressly in the advertisement.

The SFC's Appeal to the Court of First Instance

On appeal by the SFC, the CFI overturned the Magistrate's verdict, ruling that the Magistrate had erred in respect of both bases on which he had acquitted Pacific Sun and Mr. Mantel. The CFI held that the section 103(3)(k) exemption applies only if it can be seen from the advertisement itself that it is confined to professional investors and that Pacific Sun's screening process to ensure that all investors in the CIS were professional investors was irrelevant. The case was remitted to the Magistrates' Court, which then convicted Pacific Sun and Mr. Mantel of the section 103(1) offence. Pacific Sun was fined HK\$20,000 and Mr. Mantel was sentenced to two concurrent terms of four weeks' imprisonment suspended for twelve months.

Pacific Sun's Appeal to the CFA

The case was subsequently heard by the CFA, which overturned the CFI's decision in favour of Pacific Sun and Mr. Mantel. The only issue was whether or not the exemption under section 103(3)(k) applied. The parties' arguments were as follows:

- The SFC argued that for the exemption to apply, the advertisement had to state expressly that the investment product is or is intended to be disposed of only to professional investors. Its counsel contended that any other construction would defeat the statutory purpose and would be inimical to the protection of the investing public intended by the statutory scheme.
- Pacific Sun and Mr. Mantel argued that the exemption applies if, as a matter of fact, the relevant investment product is or is intended to be sold only to professional investors. It was submitted that the burden of proving this is on the person issuing or possessing the advertisement, and this could be achieved for example by proving the existence of a screening process to exclude persons who are not professional investors.

The CFA interpreted section 103(3)(k) according to its natural meaning, contextual meaning and purposive meaning.

Natural and Ordinary Meaning of Section 103(3)(k)

Section 103(3)(k) provides that the exemption applies to the issue or possession for the purposes of issue:

"...of any advertisement, invitation or document made in respect of securities or structured products, or interests in any collective investment scheme, that are or are intended to be disposed of only to professional investors."

The CFA found that, as a matter of grammar, the exemption applies to an advertisement relating to investment products that are or are intended to be disposed of only to professional investors. The use of the plural form ("...that are or are intended to be disposed of only to professional investors...") means that it is the "securities or structured products, or interests in any collective investment scheme" which must be intended to be disposed of to professionals, and not the "advertisement, invitation or document", which would require the use of the singular (and thus read "and is or is intended to be disposed of ...")

Contextual Construction

The CFA also found that, within section 103 and elsewhere in the SFO, where an express statement is required to be contained in a relevant advertisement, invitation or document in order for an exemption to apply, this is stated expressly and unambiguously. It gave the example of section 103(2)(ga) SFO which exempts any advertisement relating to an offer specified in the Seventeenth Schedule to the Companies (Winding Up and Miscellaneous Provisions) Ordinance. Certain offers included in that Schedule (such as the exemption for offers to no more than 50 persons) are subject to a requirement that they include the warning statement set out in Part 3 of the Eighteenth Schedule to the ordinance. In contrast, there is no requirement under section 103(3)(k) for any particular express statement to be included in an advertisement for the exemption to apply. The CFA thus concluded that an advertisement does not need to state expressly that the investment product is offered only to professional investors in order for section 103(3)(k) to apply.

Purposive Construction

The CFA considered the purpose of section 103(1) of the SFO to be the regulation of advertisements inviting the investing public to acquire investments. The SFC had argued that the purpose of the section was to protect the investing public from exposure to unauthorised investment advertisements and that protection was required at the point of issue of the advertisement, as distinct from and prior to any actual sale activity. It thus submitted that criminal liability under section 103(1) attaches at the time the advertisement is issued and it is irrelevant whether any investment is in fact sold subsequent to the issue of the advertisement.

However, the CFA found that the general public does not need protection if the investments are not in fact sold or intended to be sold to them, and are instead sold or intended to be sold only to professionals. The SFC had accepted that the purpose of the section 103(3)(k) exemption was that professional investors, unlike the general investing public, do not require statutory protection under section 103(1). The CFA found that, at worst, a retail investor might have his interest piqued and be inconvenienced into contacting Pacific Sun, only to find that he cannot invest in the advertised CIS. However, the purpose of section 103(3)(k) is not to protect the public from that inconvenience. The CFA further pointed to the weakness of the SFC's argument that, as the SFC had accepted, the exemption cannot be claimed merely because an advertisement states that an investment product is intended only for professional investors. The application of section 103(3)(k) depends upon

the substance of the investment being advertised and the person claiming the benefit of the exemption must demonstrate that the investment is in fact intended only for professional investors.

The CFA ruling criticised the CFI's judgment, stating that the judge appeared to have simply accepted the respondent's construction of section 103(3)(k) on the basis that retail investors require protection against having their investment appetites whetted or in wasting their time pursuing an interest in investing only to be told that they are not eligible to invest. The CFA found that the CFI judge "seems to have accepted the respondent's [SFC] construction for prosecutorial ease and convenience" and described this as a clear example of the vice referred to by Lord Millett "*of a court distorting or ignoring the plain meaning of the text of a statute in order to achieve a perceived desirable result*".

The SFC has tried to revoke Mr. Mantel's licence on two previous occasions, only for it to be re-instated on appeal on both occasions. On the second occasion, the Securities and Futures Appeal Tribunal found that full licence revocation was an excessively severe penalty in the circumstances and instead ordered that Pacific Sun and Mr. Mantel should have their licences suspended for one month and each pay a fine of HK\$50,000.

Implications of the CFA Ruling

As acknowledged by the SFC, the acquittal of Pacific Sun and its CEO suggests that it is currently possible to advertise a fund which is not suitable for retail participation to the public, notwithstanding that only professional investors are in fact eligible to invest in it. The SFC has stated that it is considering whether section 103 of the SFO should be amended so that this is not allowed. Notwithstanding the CFA ruling, the prudent course is to include a statement that the advertised investment product may only be acquired by professional investors in invitations, advertisements and other documents relating to investment products that are in fact intended to be available only to professional investors.

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