



Hong Kong

April 2016

INSIDER DEALING IN FOREIGN SECURITIES: HIGH COURT INTERPRETS SECTION 300 SFO IN LANDMARK CASE

In a landmark decision, the Court of First Instance has confirmed that insiders, as defined in the Securities & Futures Ordinance (**SFO**), Cap. 571, may be liable under Section 300 of the SFO for dealings involving non-Hong Kong listed securities.

The case *Securities and Futures Commission v Young Bik Fung* [2016] HKEC 107 English Judgment was decided on 15 January 2016. Two lawyers were found guilty of illegally profiting from inside knowledge.

The decision paves the way for the SFC to use section 300 of the SFO to pursue insider dealing cases involving securities listed on foreign markets. Proceedings for insider dealing under Section 270 or 291 can only be brought in respect of insider dealing in shares listed on the Hong Kong Stock Exchange.

Background

Parties

- The 1st and 2nd Defendants were both solicitors working at two separate law firms at the time.
- By virtue of their profession and employment with their respective law firms, they owed fiduciary duties to their principals (the law firms), including various duties of loyalty and confidentiality, and were subject to restrictions on trading securities.

- The 1st and 2nd Defendants were in a romantic relationship and cohabited between 2003 and 2006. They remained close friends after their relationship came to an end in 2006.
- The 3rd and 4th Defendants are the 2nd Defendant's sisters. Neither of them are lawyers.
- On two separate transactions, the Defendants are found guilty of contravening the SFO's insider dealing protections

The Facts

The 1st Defendant was a solicitor who had been seconded by her employer to a Hong Kong bank (**HK Bank**) to assist on HK Bank's takeover of a Taiwanese bank (**Taiwan Bank**) listed on the Taiwan Stock Exchange. The 1st Defendant had been reminded and acknowledged that she was an insider and had access to highly confidential and sensitive information.

Discussions took place between the two banks between August and September 2006. Information about the tender offer and the offer price of NT\$24.50 per share constituted confidential price sensitive information about Taiwan Bank's shares before the public announcement of the tender offer on 29 September 2006. The 1st Defendant was aware of the confidential price sensitive information on 14 September 2006.

9 days before the Tender offer, on 20 September 2006, a new securities account was opened with Tai Fook Securities Co Ltd ("**TF Account**") by the 3rd Defendant, which allowed her to trade in Taiwanese shares. Between 21 and 29 September

2006, the four Defendants put together substantial sums of money and injected them into the TF Account. Between 22 and 29 September, the 3rd Defendant acquired for the defendants 1,576,000 shares in Taiwan Bank at an average price of NT\$16.99.

The 1st and 2nd Defendants went to considerable length to raise funds, including drawing overdrafts and liquidating a considerable portion of their investment portfolios. The 1st Defendant also borrowed HK\$300,000 from her sister. The 2nd Defendant borrowed HK\$430,000 from the 3rd Defendant, for which the money came from breaking a fixed deposit due to mature in 2 weeks resulting in the forfeiture of interest of HK\$1,228.

On 29 September 2006, when the Tender Offer was announced, the offer price was 44% above the average price of the Defendants' acquisitions. The 3rd Defendant accepted the tender offer for all the Taiwan Bank shares in the TF Account and distributed the proceeds in proportion to their contributions.

The court also considered a second transaction in which the roles of the 1st and 2nd Defendant were reversed. The 2nd Defendant was the tipper and the 1st Defendant was the tippee.

Decision

In coming to a decision, the court relied on section 300 of the SFO, as opposed to the insider dealing provisions under the SFO (section 270 or section 291) because of the extra-territorial feature of the case. As the relevant shares were listed overseas, the insider dealing provisions did not come into play.

In the landmark decision, the court held that while section 300 does not have extra-territorial application, it could nevertheless be applied to the facts of this case without requiring extra-territorial application of the law.

Section 300 of the SFO

Section 300 of the SFO prohibits fraudulent or deceptive schemes in transactions involving securities:

1. A person shall not, directly or indirectly, in a transaction involving securities, futures contracts or leveraged foreign exchange trading -
 - a) employ any device, scheme or artifice with intent to defraud or deceive; or

- b) engage in any act, practice or course of business which is fraudulent or deceptive, or would operate as a fraud or deception.

2. A person who contravenes subsection (1) commits an offence.

3. In this section, a reference to a transaction includes an offer and an invitation (however expressed).

To fall within section 300, it was important for the action of the Defendants to:

- i) be fraudulent and deceptive; and
- ii) be part of a "transaction involving securities"

Fraud and Deception

The court had no difficulty applying section 300 based on the facts of the case.

The court held that the decision and actions of the 1st Defendant to misuse confidential material price sensitive information in secret, and knowingly breach dealing restrictions as a person working on the deal, amounted to a scheme or act of deception.

A transaction involving securities

The court found that the definition of "transaction" in section 300(3) SFO includes "an offer and invitation (however expressed)" and it was not necessary for the transaction to be completed. Since the offer to buy the securities was made in Hong Kong, section 300 applied. The fact that the securities were traded outside Hong Kong was irrelevant. The court also accepted that the 3rd Defendant's acceptance of the tender offer in Hong Kong would also bring the case within section 300. The court held that for the purposes of section 300, the fraudulent and/or deceptive conduct is consummated when the information is deployed to sell or purchase the securities – and not from the moment the fraudster gains the confidential information.

Conclusion

The ruling in this case makes clear that insider dealing involving shares listed overseas can be investigated and prosecuted under section 300 SFO.

CHARLTONS

Best Boutique Firm 2015

Asian Legal Business Awards

This newsletter is for information purposes only.

Its contents do not constitute legal advice and it should not be regarded as a substitute for detailed advice in individual cases.

Transmission of this information is not intended to create and receipt does not constitute a lawyer-client relationship between Charltons and the user or browser.

Charltons is not responsible for any third party content which can be accessed through the website.

If you do not wish to receive this newsletter please let us know by emailing us at unsubscribe@charltonslaw.com

Hong Kong Office

Dominion Centre

12th Floor

43-59 Queen's Road East

Hong Kong

Tel: + (852) 2905 7888

Fax: + (852) 2854 9596

www.charltonslaw.com