

Offshore hedge fund applies to strike out SFC's application to freeze its assets in Hong Kong's High Court

In brief

A two-day hearing has just concluded in Hong Kong's High Court in which the securities regulator, the Securities and Futures Commission (SFC), has argued that under section 213 of the Securities and Futures Ordinance (SFO), the SFC has a freestanding and broad power when dealing with market misconduct offences to make final orders freezing the assets of a New York-based hedge fund, Tiger Asia Management, worth HK\$38.5 million and to prevent it from operating in Hong Kong.

Tiger Asia argued that the SFC does not have such a power in relation to market misconduct offences unless used as an interim step while following either of the civil (Market Misconduct Tribunal - MMT) or criminal mechanisms prescribed by the SFO. The SFC has not done so.

Further, Tiger Asia argued that the High Court, in exercising its powers in civil proceedings (as in an injunction) and thereby acting in its civil jurisdiction, has no jurisdiction now to determine what is essentially a criminal offence. In other words, Tiger Asia claimed that the Court has no power to adjudicate upon whether there has or has not been a contravention which could be said to amount to insider dealing.

The SFC alleges that Tiger Asia and three of its officers engaged in insider dealing by short-selling 93 million shares it held in China Construction Bank after having been approached to take part in the placement of the bank's shares in January 2009.

Market misconduct and the two existing prescribed routes under the SFO

Insider dealing is one of a number of "market misconduct" offences set out under either Part XIII or Part XIV of the SFO. Market misconduct is defined as including (a) insider dealing (b) false trading (c) price rigging (d) disclosure of information about prohibited transactions (e) disclosure of false or misleading information inducing transactions or (f) stock market manipulation.

Market misconduct offences are provided for under the SFO as either (1) civil liability offences coming under Part XIII or (2) criminal offences under Part XIV.

In order to get a final freezing order (injunction) and possible related orders from the High Court, the SFC would, usually, have to go down one of two

Key issues

Recent case involving "Market Misconduct" and the SFC's authority to obtain final freezing orders per section 213 SFO over offshore entities

Two existing prescribed routes available to SFC under SFO

Third route proposed by SFC

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established statutory routes in Hong Kong: either

(1) obtain a ruling from the MMT, after a hearing between the parties, that market misconduct had occurred (under Part XIII of the SFO) and thereafter use the MMT's ruling to prove that a contravention of the SFO has taken place to get a final freezing order from the High Court, or

(2) successfully prosecute the wrongdoer for a criminal offence of market misconduct (under Part XIV of the SFO) before the criminal courts, obtain a criminal conviction and use proof of that conviction to demonstrate to the High Court that there has been contravention of the SFO, in order to obtain a final freezing order against the wrongdoer and/or his company.

Both routes, either civil or criminal, are established under the SFO, both have been utilized by the SFC in previous cases, and both also contain in-built legislative "gatekeepers" which curb the SFC's power as a regulator.

For example, for market misconduct offences to be brought before the MMT, the SFC is required to submit a report to the Financial Secretary who then may determine whether an MMT should be convened. The SFC alone cannot institute MMT proceedings.

For the SFC to be able to institute a criminal prosecution in the lower criminal courts, it is the Department of Justice that decides if there is sufficient evidence for a prosecution to be brought, not the SFC.

Both routes also provide evidential safeguards for the alleged wrongdoer in the form of precise rules of procedure and evidence, civil or criminal, to which the SFC must adhere as a public body.

A third route proposed by the SFC

This is not the first time that the SFC has sought to expand its statutory authority under section 213 to apply for freezing orders in cases of suspected insider dealing. In *Kayden v SFC* [2011] 2 HKC 44, the Court of Final Appeal (CFA) firmly rejected the SFC's contentions that section 213 allowed the SFC to apply for and obtain free-standing substantive orders and that it had inherent extra-territorial jurisdiction to seek interim orders against overseas parties. The CFA made it clear that the rules governing jurisdiction on overseas parties apply as much to the SFC as they do to any other litigant. However, in *Kayden*, the CFA left open the question of whether the section 213 power is available at all as a legal basis to extend jurisdiction to overseas parties. This very issue has now arisen in the Tiger Asia case. (In December 2010, the Court of Final Appeal reduced the scope of SFC freezing orders. Further details can be found in our [e-Legal issued in December 2010](#).)

In the Tiger Asia case, the SFC is seeking to expand its power by a third route, which effectively circumvents the two existing statutory routes. The SFC argued that it can, under a provision of the SFO in an entirely different Part of the SFO (Part X, which does not deal with "market misconduct" offences), namely Section 231(1)(a)(i)(A), make an application to the High Court for an injunction (freezing order) and/or other related orders where "a person *has contravened any of the relevant provisions*" [emphasis added].

By relying on Section 213(1)(a)(i)(A), the SFC is essentially asking the High Court to determine virtually on paper (by way of affidavits filed by the SFC setting out allegations of insider dealing against Tiger Asia) that there has been a contravention amounting to insider dealing. While the SFC does have such power in relation to other types of breaches falling outside Parts XIII and XIV of the SFO, it does not, at least on the face of the legislation, appear to have been given such a power in relation to the market misconduct offences.

The argument put forward by the SFC in the Tiger Asia case, we say, sets a dangerous precedent (certainly in the context of market misconduct). If permitted, there would be none of the usual checks and balances to curb the SFC's power as a public body to be able to seek freezing orders that would be final - not just interim - in market misconduct cases and to seek lifelong bans on market participants. It amounts in essence to a civil court being asked to decide matters relating to criminal liability on the say-so of the SFC without a proper hearing.

In the High Court before Harris J, the SFC submitted that it would be "unwieldy, inconvenient and unnecessary" to require the SFC to go down either the "MMT route" or the "criminal route" to pursue an alleged wrongdoer before it could obtain final freezing orders just because the contravention complained of happened to fall within one of the six market misconduct offences.

Counsel for Tiger Asia argued that it was a matter of pure statutory construction and that in the context of Parts XIII and XIV of the SFO, the relevant section (i.e. section 213(1)(a) (i)(A)) does not give, and was never intended by the Legislature to give, the SFC the result it contends. Moreover, Tiger Asia said that it was never intended that the SFO give the High Court power to adjudicate on issues of market misconduct. If the Legislature had so intended, it would have stated so in clear and unambiguous terms in Parts XIII and XIV of the SFO. As it has not done so, the broad and expansive power sought by the SFC to seek final freezing orders in market misconduct offences, without going down either the MMT route or the criminal route, does not exist.

Judgment reserved

Judgment has been reserved on this interesting jurisdictional issue as it relates to the SFC's powers but is expected to be handed down within two weeks. A further update will be sent as soon as the judgment becomes available.

This Client briefing does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

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