

SFC's attempt to obtain final freezing orders against offshore hedge fund's assets fails

In brief

Just over two weeks ago, we reported that Hong Kong's securities regulator, the Securities and Futures Commission (**SFC**) had argued in Hong Kong's High Court that the SFC has a freestanding and broad power when dealing with market misconduct offences to obtain *final* orders from the High Court freezing the assets of a New York- based hedge fund, Tiger Asia Management LLC (**Tiger Asia**), worth HK\$38.5 million, without the SFC first having brought either civil proceedings before the Market Misconduct Tribunal (**MMT**) or criminal proceedings (see [link](#) to our earlier client briefing here).

In a judgment delivered on 21 June 2011¹, Mr Justice Harris held, against the SFC, that without such a prior determination by an MMT or finding by a criminal court, the SFC has no power to ask the High Court to determine if Tiger Asia's, and three of its officers, conduct amounted to "insider dealing" so that the SFC could get the final freezing orders it sought under section 213 of the Securities and Futures Ordinance Cap 571 (**SFO**). Therefore, it followed that the Court had no jurisdiction to make the declarations sought by the SFC against Tiger Asia.

The SFC has indicated that it will appeal the ruling to the Court of Appeal.

Section 213 of the SFO

Section 213 of the SFO provides that where a person has contravened a provision of the SFO, the High Court has power to make a number of remedial orders, including injunctions and orders requiring the person to take such steps as the Court directs to restore the parties to any transaction to the position they were in before the transaction was entered into. In other words, it allows the SFC to apply for a court order to freeze defendants' money equal to a sum they are alleged to have earned from insider dealing or market manipulation (profits gained or loss avoided) to ensure that money is later available for distribution to compensate investors who have lost money.

In Tiger Asia's case, the SFC sought to use section 213 to obtain *final* freezing orders without a civil case ever having been brought before an MMT or without a criminal conviction ever having been obtained against Tiger Asia merely on the strength of untested affidavit evidence filed by the SFC in the High Court.

Key issues

Section 213 of the SFO

SFC's allegations

Defendants case

SFC's case

SFC to appeal High Court ruling

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¹ HCMP 1502/2009

SFC's allegations

The SFC alleged that on 31 December 2008 and 6 January 2009, Tiger Asia had breached section 291(5) of the SFO by obtaining confidential and price-sensitive information relating to two banks, Bank of China (**BOC**) and China Construction Bank (**CCB**), and had short-sold shares in both, making notional profits of HK\$8.6 million and HK\$29.9 million respectively. The SFC also alleged that Tiger Asia had sold BOC shares before a placement by the Royal Bank of Scotland on 13 January 2009 making a notional loss of around HK\$10 million. The SFC also alleged downward manipulation of CCB share price by Tiger Asia at the time of the short sales.

Defendants case

For Tiger Asia, a company with no physical presence in Hong Kong, it was argued that allegations of market misconduct against it and its officers could only be determined by two mutually exclusive routes available under Parts XIII and XIV of the SFO either (1) under the "civil" regime provided by MMT proceedings, or (2) under the "criminal" regime, by a prosecution and conviction. A review of the earlier legislative history of the SFO and references to the explanatory memoranda before Hong Kong's Legislative Council when the MMT was statutorily created, showed that there was **no "third route"** available to the SFC.

Harris, J agreed and said: *"No material has been put before me that suggests that the purpose of Parts X, XIII and XIV was to introduce a tripartite regime with, in addition to criminal prosecution or an inquiry by the MMT, a third procedure by which the Commission could go to Court to ask it to determine whether there had been a contravention of Parts XIII and XIV.... Contraventions of Parts XIII and XIV (i.e. market misconduct offences) are to be dealt with solely in accordance with those 2 Parts of the Ordinance"*.

It was wrong to allow the SFC to use section 213 (which comes under Part X) for a purpose for which the section was not intended. The Defendants argued that, in reality, because the SFC could not ask the Department of Justice to institute criminal prosecutions against Tiger Asia's three officers, because they are not in Hong Kong, and because the SFC wanted to avoid what it saw as the slow cumbersome procedure under the MMT route, it wanted to take a short cut by going to the High Court, asking it to determine whether or not there is a *prima facie* case of a contravention directly to get the final freezing orders against Tiger Asia.

SFC's case

The SFC sought to persuade the High Court, unsuccessfully, that although the SFC thought "this was a clear case of insider dealing", it had the power under section 213(1)(a) to ask the High Court to make the determination, on paper, that there had been contraventions amounting to insider dealing and market manipulation.

Mr Justice Harris did not accept this argument. Nor was Mr Justice Harris persuaded that simply because the SFC had the power to ask the High Court to make interim freezing orders (under section 213(2)(b)) pending the determination of a substantive complaint by either the MMT or the criminal courts, that this meant that the SFC had an extension of that power to ask for final freezing orders requiring the defendants to account for profit gained or loss avoided without determination of a substantive complaint by either one of those two established routes.

SFC also sought to persuade the High Court that the Court was bound, as a lower Court, by a judicial comment made in a previous Court of Appeal (**CA**) case, *SFC v C*,² that "*relief under section 213 is entirely freestanding and is not contingent or conditional on there being proceedings before the Market Misconduct Tribunal*". However, Mr Justice Harris did not agree that he was bound by the CA's comment and said that it had been made in that case without the CA having heard full argument on the question. Moreover, Mr Justice Harris, cited Mr Justice Ribeiro PJ's comments in the Court of Final Appeal (**CFA**) in *Kayden Ltd v SFC*,³ where the CFA had left open the question as to whether the SFC could rely upon section 213 (in that case at a very late stage), that "*It would be inappropriate for this Court (the CFA) to entertain such questions without a proper foundation.. having been laid.*"

Similarly, Mr Justice Harris was not persuaded that any of the Australian authorities cited by the SFC were relevant (which are premised on a materially different legislative base than Hong Kong's).

Conclusion

Thus, Mr Justice Harris concluded, the High Court had no jurisdiction to grant the declarations sought by the SFC under section 213(1)(a) to allow the SFC to obtain final freezing orders against Tiger Asia. It was also unlikely that the

² [2009] 4 HKLRD 315

³ [2011] 2 HKC 44

Legislature had intended that the Defendants could still find themselves subject to a criminal prosecution (if the SFC later chose to proceed down the criminal regime path if any of the Defendants returned to Hong Kong) after they had been found by the High Court to have contravened the market misconduct provision under section 291.

SFC to appeal High Court ruling

The SFC immediately issued a press release stating that "*it challenged the correctness of the ruling and would appeal the ruling*".

We are of the view that the High Court ruling is correct. However, in addition to the SFC appealing the ruling, it is possible that at some future date the SFC may well take steps to initiate changes to the securities legislation to give it the power it presently lacks. However, this cannot be done with immediate effect. Such a bold step, aside from the period of time it would take for any amendment to the law through drafting and bills stages to final enactment, will, we consider, generate much public debate because it would result in the SFC being able to by-pass the current dual regimes, civil and criminal, presently available to the securities regulator, and will not necessarily be met with rubber-stamp approval by the Legislature.

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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