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Hong Kong Court of Appeal finds that the Court of First Instance has jurisdiction to make final orders against an offshore hedge fund

In brief

In a unanimous ruling delivered on 23 February 2012, Hong Kong's Court of Appeal (**CA**) has upheld an appeal by Hong Kong's securities regulator, the Securities and Futures Commission (**SFC**), holding that the High Court of Hong Kong (Court of First Instance)(**CFI**) has jurisdiction to make *final* freezing orders against the assets of Tiger Asia Management LLC (**Tiger Asia**), (worth approximately HK$38.5 million), an offshore New York based hedge fund, alleged by the SFC to have engaged in insider dealing and false trading.

Tiger Asia has indicated that it will appeal the CA's ruling against the hedge fund to Hong Kong's highest court, the Court of Final Appeal.

The SFC has, on the other hand, stated that the CA's judgment has vindicated the SFC's enforcement action being taken against Tiger Asia and similar institutions, such as proceedings being taken against Hontex International Holdings Co and former executives of China Forestry Holdings Ltd and Gome Electrical Appliances Ltd. The SFC plans to return to the High Court as early as possible to ask the High Court to determine *if* the final freezing orders it seeks against Tiger Asia for alleged insider dealing can be granted.

Background

SFC's Allegations

The SFC alleges that in late December 2008 and early 2009, Tiger Asia breached section 291(5) of the Securities and Futures Ordinance (SFO) by obtaining confidential and price-sensitive information relating to two banks, Bank of China (**BOC**) and China Construction Bank (**CCB**) and that it 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 further alleged downward manipulation of CCB share prices by Tiger Asia at the time of the "short" sales.

Tiger Asia's position

In June 2011, in two earlier client briefings, we wrote that Tiger Asia argued in the CFI that the SFC did not have a power to obtain final freezing orders against it in relation to market misconduct offences unless used as an interim step while pursuing either civil liability in the Market Misconduct Tribunal (**MMT**) or criminal liability through the Hong Kong criminal courts.

Key issues

- SFC's Allegations against Tiger Asia
- Tiger Asia's Position
- Recent Court of Appeal Ruling
- Next Steps
- Relevance of CA's Ruling

Tiger Asia argued that it was wrong of the SFC to use section 213 of the SFO (the power given to the CFI, on application of the SFC, to grant " injunctions and other orders") as a "short cut" and for a purpose for which Tiger Asia argued the section was not intended, by going to the CFI and asking it to determine whether or not there is a *prima facie* case of a contravention of insider dealing (section 291) or false trading (section 295) directly (without the SFC first going down either of the civil liability or the criminal liability routes and obtaining either a formal finding or criminal conviction against Tiger Asia).

Before the CFI, the SFC argued that it did have a power to ask the CFI to impose final freezing orders against

Tiger Asia's assets under section 213(2)(b) or (e) and could ask the CFI for determinations, on paper (by way of SFC's affidavit evidence filed), that there had been contraventions amounting to insider dealing and market manipulation.

(See our two previous client briefings on the subject: Offshore hedge fund applies to strike out SFC's application to freeze its assets and SFC's attempt to obtain final freezing orders against offshore hedge fund's assets fails)

Following the High Court's ruling, which went against the SFC, the SFC appealed to Hong Kong's Court of Appeal.

Court of Appeal Ruling

It was common ground between the parties that, in considering whether the CFI has jurisdiction to make final orders under section 213(2)(b) or (e) of the SFO on the basis that there has been a contravention of such market misconduct under sections 291 or 295, in order to obtain any such order the SFC has to show contraventions of sections 291 or 295. What divided the parties was whether the SFC could obtain a *final order* under section 213(2) otherwise than on the basis of a finding of such market misconduct by the MMT or the criminal court.

In Vice-President Tang's judgment, with which the other two appellate judges agreed, he accepted the SFC's submissions that,

- on the plain and natural meaning of the words set out in section 213(1)(a) SFO, which reads "*where a person has contravened any of the relevant provisions*", what must be established is the fact that a person has contravened a relevant provision, not that any such contravention has been determined in other prior proceedings under Parts XIII and XIV of the SFO;
- the nature and purpose of section 213 is remedial in nature (i.e. giving power to obtain injunctive relief) not punitive and is different from market misconduct under other parts in the SFO such as Parts XIII or XIV;
- since the ordinary and natural meaning of the words "where a person has contravened any of the relevant provisions" denotes the fact of contravention, not a finding or opinion of contravention by another tribunal, since the jurisdiction to make orders under section 213 (2) is conferred on the CFI, the CFI must have jurisdiction to determine whether the precedent fact of contravention has occurred;
- if the legislature had intended to make the finding of contravention by another tribunal, for example, the MMT or a criminal court, a condition precedent to the exercise of the jurisdiction by the CFI under section 213, it would have said so.
- section 213 is a broadly drafted provision under which the CFI may make remedial orders, such as injunction orders to restrain occurrence or recurrence, declaring contracts to be void or voidable, and requiring the person ("who has contravened any of the relevant provisions") to pay damages;
- finally the CA said that there may be circumstances where it would be "eminently reasonable" for proceedings to be taken under section 213 by the SFC for the benefit of investors (as perhaps, we suggest, was the instant case, where Tiger Asia, being an offshore hedge fund and out of the reach of the criminal jurisdiction of the Hong Kong courts, was alleged by the SFC to be manipulating the Hong Kong market).

As the CA was concerned with the "jurisdiction point" only, it was not required, and did not decide, whether any of the actual relief (declaratory orders and injunctive relief) claimed by the SFC against Tiger Asia should in fact be granted.

Next Steps

The next step to be taken will now be a matter for the SFC. As noted above, we understand that the SFC plans to return to the High Court as early as possible to ask the High Court to determine *if* the final freezing orders it seeks against Tiger Asia for alleged insider dealing can be granted. The SFC has recently stated that it will continue to "prosecute such cases fairly and vigorously". Tiger Asia, on its part, has indicated it will appeal the CA's ruling.

Relevance of the CA's Decision

The relevance of the CA's recent ruling is that, until and unless overturned on appeal by the CFA, the SFC now has the power under section 213 of the SFO to ask the High Court to grant such declaratory orders and injunctive relief as final orders under section 213 of the SFO against errant parties which are alleged to have committed market

misconduct in relation to Hong Kong's securities and futures markets.

We consider that the CA's decision is correct and that the power under section 213 of the SFO ought to be recognized as being available to the SFC, so that investors may be confident that market misconduct will be controlled and ultimately punished in Hong Kong - if the person (or company) is found to have contravened any of the relevant provisions under Hong Kong's securities laws.

However, there is an open question as to how broad an impact this decision will have.

Will it be limited to cases, such as Tiger Asia, where the party alleged to have committed market misconduct is offshore, and not otherwise amenable to the jurisdiction of the criminal courts or the MMT? If so, such cases may not be very common. The case involving Tiger Asia appears to be the first case, in eight years since the SFO was enacted, in which this fact pattern, involving an offshore investor outside of Hong Kong, has arisen. However, there is nothing in the CA's ruling or in section 213, which limits its application to offshore parties.

Secondly, section 213 is limited in its application to circumstances in which the SFC seeks one of the orders specified in section 213(2). However, section 213(2) includes not only injunctions restraining assets (Mareva-type relief) but also injunctions restraining continued misconduct and declarations declaring contracts relating to securities etc to be void or voidable. Will the SFC consider adopting the position that in virtually every case of market misconduct (insider dealing or market manipulation) it is appropriate in principle to seek an order enjoining continued misconduct, so that in many cases the SFC can elect to use an application to the court under section 213 to determine whether market misconduct has happened, rather than go down the MMT route? Bearing in mind that the MMT's judicial resources are currently limited so that it only manages to issue an average of 3 decisions a year, will the SFC be tempted to use the High Court more, even for "ordinary" cases involving market misconduct? If this course is adopted, there might be more cause to complain that the MMT route is being inappropriately side-stepped, particularly bearing in mind that the MMT is designed to ensure that cases are heard by way of inquiry rather than court litigation and the MMT affords respondents the protection of having the tribunal comprise not just a High Court judge but also two lay persons with experience of the markets. It is hoped that the SFC will restrict itself in using section 213 to those civil cases in which relatively exceptional circumstances exist which require orders to be made by the High Court under section 213(2) and where it is not possible to utilize the MMT to properly protect the market and investors.

It remains to be seen whether Tiger Asia will indeed pursue an appeal to the CFA but it is noted that it has said that it will appeal. A different outcome before the CFA, curtailing the SFC's powers to obtain declaratory and injunctive relief under section 213 of the SFO, is far from certain.

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