

SFC's claim of alleged insider dealing struck out by Hong Kong's Court of First Instance as "an abuse of process"

In a recent decision by the Court of First Instance of Hong Kong, (the High Court), *Securities and Futures Commission (SFC) v Lee Sung Ho and Others (HCA 2177A/2011)*, the High Court has struck out the SFC's claim (writ) of alleged insider dealing against one defendant, discharged worldwide interim injunctions granted in relation to three other defendants and awarded costs against the SFC in favour of all six defendants. In the judgment of 5th September 2012, Mr. Justice Barma described the SFC's writ against one of the defendants as being "*at best, speculative*" and further stated that "*the SFC's assertion that the transactions were not genuine ones did not appear to have any solid basis*". The High Court affirmed the SFC's power to pursue substantively claims for insider dealing through the court, rather than the slower process of a full investigation and then a referral to the Market Misconduct Tribunal. However, the case suggests that bringing direct court proceedings, particularly where started with interim injunction relief, can carry greater risks for the SFC.

Key issues

- High Court strikes out SFC's claim of insider dealing as "an abuse of process"
- Worldwide injunctions against defendants dismissed
- Court describes SFC's case of insider dealing as being "speculative"

Background

In *SFC v Lee Sung Ho and Others (HCA 2177A/2011)*, delivered by Mr. Justice Barma on 5th September 2012, the High Court held that the SFC's writ of alleged insider dealing against one of the defendants was "*speculative*" and should be struck out as being "*an abuse of process of the court*". The High Court held that the

SFC's case had changed, from its original position when it had earlier obtained interim injunctions against all six defendants, and that "*the SFC's assertion that the transactions were not genuine ones did not appear to have any solid basis.*"

On the 20th December 2011, the SFC obtained interim injunctions against the six defendants in respect of their

worldwide assets. The injunctions were obtained in support of legal proceedings issued by the SFC the next day, in which various orders under section 213 of the Securities and Futures Ordinance (SFO) were sought against the defendants. The SFC was granted leave to issue its proceedings in respect of four offshore defendants in South Korea (the 1st, 3rd, 4th and 6th defendants)

and two Hong Kong-based defendants (the 2nd and 5th defendants).

The SFC's allegations

The gist of the SFC's case, according to the SFC's evidence initially filed, was that the 1st to 5th defendants (comprising individuals and local and offshore companies), had been involved in insider dealing between about March and July 2011 in relation to shares in Schramm Holding AG (Schramm), a German company whose shares were listed on the Hong Kong Stock Exchange, in contravention of sections 270 and/or 291 of the SFO (both provisions prescribe offences of insider dealing) and were thus liable to have interim orders made against them under section 213(2) of the SFO to prevent dissipation of assets and to require disgorgement of any alleged benefits. Schramm was said by the SFC to be a subsidiary of a Hong Kong-based South Korean company, SSCP Co. Ltd.

The SFC believed that the inside information had been supplied by the 1st defendant, Mr. Lee, (Lee) to the 2nd defendant, Miss Chang (Chang) (a Korean national and former employee of Schramm), and that Lee had done so on behalf of the 5th defendant, SSCP Holdings (HK) Ltd (SSCP HK), which had benefitted from the dealings in Schramm shares by both Chang and Winwell Global Trading Ltd (Winwell), the 4th defendant, by receiving, through its alleged subsidiary STM Corporation (STM), the 6th defendant, the bulk of the sale proceeds. Through the flow of funds, which ultimately made their way to STM, an offshore South Korean company, Chang and the other local and offshore companies, the 3rd to 5th defendants, were said to

have been implicated in the alleged insider dealing.

The 6th defendant, the offshore STM, was therefore, according to the SFC's writ, liable to have an order made against it under section 213 (2)(b) of the SFO – being an order requiring STM either to transfer the funds it received (alleged to have been proceeds of insider dealing) from its South Korean bank account for payment into the High Court or for payment to the counterparties to the alleged insider dealing transactions.

On the basis of the SFC's allegations made in December 2011, the SFC obtained worldwide interim injunctions against each of the defendants, together with orders for them to disclose their assets.

The SFC discontinued its action against 1st defendant

However, shortly after the SFC had obtained the interim injunctions and related disclosure orders, it abandoned its claim in January 2012 against Lee, the 1st defendant, because, the SFC had by then obtained further information and had concluded that Lee had no interest in Winwell, the 4th defendant. The SFC's case against Lee was dismissed by the High Court with costs in favour of the 1st defendant.

Offshore defendant company then succeeded in setting aside SFC's section 213 injunction

Meanwhile, the 6th defendant, STM, the offshore South Korean company, applied in April 2012 to set aside the leave that had been granted to the SFC to serve its writ on STM outside Hong Kong. STM also claimed that the High Court had no jurisdiction to

grant the injunction orders sought by the SFC under section 213 of the SFO. STM was successful.

(*Securities and Futures Commission v Lee Sung Ho and Others (HCA 2177/2011)*). In a decision of 27 April 2012, Mr. Justice Barma held that the section 213 injunction order sought by the SFC against STM could not be granted because it would have required STM, an offshore company, being ordered to take action *outside* Hong Kong, such as requiring it to transfer monies from STM's offshore account to court in Hong Kong or to make payment to counter parties. These were things over which the High Court itself did not have jurisdiction to so order against an offshore defendant because, the High Court held, they were not *within* Hong Kong's jurisdiction. Costs were awarded to STM against the SFC.

Shifting sands: the SFC's changed its case

In relation to the remaining defendants, the 2nd to 5th defendants, the SFC applied for continuation of the interim injunctions against them. The SFC's writ also maintained that the 6th defendant, STM, the offshore company, was a wholly owned subsidiary of SSCP HK, the Hong Kong-based 5th defendant.

At a hearing held in the High Court on 28th June 2012, it became apparent that the SFC had changed its case from its original affirmation evidence filed against the defendants. In the SFC's evidence filed for this hearing, the SFC claimed (for the first time) that some of the 2nd defendant's (Chang's) and the 4th defendant's (Winwell's) share purchases were funded in part by monies received by SSCP HK, the 5th defendant. The SFC's now-revised case did not identify any person at SSCP HK who

was said to have supplied the inside information (even on the SFC's case, it could not have been the 1st defendant, Lee, as the SFC had originally hypothesized, because the SFC had already abandoned its claim against him). SSCP HK applied to strike out the SFC's writ on the basis that *"it disclosed no reasonable cause of action, was frivolous and vexatious, and/or was an abuse of the process of the court."*

Defendants position

The 2nd to 4th defendants opposed continuation of the interim injunctions against them. The 5th defendant, SSCP HK, through its director, had filed affirmation evidence in which it disputed any knowledge of the proposed acquisition of Schramm and stated that STM, the offshore company, was not in fact a subsidiary of SSCP HK. SSCP HK said it had not benefitted from the alleged insider dealing as it had no interest in STM and thus had no monies said to represent the proceeds of alleged insider dealing.

The SFC, in further affirmation evidence, had by then accepted that SSCP HK was not and never had been an owner of STM but still maintained the allegation that SSCP HK had disclosed the inside information to Chang, the 2nd defendant.

High Court findings against the SFC

From a careful analysis of the various

affirmations filed, the High Court held in its judgment of 5th September 2012 that:

- The SFC's case as pleaded in its writ was *"seriously lacking in particularity"*.
- The SFC's case had *"undergone significant shifts"* (from its initial allegations) which, the learned Judge said *"tends to suggest that the SFC is far from certain as to what its case actually is"*.
- If allegations of dishonest conduct (i.e. insider dealing) are made, they should be fully pleaded and made with a proper foundation.
- None of the items of evidence put forward by the SFC were sufficient or adequate to make out a case of insider dealing (against SSCP HK).
- It was *"difficult to see how there could be a good, arguable case that Chang was guilty of insider dealing"*.
- While not going so far as to hold that the SFC was guilty of material non-disclosure, the learned Judge determined that *"the SFC's assertion that the transactions were not genuine ones did not appear to have any solid basis"*.
- *"The claim against SSCP HK should be regarded as speculative and, on that ground, be struck out and the action against it dismissed"*.

- The interim worldwide injunctions previously granted against the 2nd to 4th defendants were to be discharged.
- Funds paid into court by the 5th defendant, SSCP HK, were to be returned to it with interest.
- Costs were awarded in favour of the defendants against the SFC.

The end result was, ultimately, favourable for the defendants in this case but it was not reached without a fight. The High Court's robust judgment in this case serves however to demonstrate that Hong Kong's High Court will take the necessary steps to make Hong Kong's securities regulator, the SFC, account for its actions and will not hesitate to dismiss interim injunction orders and claims of insider dealing brought by the SFC if those claims are found to be speculative and unsupported by solid evidence.

Clifford Chance acted for the 1st defendant, Lee Sung Ho, in this case.

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