

SFC loses landmark Hong Kong discovery battle

In a key ruling, the Hong Kong Court of First Instance held that the Securities and Futures Commission (SFC) should adopt a more generous standard of disclosure in cases of a disciplinary or regulatory nature, given the severity of the possible sanction. It stressed that the regulator has a "duty to act fairly" in such cases. The ruling comes just weeks after the SFC laid out its enforcement priorities, which emphasise an increased targeting of individuals caught up in corporate wrongdoing.

Background

In early 2015, the SFC filed a petition under section 214 of the Securities and Futures Ordinance (SFO) seeking disqualification orders against the former chairman and directors of Inno-Tech Holdings Limited (Inno-Tech) over alleged misconduct that it claimed caused the company to lose more than HK\$120 million.¹

Section 214 of the SFO allows the court, among other things, to make orders to disqualify a person from being a director or being involved, directly or indirectly, in the management of any corporation for up to 15 years.

The SFC alleged that Inno-Tech's former chairman and three former directors (the respondents in the petition) breached their duties as directors in relation to the acquisitions

and/or disposals of interests in three hotels and a gold mine in the PRC between 2007 and 2010 and that they failed to carry out adequate due diligence prior to the acquisitions, failed to obtain proper independent assessments as to the suitability and prospects of the investments for Inno-Tech and failed to negotiate the purchase price, resulting in substantial and material losses to Inno-Tech.

In their defence, the respondents said they had reasonably and honestly entrusted third parties to which specific independent and professional advice was sought and had reasonably relied on the advice; that each of the acquisitions was executed in good faith and in the interests of the company; and that they had carried out extensive due diligence which included site visits.

Disclosure

As part of their investigations, the SFC made enquiries under sections 179, 182 and 183 of the SFO. Section 179 empowers the SFC to obtain documents and explanations from the corporation concerned and

Key issues

- The test for disclosure of documents by the SFC in disqualification proceedings is more akin to that in a criminal, rather than a civil, trial.
- The Court said the SFC should act fairly and take a "generous view" of its disclosure obligations, given the severity of the potential sanction.
- The ruling comes weeks after the SFC said it was highlighting corporate fraud and misfeasance as its key enforcement priority.

its related corporations, authorised financial institutions, auditors and others.

Section 182 allows the SFC to appoint an investigator where it suspects wrongdoing, whilst section 183 gives the SFC wide powers to require any person suspected of having relevant information to

¹ *Securities and Futures Commission v Wong Yuen Yee* HCMP 241/2015

produce such information to the investigator or attend an interview. As the Court noted, in these circumstances the privilege against self-incrimination is abrogated and failure to comply without reasonable excuse is an offence.

Subsequent to the voluntary disclosure of certain documents by the SFC, the respondents asked the SFC to provide a list of the materials it had obtained pursuant to these provisions. The SFC refused, following which the respondents issued a summons seeking discovery of all authorisations, directions and search warrants issued together with the records and documents and explanations or statements produced, as well as answers in writing and records of interviews prepared, pursuant to these authorisations and directions.

Standard of Discovery

The question before Mr Justice Lam concerned the standard of discovery in proceedings seeking disqualification – should it be the standard adopted in criminal proceedings (under which it was argued the SFC's discovery obligations extend to all relevant unused materials obtained during the investigation), the narrower test for relevance to be found in civil proceedings, or somewhere in between?

The Court agreed with international authorities that, whilst not being a penalty as such, a disqualification order involves a "substantial interference with the freedom of the individual" so that in the conduct of such proceedings, "the rights of the individual must be fully protected."

The documents in question were materials gathered by the SFC

through the exercise of its coercive powers under the SFO and were powers not generally available to respondents to disqualification proceedings. The respondents were under a particular handicap in that the matters complained of occurred between 2007 and 2011 yet the petition had not been issued until 2015. In the meantime, the respondents had lost any access to the company's documents in their capacity as directors.

The Court said the investigative powers are invested in the SFC "not for private ends but for a public purpose." The purpose included "not only disqualifying those guilty of misfeasance but also dismissing the case against those who are not."

Fair Trial

The Court cited Article 11(2)(b) of the Hong Kong Bill of Rights setting out the principle of "equality of arms" for the entitlement of the accused to disclosure of relevant material. While accepting disciplinary proceedings are non-criminal in nature, the courts in various jurisdictions, including the UK, New Zealand and Canada, have "been prepared to recognise a duty of disclosure on the prosecuting authority that approaches the duty on the prosecution in criminal proceedings."

The Court distinguished the Hong Kong Court of Appeal judgment in *Li Kwok Keung Asser v Securities and Futures Commission*² (which disapproved of the expression by the Securities and Futures Appeal Tribunal that the need for fairness

under Article 10 of the Bill of Rights should lead to a requirement for the disclosure of unused material in disciplinary proceedings equivalent to that in criminal proceedings), on the basis that it concerned neither disqualification proceedings nor discovery of documents. The Court held that *Li Kwok Keung Asser* is not authority against adopting an approach to disclosure in disqualification proceedings resembling the practice in disciplinary proceedings in other jurisdictions.

Appropriate Test

The Court concluded that the SFC's disclosure in disqualification proceedings should "ordinarily include the information and documents it has obtained from the investigation of the transactions that are eventually relied upon and complained of in the disqualification proceedings, except those which are obviously irrelevant even on this generous test". The test for relevance "should be applied as broadly as is consistent with the requirements of justice".

The Court also had words as to the role of the SFC in such cases. Its proper role was "not a prosecutor bent on securing the disqualification of a respondent" but was rather to act as "a fair-minded regulator willing if not anxious to make all materials available for potential use in the trial to ensure a just outcome."

On the facts, the Court found that it was "pertinent to see at least in broad terms what the scope of the Commission's investigation was and what information the Commission has actually been able to obtain." The Court ordered the SFC within 28 days to file a list of documents which are or have been in the SFC's possession, custody or power relating to "any

² [2010] HKEC 1834

matter in question in proceedings", and was not limited to matters that had been pleaded between the parties.

Analysis

Whilst there have been challenges to the constitutionality of the section 183 process, these have met with little success. The requirement for the SFC to take a "*generous view*" of the relevance of documents for individuals seeking to establish their innocence (at least in disqualification proceedings) marks the most substantial setback for the regulator before the courts in a while.

The decision – which could still be appealed – comes weeks after the SFC's Director of Enforcement, Thomas Atkinson, laid out the SFC's enforcement priorities under his direction.

These included a clear focus on corporate fraud and misfeasance, including holding senior management to account where they are suspected of being involved in the wrongdoing. The SFC has formed a specialised team to focus on these cases which the SFC believes pose one of the greatest threats to investors.

The Court's ruling in *Wong Yuen Yee* may prove to be a hurdle in this process; however it does provide reassurance to those under investigation of the courts' willingness to step in to ensure the interests of justice are served.

Contacts



Edward Johnson
Partner

T: +852 2826 3427
E: Edward.Johnson
@CliffordChance.com



Donna Wacker
Partner

T: +852 2826 3478
E: Donna.Wacker
@CliffordChance.com



William Wong
Senior Associate

T: +852 2826 3588
E: William.Wong
@CliffordChance.com

This publication 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.

www.cliffordchance.com

Clifford Chance, 27th Floor, Jardine House, One Connaught Place, Hong Kong

© Clifford Chance 2017

Clifford Chance

Abu Dhabi ■ Amsterdam ■ Bangkok ■ Barcelona ■ Beijing ■ Brussels ■ Bucharest ■ Casablanca ■ Doha ■ Dubai ■ Düsseldorf ■ Frankfurt ■ Hong Kong ■ Istanbul ■ Jakarta* ■ London ■ Luxembourg ■ Madrid ■ Milan ■ Moscow ■ Munich ■ New York ■ Paris ■ Perth ■ Prague ■ Riyadh ■ Rome ■ São Paulo ■ Seoul ■ Shanghai ■ Singapore ■ Sydney ■ Tokyo ■ Warsaw ■ Washington, D.C.

*Linda Widyati & Partners in association with Clifford Chance.

Clifford Chance has a best friends relationship with Redcliffe Partners in Ukraine.