

Legal Services

[Achievements]

- Worked with the Government on maintenance of the SFO and formulated amendments to its subsidiary legislation on statutory backing for listing requirements, disclosure of interests and other matters
- Advised on possible breaches of the securities laws
- Conducted a significant number of successful prosecutions for a wide range of regulatory offences
- Successfully opposed an application for leave to apply for judicial review against the Commission

[This Chapter Is About]

- The Securities and Futures Ordinance
- Prosecutions and appeals
- Legal support for the Commission's work
- Legal advice and assistance in policy initiatives

What We Do

- Advise operational divisions on possible breaches of the securities laws;
- Advise the Commission in relation to suspected insider dealing;
- Advise on the applicability and interpretation of laws under the SFC's purview;
- Assist with reform of the laws governing the securities and futures markets;
- Prosecute in the Magistrates' Courts for a wide range of regulatory offences;
- Handle civil litigation matters involving the SFC, including appeals;
- Advise the Takeovers Executive and the Takeovers Panel; and
- Provide general in-house legal advice and support.

What We Did

The Securities and Futures Ordinance

We continued to work with the Government on the maintenance of the SFO to consider if the provisions continue to meet the policy objectives and whether any of its provisions or the subsidiary legislation made under it should be updated in view of market developments. The ongoing review will result in the Securities and Futures (Amendment) Bill 2005 proposed by the FSTB and various amendment rules.

The Bill will include the amendments required for the new statutory framework to implement the Government's proposals to enhance the regulation of listing. The Government's proposals went out for public consultation in January 2005, when the SFC also consulted on proposed amendments to the Securities and Futures (Stock Market Listing) Rules. We formulated the amendments to codify the more important listing requirements.



The Securities and Futures (Amendment) Bill 2005 will be introduced to the LegCo.

During the year, the SFC also consulted on proposed amendments to the disclosure of interests regime. The proposals aim to reduce compliance burden while preserving transparency.

Both SFC consultations have closed and we will study the responses before refining the proposed legislative changes.

Prosecutions and Appeals

We continued to advise on evidence and prosecute a wide range of offences in the Magistrates' Courts under section 388 of the SFO and the old securities-related ordinances. These offences include short selling, market manipulation, unlicensed investment advising, breach of disclosure requirements, providing false or misleading information and failing to assist SFC investigations.

During the year, there was a further increase in prosecutions handled by the prosecution team of the Division. There was also an increasing trend for persons to be prosecuted by the Commission for providing false or misleading information as more of this activity seemed to be occurring.

We successfully prosecuted a company for holding itself out on its website as carrying on a business of advising on corporate finance, in contravention of section 114 of the SFO. We anticipate more prosecutions involving unlicensed activities via websites because more individuals give investment advice online these days.

In our continuing effort to prosecute persons for not co-operating in inquiries, two individuals were convicted of failing to comply with notices issued by the SFC under section 33(4) of the repealed

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Securities and Futures Commission Ordinance (by virtue of the transitional provisions in Schedule 10 to the SFO) to attend interviews in connection with investigations into short selling and market manipulation. They were fined and ordered to pay the SFC's investigation costs.

First Prosecution under Dual Filing



In one of the successful prosecutions, Huafeng Textile International Group Limited and its director Mr Cai Yang Bo were convicted of providing false or misleading information. It was the first prosecution under Dual Filing (which came into effect with the SFO).

It was found that, in response to an enquiry from HKEx on 23 July 2003 about untoward movements in the price and trading volume of Huafeng shares during that morning, Huafeng issued an untrue announcement later in the day stating that the board of directors of the company was not aware of any reasons for the untoward movements. However, the fact is that on 23 July 2003, Cai sold 25.6 million Huafeng shares owned by him and other Huafeng directors. The sale of shares had caused untoward movements in the price and trading volume of Huafeng shares on that day. Cai had received confirmation of the sale on 23 July 2003 but did not disclose the sale to Huafeng until 25 July 2003.

Owing to Cai's delay in disclosing the sale, Huafeng had to issue a clarification announcement on 25 July 2003. This announcement was itself misleading and for that reason Huafeng had to issue a second clarification announcement on 31 July 2003.

Legal Support for the Commission's Work

In June 2004, the SFC applied successfully to the High Court for a *mareva* injunction to prevent Mr Charles Schmitt, CEO of Charles Schmitt & Associates Limited, from dealing with any assets he held or controlled. We also obtained an order for the appointment of an administrator of his

property, in connection with suspected misappropriation of client assets. This was the first exercise of the Commission's power to seek such court orders under section 213 of the SFO.

We provided legal advisers to the Takeovers and Mergers Panel and the Takeovers Executive in relation to disciplinary proceedings.

Legal Advice and Assistance in Policy Initiatives

One of our main functions is to provide legal advice to the SFC's operational and support divisions. During the year, we advised on matters including:

- legal issues arising from the review of the handling of broker defaults and the operation of the investor compensation arrangements;
- legal issues arising from the liquidations of Chark Fung Securities Company Limited and Forlux Securities Limited;
- legal and practical issues arising from the migration to the new licensing regime in the run up to the deadline of 31 March 2005;
- the draft legislation to enable the creation of a scripless securities market in Hong Kong;
- the prospectus-related amendments in the Companies (Amendment) Ordinance 2004; and
- all aspects of the Commission's decision-making process including the exercise of our investigative, disciplinary and intervention powers.

We also provide general legal support to the Commission in relation to employment matters, insurance, and other commercial contracts and agreements.

SFC Successfully Opposed An Application for Leave to Apply for Judicial Review



In April 2004, the SFC commenced disciplinary proceedings against Berich Brokerage Limited for alleged misconduct. The SFC wrote to Berich proposing to take certain disciplinary action.

Berich lodged a complaint against two employees of the SFC and the SFC commenced an internal inquiry. In August 2004, following the completion of the internal inquiry, the SFC informed Berich that its complaint could not be substantiated. In October 2004, the SFC concluded its disciplinary proceedings and informed Berich of its decision.

Berich immediately appealed the SFC's disciplinary decision to the Securities and Futures Appeals Tribunal (SFAT). Less than two weeks later, Berich also made an *ex parte* application to the Court for leave to apply for judicial review of the SFC's decision to dismiss its complaint against the two employees. The SFC sought to intervene in Berich's application and the Judge gave leave to the SFC to attend the hearing of Berich's application to render whatever assistance the Court deemed necessary.

Mr Justice Hartmann heard the application in January 2005. In his judgment he stated that "judicial review being an exceptional remedy and a discretionary one...

should be the remedy of last resort". It was "a collateral process" which "unless restrained within permissible boundaries, may result in a proliferation of proceedings when one set of proceedings would be entirely adequate". In addition, he observed that the existence of "an effective alternative remedy" was accorded even greater weight where, as here, "relevant legislation lays down a comprehensive system of appeals procedure guaranteeing that alternative remedy".

The Judge ruled that "the judicial review process should not be allowed to supplant the normal statutory appeal procedure" before the SFAT. He refused to grant leave to Berich to apply for judicial review as "there clearly exists a comprehensive statutory appeal procedure available to the applicant, one which is capable of giving it the remedy it has sought".

The Judge "saw no reason to agree to the applicant being entitled to pursue a collateral action in this court, one which would, for no material purpose, add to the costs of the litigants, place an extra burden on this court and go to the public expense". He awarded costs against Berich in view of its failure to disclose that it was also in the process of pursuing an alternative remedy of appeal to the SFAT.